BOULDER GROWTH & INCOME FUND
Form N-2/A
April 15, 2008

As filed with the Securities and Exchange Commission on April 15, 2008.

Securities Act Registration No. 333-149535

Investment Company Registration No. 811-02328

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM N-2

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933 |X|
Pre-Effective Amendment No. 1 |_|
Post-Effective Amendment No. ___ |_|
And/or
REGISTRATION STATEMENT UNDER
THE INVESTMENT COMPANY ACT OF 1940 |X|
AMENDMENT NO. 19 |X|

Boulder Growth & Income Fund, Inc.
(Exact Name of Registrant as Specified In Charter)

2344 Spruce Street, Suite A
Boulder, Colorado 80302
(Address of Principal Executive Offices)

(303) 444-5483
(Registrant's Telephone Number, including Area Code)

Stephen C. Miller, Esq.
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2344 Spruce Street, Suite A
Boulder, Colorado 80302

(Name and Address of Agent for Service)

Copies to:

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Paul, Hastings, Janofsky & Walker, LLP
515 South Flower Street, 25th Floor
Los Angeles, CA 90071

APPROXIMATE DATE OF PROPOSED PUBLIC OFFERING: As soon as practicable after the effective date of this Registration Statement.

If any securities being registered on this form will be offered on a delayed or continuous basis in reliance on Rule 415 under the Securities Act of 1933, other than securities offered in connection with a dividend reinvestment plan, check the following box. [_]

It is proposed that the filing will become effective when declared effective pursuant to Section 8(c). [x]

CALCULATION OF REGISTRATION FEE UNDER THE SECURITIES ACT OF 1933

Title of Securities Being Registered	Amount Being Registered	Proposed Maximum Offering Price per Unit	Pro Aggr
Shares of Common Stock, par value $.01 per share ("Shares")	___________ Shares	$____	$1

(1) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(o) under the Securities Act of 1933, as amended.

The registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment that specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until this Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

BOULDER GROWTH & INCOME FUND, INC.

Form N-2

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PART C OTHER INFORMATION

Information required to be included in Part C is set forth under the appropriate item, so numbered, in Part C to this Registration Statement.

The information in this Prospectus is not complete and may be changed. A registration statement relating to the Securities has been filed with the Securities and Exchange Commission. We may not sell these securities until this registration statement is effective. This Prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer, solicitation or sale is not permitted.

PROSPECTUS

[________________] RIGHTS FOR [_______________] SHARES

BOULDER GROWTH & INCOME FUND, INC.

COMMON STOCK

The Boulder Growth & Income Fund, Inc. (the "Fund") is issuing non-transferable rights ("Rights") to its holders of record of shares ("Shares") of common stock ("Common Stock") (such holders, "Common Stockholders"). These Rights will allow Common Stockholders to subscribe for new Shares of Common Stock. For every three (3) Rights a Common Stockholder receives, such Common Stockholder will be entitled to buy one (1) new Share. Each Common Stockholder will receive one Right for each outstanding Share it owns on ______________ (the "Record Date"). Fractional Shares will not be issued upon the exercise of the Rights. Accordingly, the number of Rights to be issued to a Common Stockholder on the Record Date will be rounded up to the nearest whole number of Rights evenly divisible by three. Common Stockholders on the Record Date may purchase Shares not acquired by other Common Stockholders in this Rights offering (the "Offering"), subject to limitations discussed in this Prospectus. Additionally, if there are not enough unsubscribed Shares to honor all over-subscription requests, the Fund may, in its discretion, issue additional Shares up to 100% of the Shares available in the Offering to honor oversubscription requests. See "The Offering - Over-Allotment and Over-Subscription Privilege" below.

The Rights are non-transferable, and may not be purchased or sold. Rights will expire without residual value at the Expiration Date (defined below). The Rights will not be listed for trading on the NYSE, and there will not be any market for trading Rights. The Shares to be issued pursuant to the Offering will be listed for trading on the NYSE, subject to the NYSE being officially notified of the issuance of those Shares.

On _________________, the last reported net asset value ("NAV") per Share was $____ and the last reported sales price per Share on the NYSE was $____, which represents a _____% premium to the Fund's NAV per Share. The subscription price per Share (the "Subscription Price") will be the NAV per Share as calculated at the close of trading on the date of expiration of the Offering (referred to herein as the "Expiration Date").

STOCKHOLDERS WHO CHOOSE TO EXERCISE THEIR RIGHTS WILL NOT KNOW THE SUBSCRIPTION PRICE PER SHARE AT THE TIME THEY EXERCISE SUCH RIGHTS SINCE THE OFFERING WILL

EXPIRE (I.E., CLOSE) PRIOR TO THE AVAILABILITY OF THE FUND'S NAV AND OTHER RELEVANT MARKET INFORMATION ON THE EXPIRATION DATE. ONCE A STOCKHOLDER SUBSCRIBES FOR SHARES AND THE FUND RECEIVES PAYMENT OR GUARANTEE OF PAYMENT, SUCH STOCKHOLDER WILL NOT BE ABLE TO CHANGE THEIR DECISION. THE OFFERING WILL EXPIRE AT 5:00 P.M., NEW YORK CITY TIME, ON _______________ (THE "EXPIRATION DATE"), UNLESS THE OFFERING IS EXTENDED AS DISCUSSED IN THIS PROSPECTUS.

For more information, please call Morrow & Co., Inc. (the "Information Agent") toll free at (800) 607-0088.

The Fund is a registered closed-end, non-diversified management investment company incorporated under the laws of the State of Maryland. The Fund's investment objective is total return. The Fund seeks to produce both long-term capital appreciation through investment in common stocks of domestic and foreign issuers and high current income consistent with preservation of capital through investments in income producing securities. See "Investment Objective and Policies." There can be no assurance that the Fund's investment objective will be achieved. Boulder Investment Advisers, LLC ("BIA") and Stewart West Indies Trading Company, Ltd. doing business as Stewart Investment Advisers ("SIA") (collectively the "Advisers") act as the investment advisers to the Fund. The address of the Fund and BIA is 2344 Spruce Street, Suite A, Boulder, Colorado 80302. The address for SIA is Bellerive, Queen Street, St. Peter, Barbados.

AN INVESTMENT IN THE FUND IS NOT APPROPRIATE FOR ALL INVESTORS. NO ASSURANCES CAN BE GIVEN THAT THE FUND'S INVESTMENT OBJECTIVE WILL BE ACHIEVED. FOR A DISCUSSION OF CERTAIN RISK FACTORS AND SPECIAL CONSIDERATIONS WITH RESPECT TO OWNING SHARES OF THE FUND, SEE "RISK FACTORS" ON PAGE 29 OF THIS PROSPECTUS.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Estimated Subscription Price	Estimated Sales Load	Estim
Per Share	$____(1)	None	
Total	$____	None	

(1) Since the Subscription Price will not be determined until after printing and distribution of this Prospectus, the "Estimated Subscription Price" above is an estimate of the subscription price based on the Fund's per-Share NAV at the end of business on _________________, the Friday immediately preceding the printing and distribution of this Prospectus. See "The Offering - Subscription Price" and "The Offering - Payment For Shares" below.

(2) Proceeds to the Fund before deduction of expenses incurred by the Fund in connection with the Offering. Offering expenses are estimated to be

approximately $_______. Funds received by check prior to the final due date of this Offering will be deposited in a segregated interest-bearing account pending allocation and distribution of Shares. Interest on subscription monies will be paid to the Fund regardless of whether Shares are issued by the Fund; interest will not be used as credit toward the purchase of Shares.

Trusts and other entities affiliated with the Horejsi family hold 15.7% of the Common Stock, and certain other persons affiliated with the Fund and the Advisers (collectively referred to herein as the "Horejsi Affiliates" and more specifically described on Pages 36 and 46 of this Prospectus and in the Statement of Additional Information), may be deemed to control the Fund. The Horejsi Affiliates have indicated that they will fully subscribe in the Primary Subscription (defined below) on the same terms as other Common Stockholders. The Horejsi Affiliates may subscribe in the Over-Subscription Privilege (defined below). See "The Offering - Over-Allotment and Over-Subscription Privilege" below.

This Prospectus concisely sets forth certain information about the Fund that a prospective investor should know before investing. Investors are advised to read and retain it for future reference. A Statement of Additional Information, dated April _____, 2008 (the "SAI"), containing additional information about the Fund has been filed with the Securities and Exchange Commission and is incorporated by reference in its entirety into this Prospectus. A copy of the SAI, the table of contents of which appears on Page 62 of this Prospectus, the Fund's most recent annual and semi-annual report to Stockholders (the "Shareholder Reports") and additional information about the Fund and other Stockholder inquiries may be obtained without charge by contacting Morrow & Co., Inc., the Fund's Information Agent, at (800) 607-0088. The SAI and other reports and information regarding the Fund are available at the Fund's website at www.boulderfunds.net. The SAI and Shareholder Reports will be sent within two business days of receipt of a request.

The Securities and Exchange Commission ("SEC") maintains an Internet site (http://www.sec.gov) that contains the SAI, materials incorporated by reference, and other information regarding the Fund.

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PROSPECTUS SUMMARY

This summary highlights some information that is described more fully elsewhere in this Prospectus. It may not contain all of the information that is important to a stockholder or prospective stockholder. To understand the Offering fully, each stockholder or prospective stockholder should read the entire document carefully, including the risk factors as set forth below.

The Fund

Boulder Growth & Income Fund, Inc. (the "Fund") is a non-diversified, closed-end management investment company organized in October 1972 and began investment activities in January 1974. Shares of common stock, par value $0.01 per share ("Common Stock"), of the Fund ("Shares") are traded on the New York Stock Exchange (the "NYSE") under the symbol "BIF." As of ___________________, the Fund had __________ Shares and 1,000 shares of auction market preferred stock outstanding. The average weekly trading volume of the Shares on the NYSE during the period from January 1, 2008 through ___________, 2008 was _________ Shares. As of _________________, the total net assets of the Fund were approximately $_____ million, including $25 million in auction market preferred stock leverage. The Fund's investment advisers are Boulder Investment Advisers, LLC ("BIA") and Stewart West Indies Trading Company, Ltd. d/b/a Stewart Investment Advisers ("SIA") (collectively, the "Advisers"). The address of the Fund and BIA is 2344 Spruce Street, Suite A, Boulder, Colorado 80302. The address of SIA is Bellerive, Queen Street, St. Peter, Barbados.

The Offering

The Fund is issuing to its holders of record of Common Stock ("Common Stockholders") as of the close of business on _____________ (the "Record Date") non-transferable rights ("Rights") to subscribe for an aggregate of approximately _________ Shares of Common Stock (the "Offer"). Common Stockholders will receive one Right for each outstanding Share held as of the Record Date. The number of Rights to be issued to a Common Stockholder on the Record Date will be rounded up to the nearest whole number evenly divisible by three. For every three Rights that a Common Stockholder receives, such Common Stockholder may subscribe for one new Share of the Fund at a subscription price equal to the NAV per Share as calculated at the close of trading on the date of expiration of the Offering (referred to herein as the "Expiration Date"). No fractional Shares will be issued. A Common Stockholder's right to acquire Shares during the period in which Rights may be exercised (the "Subscription Period") is referred to as the "Primary Subscription." See "The Offering."

In addition to the Primary Subscription, Record Date Stockholders who exercise all of their Rights are entitled to subscribe for Shares which were not otherwise subscribed for by others in the Primary Subscription (the "Over-Subscription Privilege"). If sufficient Shares are not available to honor all requests under the Over-Subscription Privilege, the Fund may, in its discretion, issue additional Shares up to 100% of the Shares available in the Offering (or _________ Shares for a total of __________ Shares) (defined below as "Over-Allotment Shares") to honor over-subscription requests, with such Shares subject to the same terms and conditions of this Offering. See "Over-Allotment and Over-Subscription Privilege" below.

Purpose of the Offering

The Board of Directors of the Fund (the "Board") has determined that it would be in the best interests of the Fund and its existing stockholders to increase the assets of the Fund. The primary reasons include:

* The Primary Subscription will provide existing Common Stockholders an opportunity to purchase additional Shares at a price that is potentially below market value without incurring any commission or transaction charges.

* Raising more cash will better position the Fund to take advantage of investment opportunities that may arise.

* Increasing the Fund's assets will provide the Fund flexibility in maintaining the Distribution Policy (defined below). The Distribution Policy permits holders of Common Stock to realize a predictable, but not assured, level of cash flow and some liquidity periodically with respect to their Common Stock without having to sell Shares. See "The Offering - Purpose of the Offering" below.

* Increasing Fund assets may lower the Fund's expenses as a proportion of net assets because the Fund's fixed costs would be spread over a larger asset base. For example, as a result of the Fund's 2007 rights offering and as of the date of this Prospectus, the Fund's expense ratio was reduced from ___% to ___%, a decrease of ____basis points. There can be no assurance that by increasing the size of the Fund, the Fund's expense ratio will be lowered.

* Since the Offering will increase the Fund's outstanding Shares and the liquidity of the Shares, it may increase the number of beneficial owners of the Shares over the long term, which could increase the level of market interest in and visibility of the Fund and improve the trading liquidity of the Shares on the NYSE.

* Increasing the Fund's total assets will reduce the Fund's leverage as a percentage of assets from __% to approximately __% (assuming the Primary Subscription is fully subscribed). The Fund is currently leveraged with $25 million of Auction Market Preferred Shares (the "AMPS") and the Fund intends to maintain this amount of leverage. Because leveraging increases risk, the additional assets raised from the Offering will mitigate risks commonly associated with leverage.

* The increase in assets will result in the Fund exceeding the AMPS' asset-coverage ratio requirements under its Articles Supplementary by a wider margin, thus giving the Fund greater flexibility to buy and hold investments without violating those requirements.

Investment Objective and Principal Investment Strategies

The Fund's investment objective is total return. The Fund seeks to produce both income and long-term capital appreciation by investing in a portfolio of equity and debt securities. The Fund invests primarily in common stocks, including dividend paying common stocks such as those issued by utilities, real estate investment trusts ("REITs") and regulated investment companies under the Code (as defined below) ("RICs"). The Fund also invests in fixed income securities such as U.S. government securities, preferred stocks and bonds. The Fund invests primarily in securities of U.S.-based companies and to a lesser extent in foreign equity securities and sovereign debt, in each case denominated in foreign currency. The Fund has no restrictions on its ability to invest in foreign securities. The Fund is concentrated in real estate related companies, which means it must invest more than 25% of its total assets in REITs or the equity or debt securities of companies in or primarily servicing the real estate industry or deriving a substantial portion of their revenue from, or having a substantial portion of their assets invested in, real estate ("Real Estate Related Companies"). No assurance can be given that the Fund will achieve its investment objective. See "Investment Objective and Policies."

The Fund is a "non-diversified" investment company, as defined in the Investment Company Act of 1940, as amended (the "1940 Act"), which means that it is permitted to invest its assets in a more limited number of issuers than "diversified" investment companies. A diversified company may not, with respect to 75% of its total assets, invest more than 5% of its total assets in the securities of any one issuer and may not own more than 10% of the outstanding voting securities of any one issuer. However, under Subchapter M of the Internal Revenue Code of 1986, as amended (the "Code"),

(A) not more than 25% of the Fund's total assets may be invested in securities of any one issuer (other than U.S. government securities and RICs) or of any two or more issuers controlled by the Fund which may be deemed to be engaged in the same, similar or related trades or businesses; and (B) with respect to 50% of the total value of the Fund's portfolio, (i) the Fund must limit to 5% the portion of its assets invested in the securities of a single issuer (other than U.S. government securities and RICs), and (ii) the Fund may not own more than 10% of the outstanding voting securities of any one issuer (other than U.S. government securities and RICs). The Fund intends to concentrate its common stock investments in a few issuers and to take large positions in those issuers, consistent with being a "non-diversified" fund. As a result, the Fund may be subject to a greater risk of loss than a diversified fund or a fund that has diversified its investments more broadly. Taking larger positions is also likely to increase the volatility of the Fund's NAV, reflecting fluctuation in the value of large Fund holdings.

The Fund has adopted a concentration policy pursuant to which it must, under normal market conditions, invest more than 25% of its total assets in Real Estate Related Companies. The Fund must obtain stockholder approval prior to changing this policy. Real Estate Related Companies include, but are not limited to: REITs and other closed-end registered investment companies that invest primarily in REITs; home builders; real estate developers; property management companies; real estate brokerage companies; commercial and industrial construction companies; financial companies who make or service real estate mortgages and/or construction loans; title, homeowners and builders risk insurance companies; manufacturers, distributors and retailers of construction materials and/or building supplies; lumber, paper, forest products, and other companies with significant real estate holdings; holding companies of any of these companies; and any other companies that the Fund's advisers reasonably determine are "real estate related companies." Although the Fund may invest in Real Estate Related Companies of any size, it currently intends to invest in such companies with market capitalizations of greater than $500 million. Although the Fund generally invests in U.S.-based Real Estate Related Companies, such companies may invest directly or indirectly in non-U.S. properties, and the Fund may make direct investments in foreign Real Estate Related Companies.

Under the 1940 Act, the Fund is subject to certain conditions and restrictions with regard to its investments in RICs (see "Portfolio Contents - Registered Investment Companies"). Under Subchapter M, no single investment can exceed 25% of the Fund's total assets at the time of purchase. These percentage limitations are calculated at the time of investment, and the Fund is not required to dispose of assets if holdings increase above these levels due to appreciation. As of [________], [________] of the Fund's total assets were invested in RICs, and [________] of the Fund's total assets were invested in Berkshire Hathaway, Inc. (NYSE: BRK) ("Berkshire"). Despite the [________] holding in Berkshire, the Fund remains in compliance with Subchapter M (as discussed above) because, at the time of investment, the Fund's holdings in Berkshire were less than 25% and all subsequent increases are due to market appreciation. The Fund's holdings in Berkshire, while a significant percentage of its overall holdings, do not violate the Fund's concentration policy in Real Estate Related Companies because the Fund is able to satisfy its obligation to invest more than 25% of its assets in Real Estate Related Companies while at the same time having a large position in Berkshire. The Fund has no restrictions on its ability to invest in foreign securities. As of [________], [________] of the Fund's total assets were invested in foreign securities.

Under normal market conditions, the Fund intends to invest at least 80% of its total assets in common stocks, primarily domestic common stocks and secondarily in foreign common stocks denominated in foreign currencies. The Fund's investments in common stocks may include, but is not limited to, RICs whose objective is income, REITs, and other dividend-paying common stocks. The portion of the Fund's assets that are not invested in common stocks may be invested in fixed income securities, cash equivalents and other income-producing securities. The term "fixed income securities" includes but is not limited to corporate bonds, U.S. government securities, notes, bills, debentures, preferred stocks, convertible securities, bank debt obligations, repurchase agreements and short-term money market obligations.

Under normal market conditions, the Fund will have 20% or less of its total assets in cash or cash equivalents. The Fund may, for temporary defensive purposes, allocate a higher portion of its assets to cash and cash equivalents. For this purpose, cash equivalents consist of, but are not limited to, short-term (less than twelve months to maturity) U.S. government securities, certificates of deposit and other bank obligations, investment grade corporate bonds, other debt instruments and repurchase agreements. When the Fund takes temporary defensive positions it may have difficulty achieving its investment objective.

Except for the Fund's investment objective, industry concentration and fundamental investment restrictions as described in this Prospectus and in the SAI, the percentage limitations and investment policies set forth in this Prospectus can be changed by the Board without stockholder approval.

In May 2006, the Fund adopted a level-rate distribution policy (the "Distribution Policy") pursuant to which Common Stockholders would receive a consistent, but not assured, periodic cash payment. Presently, under the Distribution Policy, the Fund makes regular distributions at the rate of $0.115 per Share per month, or $1.38 per Share annually. The monthly dividend is equivalent to ____% of the Fund's per Share market price and ___% of the Fund's most recent NAV of $____ per share, both on an annualized basis. The annualized distribution rate under the Distribution Policy is reviewed periodically by the Board and generally will not exceed the long term performance of the Fund based on a rolling 5-year performance history, subject to the Board's discretion to suspend, modify or terminate the Distribution Policy at any time. See "Dividends and Distributions - Level-Rate Distribution Policy."

The Advisers do not expect to make significant changes to the makeup of the Fund's portfolio or seek to invest in "high yielding" securities as a result of the Distribution Policy. The Fund may carry a slightly higher cash balance from time to time in order to fulfill the distribution payments. If the Fund carries higher cash balances during rising equity markets, the Fund's performance may be negatively affected relative to other equity funds. Conversely, carrying higher cash balances during declining equity markets may positively affect the Fund's performance. To avoid Code and 1940 Act requirements to make distributions in excess of the Distribution Policy, the Advisers expect to manage the portfolio slightly differently than in the absence of the Distribution Policy, but in a manner consistent with the Fund's investment objective and policies. For example, the Advisers may realize a loss in a security by selling it in order to offset realized capital gains, whereas, absent the Distribution Policy, the Advisers may not have realized the loss. The Advisers also may increase the

Fund's position in a security with an unrealized loss, and subsequently sell the tax lot with the higher tax cost basis 31 days or more after the purchase to avoid a wash sale, leaving the Fund with approximately the same position in the security but with a lower tax cost basis. The Advisers may also purchase stock of an issuer paying an unusually large dividend and, after the stock begins trading ex-dividend, sell the stock at a loss, thereby allowing the Fund to offset gains realized on other securities sold during the year. The Advisers enter into such transactions only when they believe that there is a high probability of realizing an economic profit for the Fund. The investment strategies described above were utilized by the Advisers prior to the implementation of the Distribution Policy to realize losses for the Fund in an effort to be tax efficient, and may result in slightly higher portfolio turnover and transaction costs. The Fund may have a slightly higher portfolio turnover rate than other similar equity funds due to the periodic need to liquidate securities for the purpose of making payments under the Distribution Policy and the strategy of purchasing stocks paying unusually large dividends as discussed above. See "Dividends and Distributions - Level-Rate Distribution Policy" and "Investment Objective and Policies - Level-Rate Distribution Policy." The Advisers will not hold positions with unrealized capital gains that they believe should be sold based on their fundamental analysis of the underlying issuer. The Advisers believe it would be better to discontinue the Distribution Policy than to see unrealized gains turn into unrealized losses.

The Fund may have net realized gains for the fiscal year ending November 30, 2008. In such case, unless the Fund (i) realizes capital losses prior to November 30, 2008 in an amount sufficient to offset all realized gains for the Fund's fiscal year or (ii) obtains exemptive relief from the Securities and Exchange Commission (the "SEC") from Section 19(b) of the 1940 Act and Rule 19b-1 under the 1940 Act prior to November 30, 2008 so it can characterize a portion of its previous distributions as realized capital gains, the Fund would be required to distribute the entire amount of its net realized capital gains for the fiscal year to its stockholders in December 2008. The per share amount of any such net realized capital gains distribution may be greater than per share amount at which monthly distributions previously have been made pursuant to the Distribution Policy, and therefore could shrink the Fund's assets more quickly than would otherwise be the case. The Advisers may utilize the investment strategies described in the preceding paragraph to realize capital losses in an amount sufficient to offset the Fund's realized capital gains for the fiscal year.

Limitations on investments expressed in percentages are measured and are applicable only at the time of investment. They are not measured or applied on an ongoing basis. There is no requirement for the Fund to sell or change its portfolio investments resulting from changes in valuations to such investments.

Investment Philosophy

Common Stocks. With respect to the Fund's common stock portfolio (other than common stocks purchased primarily for their income-producing potential), the Advisers use an "intrinsic value" approach to selecting securities for the Fund's portfolio. The Advisers define intrinsic value as the discounted value of the cash that can be taken out of a business during its remaining life. Accordingly, in their securities selection process, the Advisers put primary emphasis on analysis of balance sheets, cash flows, the quality of management and its ability to efficiently and effectively allocate capital, and indicators of internal returns (e.g., return on capital) which suggest future profitability and the relationships that these factors have to the price of a given security. The intrinsic value approach is based on the belief that the securities of certain companies may sell at a discount from the Advisers' estimate of such companies' "intrinsic value." The Advisers will attempt to identify and invest in such securities with the expectation that such value discount will narrow over time and thus provide capital appreciation for the Fund. When the Fund makes an investment in the common stock of an issuer, it will likely make a significant investment and typically hold such stock for a long period of time. Over time, the Fund believes that value investing produces superior total returns. There are risks associated with this "intrinsic value" approach which are outlined in "Risk Factors" below.

Fixed Income Investments. In seeking its total return objective, the Fund may invest a portion of its assets in U.S. government securities, preferred stocks, bonds and other income producing securities. In selecting such investments, the Advisers consider, among other things, current yield, liquidity, price variability and the underlying fundamental characteristics of the issuer, with particular emphasis on debt to equity and debt coverage ratios.

Use of Leverage by the Fund

The Fund has utilized financial leverage on an ongoing basis for investment purposes specifically through the issuance of the AMPS. In October 2005, the Fund issued 1,000 shares of AMPS at a purchase price of $25,000 per share plus accrued dividends. As of __________________, the Fund's total leverage from the issuance of AMPS was approximately __% of the Fund's total assets. This amount may change, but the Fund will not incur additional leverage in the form of preferred shares if as a result its total leverage would exceed 50% of the Fund's total assets. Although the Fund may in the future offer other preferred shares, increase the number of AMPS, or incur other indebtedness, which would further leverage the Fund, the Fund does not currently intend to offer preferred shares or to incur indebtedness, other than short-term credits in connection with the settlement of portfolio transactions.

Starting in early 2008 and continuing as of the date of this Prospectus, the market for auction market preferred securities experienced an unprecedented lack of liquidity that has resulted in failed auctions across the closed-end fund industry, including the AMPS issued by the Fund. The Fund continues to pay interest to the holders of AMPS, and continues to be AAA-rated by one or more nationally recognized credit agencies. Given the current interest rate environment, the Advisers believe that leverage is beneficial to the overall performance of the Fund, even though the auctions for the AMPS may continue to fail. There is no readily available solution that will resolve the failed auction situation. Any potential solution would be subject to factors beyond the Advisers' control such as market, credit and economic developments and, possibly, regulatory approval. There cannot be any assurance that potential solutions will be workable, receive all necessary approvals or implemented. As of the date of this Prospectus, there is no definitive timing for a resolution to this issue.

The Fund generally will not utilize leverage if the Advisers anticipate that leverage would result in a lower return to Common Stockholders over time. Use of financial leverage creates an opportunity for increased returns for the Common Stockholders but, at the same time, creates the possibility for greater loss (including the likelihood of greater volatility of NAV and market price of the Shares and of dividends), and there can be no assurance that a leveraging strategy will be successful during any period in which it is employed. Because the fees paid to the Advisers and FAS (defined below) will be calculated on the basis of the Fund's managed assets, the fees will be higher when leverage (including the AMPS) is utilized, giving the Advisers an incentive to utilize leverage.

All attendant costs of the AMPS leverage (e.g., auction agent and brokerage fees, dividends to AMPS stockholders, etc.) are borne by the Common Stockholders. The issuance of AMPS by the Fund may have costs and present other risks for Common Stockholders, including: (i) leverage may magnify market fluctuations in the Fund's underlying holdings, thus causing a disproportionate change in the Fund's NAV; (ii) the Fund's cost of leverage may exceed the return on the underlying securities acquired with the proceeds of the leverage, thereby diminishing rather than enhancing the return to stockholders and generally making the Fund's total return to such stockholders more volatile; (iii) the Fund may be required to sell investments in order to meet dividend or interest payments on the debt or preferred stock it has issued when it may be disadvantageous to do so; (iv) leveraging through the issuance of preferred stock requires that the holders of the preferred stock have class voting rights on various matters that could make it more difficult for Common Stockholders to change the investment objective or fundamental policies of the Fund, to convert it to an open-end fund or make certain other changes; and (v) the Fund may be forced to redeem some or all of the AMPS at inopportune times due to a decline in market value of Fund investments.

Additionally, the AMPS stockholders have a "dividend preference" for their shares meaning that, should the Fund decide to liquate the AMPS, the Fund, or both, AMPS stockholders would receive first priority in payment of their liquidation preference, or $25,000 per share, plus accrued and unpaid dividends, before Common Stockholders would receive payment on the value of their liquidated shares. The net result may be that Common Stockholders receive an amount per share upon liquidation of the Fund that is reduced by the liquidation preference plus accrued and unpaid dividends first paid to AMPS stockholders. This reduced amount could be less than the current market value if the Fund is trading at a premium to its net asset value at the time of such liquidation.

Dividends and Distributions

In May 2006, the Fund adopted the Distribution Policy, pursuant to which Common Stockholders would receive a consistent, but not assured, periodic cash payment. Presently, under the Distribution Policy, the Fund makes regular distributions at the rate of $0.115 per Share per month, or $1.38 per Share annually. The monthly dividend is equivalent to _____% of the Fund's per Share market price and ___% of the Fund's most recent NAV of $____ per Share, both on an annualized basis. The annualized distribution rate under the Distribution Policy is reviewed periodically by the Board and generally will not exceed the long term performance of the Fund based on a rolling 5-year performance history, subject to the Board's discretion to suspend, modify or terminate the Distribution Policy at any time. The Fund may have net realized gains for the fiscal year ending November 30, 2008. In such case, unless the Fund (i) realizes capital losses prior to November 30, 2008 in an amount sufficient to offset all realized gains for the Fund's fiscal year or (ii) obtains exemptive relief from the SEC from Section 19(b) of the 1940 Act and Rule 19b-1 under the 1940 Act prior to November 30, 2008, so it can characterize a portion of its previous distributions as realized capital gains, the Fund would be required to distribute the entire amount of its net realized capital gains for the fiscal year to its stockholders in December 2008. The per share amount of any such net realized capital gains distribution may be greater than the per share amount at which monthly distributions previously have been made pursuant to the Distribution Policy, and therefore could shrink the Fund's assets more quickly than would otherwise be the case.

Rights holders who exercise their Rights will receive newly issued Shares within fifteen (15) days of the record date of the most recent monthly payment under the Distribution Policy, which record date may occur during the Subscription Period. Common Stockholders who receive newly issued Common Stock in the Offering will not receive a distribution under the Distribution Policy with respect to such newly issued Shares for the record date immediately prior to issuance of the newly issued Shares. Common Stockholders will be entitled to receive monthly distributions for record dates subsequent to their receipt of newly issued Common Stock in accordance with the Distribution Policy. The Offering will not impact the distributions to be paid to current Common Stockholders regardless of whether they exercise their Rights or allow their Rights to lapse, subject to suspension, termination, or modification of the Distribution Policy by the Board at any time.

See "Dividends and Distributions - Level-Rate Distribution Policy" and "Risk Factors."

Dividend Reinvestment Policy

Common Stockholders receive all dividends and capital gains distributions in cash. However, the Fund has established a dividend reinvestment plan under which all Common Stockholders whose Shares are registered in their own name may elect to have all such dividends and distributions automatically reinvested in additional Shares. Common Stockholders who elect to hold their Shares in the name of a broker or nominee should contact such broker or nominee to determine whether they may participate in the Plan. See "Dividends and Distributions - Dividend Reinvestment Plan."

Periodic Rights Offerings

The Fund has conducted several rights offerings in the past and is likely to continue to conduct rights offerings in the future. The Fund conducted a one-for-one rights offering in 2002, which doubled the number of common shares outstanding at the time and resulted in approximately $24.35 million in net proceeds to the Fund. Over a period of approximately 4 1/2 months following the offering, the Fund invested the proceeds in accordance with its investment objectives. The Fund conducted a one-for-three rights offering in September 2007, which resulted in the issuance of approximately 3.8 million common shares and approximately $32.8 million in net proceeds to the Fund. As of April [ ], 2008, the Fund has invested approximately [48%] of these proceeds. During this period, the market declined with the S&P 500 Index down over 13%. Pending investment in accordance with its investment objective, the Fund has invested some of the proceeds in short-term securities issued by the U.S. government or its agencies or instrumentalities or in high quality, short-term or long-term debt obligations or money market instruments. Some of these investments have included investments in the ARPS (auction rate preferred securities) of other issuers. As of the date of this Prospectus, the Fund has invested approximately $17.9 million, or approximately 12% of its assets, in ARPS of three different issuers. Although the auctions for these ARPS have recently failed, the Fund continues to receive dividend payments from these securities which conform to the Advisers' expected return on these types of investments. See "Investment Objective and Policies" and "Use of Proceeds" below.

Risk Factors

General Risks of Investing in the Fund. The Fund is not a complete investment program and should only be considered as an addition to an investor's existing diversified portfolio of investments. Due to uncertainty inherent in all investments, there can be no assurance that the Fund will achieve its investment objectives.

* Non-Diversified Status Risk. The Fund is classified as "non-diversified" under the 1940 Act. As a result, it can invest a greater portion of its assets in obligations of a single issuer than a "diversified" fund. The Fund will therefore be more susceptible than a diversified fund to being adversely affected by any single corporate, economic, political or regulatory occurrence. The Fund intends to diversify its investments to the extent necessary to qualify, and maintain its status, as a regulated investment company under U.S. federal income tax laws. See "Risk Factors" and "Federal Income Tax Matters."

* Investments in Common Stocks. The Fund intends to invest, under normal market conditions, at least 80% of its total assets in publicly traded common stocks. Common stocks generally have greater risk exposure and reward potential over time than bonds. The volatility of common stock prices has historically been greater than bonds, and as the Fund invests primarily in common stocks, the Fund's NAV may also be volatile. Further, because the time horizon for the Fund's investments in common stock is longer, the time necessary for the Fund to achieve its objective of total return will likely be longer than for a fund that invests solely for income.

* Concentration Risk. The Fund intends to concentrate its common stock investments in a few issuers and to take large positions in those issuers, consistent with being a "non-diversified" fund. As a result, the Fund may be subject to a greater risk of loss than a diversified fund or a fund that has diversified its investments more broadly. Taking larger positions is also likely to increase the volatility of the Fund's NAV, reflecting fluctuation in the value of large Fund holdings.

* Investment in Berkshire Hathaway. The Fund presently has invested a significant percentage of its portfolio in Berkshire Hathaway, Inc. (NYSE: BRK) (defined above as "Berkshire"). As of _________________, the Fund held ___ Berkshire Class A shares and ___ Berkshire Class B shares, representing ____% of the Fund's total assets. The Advisers do not currently intend to liquidate any portion of the Fund's position in Berkshire. Although not an insurance company itself, Berkshire owns Geico Insurance, General Re Insurance and other insurance companies, and therefore derives a significant portion of its income, and its net asset value, from insurance companies. The insurance business can be significantly affected by interest rates as well as price competition within the industry. In addition, an insurance company may experience significant changes in its year to year operating performance based both on claims paid and on performance of invested assets. Insurance companies can also be affected by government regulations and tax laws, which may change from time to time. A significant decline in the

market price of Berkshire or any other company in which the Fund has made a significant common stock investment (i) would result in a significant decline in the Fund's NAV; (ii) may result in a proportionate decline in the market price of the Shares; and (iii) may result in greater risk and market fluctuation than a fund that has a more diversified portfolio. The Fund's holdings in Berkshire, while a significant percentage of its overall holdings, do not violate the Fund's concentration policy in Real Estate Related Companies because the Fund is able to satisfy its obligation to invest more than 25% of its assets in Real Estate Related Companies while at the same time having a large position in Berkshire.

* Investments in Real Estate Related Companies. The Fund has adopted a concentration policy pursuant to which it must, under normal market conditions, invest more than 25% of its total assets in Real Estate Related Companies. The Fund must obtain stockholder approval prior to changing this policy, thus limiting its flexibility to liquidate such companies in the future should market conditions warrant. Since the Fund will concentrate its assets in the real estate industry, the Fund's performance will be generally linked to performance of the real estate markets. Property values may fall due to increasing vacancies or declining rents resulting from economic, legal, cultural or technological developments. REIT and other Real Estate Related Company prices also may drop because of the failure of borrowers to pay their loans and poor management. Many REITs utilize leverage, which increases investment risk and could adversely affect a REIT's operations and market value in periods of rising interest rates, as well as risks normally associated with debt financing. In addition, there are risks associated with particular sectors of real estate investments (e.g., retail, office, hotel, healthcare and multifamily properties), although the Fund does not intend to focus on any particular sector of real estate investments.

* Leveraging Risk. The Fund is currently leveraged with the AMPS. All attendant costs of the AMPS leverage (e.g., auction agent and brokerage fees, dividends to AMPS stockholders, etc.) are borne by the Common Stockholders. Use of leverage may have a number of adverse effects on the Fund and its stockholders including: (i) leverage may magnify market fluctuations in the Fund's underlying holdings thus causing a disproportionate change in the Fund's NAV; (ii) the Fund's cost of leverage may exceed the return on the underlying securities acquired with the proceeds of the leverage, thereby diminishing rather than enhancing the return to stockholders and generally making the Fund's total return to such stockholders more volatile; (iii) the Fund may be required to sell investments in order to meet dividend or interest payments on the debt or preferred stock it has issued when it may be disadvantageous to do so; (iv) leveraging through the issuance of preferred stock requires that the holders of the preferred stock have class voting rights on various matters that could make it more difficult for Common Stockholders to change the investment objective or fundamental policies of the Fund, to convert it to an open-end fund or make certain other changes; and (v) the Fund may be forced to redeem some or all of the AMPS at inopportune times due to a decline in market value of Fund investments. Because the fees paid to the Advisers and FAS (defined below) will be calculated on the basis of the Fund's managed assets, the fees will be higher when leverage (including the AMPS) is utilized, giving the Advisers an incentive to utilize leverage.

Additionally, the AMPS holders have a dividend preference for their shares, meaning that should the Fund decide to liquate the AMPS, the Fund, or both, the holders of AMPS would receive first priority in payment of their liquidation preference, or $25,000 per share, plus accrued and unpaid dividends, before Common Stockholders would receive payment on the value of their liquidated shares. The net result could be that Common Stockholders receive an amount per share upon liquidation of the Fund an amount that is reduced by the AMPS liquidation preference plus accrued and unpaid dividends first paid to AMPS holders. This reduced amount could be less than the current market value if the Fund is trading at a premium to its net asset value at the time of such liquidation.

In February 2008, the recent liquidity crisis in the credit markets spilled over into the auction rate preferred market, disrupting trading in auction rate preferred securities ("ARPS") like the AMPS and resulting in widespread failed auctions of ARPS. The Fund's most recent AMPS auction similarly failed on [ ], 2008, and as of the date of this Prospectus, there has not been a successful subsequent auction. A failed auction occurs when there are too few buyers willing to bid on and purchase the ARPS at the periodic auction. Generally in a failed auction, because there are too few buyers, holders of ARPS are unable to sell and therefore must remain holders of the ARPS, although they continue to be paid interest on the shares they hold, typically at a higher interest rate. In the case of the AMPS, this higher rate is referred to as the "Maximum Applicable Rate". The Maximum Applicable Rate is intended in part to mitigate the inconvenience and temporary illiquidity of failed auctions, although the holder must continue to hold the ARPS until a subsequent successful auction is conducted or the issuer redeems the ARPS.

In the case of the AMPS, the Maximum Applicable Rate depends on the credit rating assigned to the AMPS and the duration of the dividend period. Currently, the AMPS have a Fitch rating of "AAA", a Moody's rating of "Aaa" and a 28-day dividend period. This corresponds with a Maximum Applicable Rate which is the higher of 125% of the reference rate (i.e., the 30-day London Inter-Bank Offered Rate or "LIBOR") or 1.25% plus the reference rate. As of _________________, the Maximum Applicable Rate for the Fund was ___%. As a point of reference, prior to the first failed AMPS auction, the rate paid by the Fund was ___%. Although the Maximum Applicable Rate presently paid by the Fund is relatively close to the rate set at its most recent successful auction, these circumstances could abruptly change if short-term interest rates increase. In such event, the Maximum Applicable Rate could also increase substantially.

Additionally, should the credit rating assigned to the AMPS be downgraded, the Maximum Applicable Rate paid by the Fund would increase depending on the revised credit rating. For example, should the AMPS' credit rating be downgraded to A+ by Fitch and/or to A1 by Moody's, the Maximum Applicable Rate payable by the Fund would increase to the higher of 200% of the reference rate (e.g., LIBOR) or 2.00% plus the reference rate. In no instance would the Maximum Applicable Rate exceed the greater of 300% of the reference rate or 3.00% plus the reference rate.

* Level-Rate Distribution Policy. In May 2006 stockholders voted in favor of, and the Fund adopted, the Distribution Policy. A level-rate

distribution policy allows a fund to provide a regular, periodic (but not assured) distribution to its common stockholders which is not dependent on the amount of income earned or capital gains realized by the fund. An equity fund, such as the Fund, is designed for investors to participate in a professionally managed portfolio of equity investments. Over the long-term, equity investments have historically provided higher total returns than fixed income investments such as bonds. However, unlike most fixed income funds, which pay stockholders a regular dividend based on the fund's investment income, equity funds generally pay only one dividend per year consisting of a relatively small amount of net investment income and any net realized capital gains. A managed distribution permits a fund to distribute a predetermined monthly amount, regardless of when or whether income is earned or capital gains are realized. However, the practice of making distributions that exceed income earned or capital gains realized can result in the Fund making distributions that consist of a return of capital. A level-rate distribution policy recognizes that many investors are willing to accept the potentially higher asset volatility of equity investments, but would prefer that a consistent level of cash distributions are available to them each month for reinvestment or other purposes of their choosing.

The Distribution Policy initially provided for monthly distributions at the rate of $0.10 per Share per month, or $1.20 per Share annually, which represented a 14.9% annual distribution rate relative to the Fund's NAV at the time. In February 2007, because the NAV of the Fund had increased substantially since the Distribution Policy was adopted, and the Board wished to maintain a similar annual distribution rate to that originally adopted, the Fund increased the distribution rate to $0.115 per Share per month, or $1.38 per Share annually, representing a 14.6% annual distribution rate relative to the Fund's NAV at the time. At its quarterly meeting in January 2008, the Board considered and resolved to maintain the then-current distribution rate at $0.115 per Share per month, or $1.38 per Share annually, representing ___% of the Fund's per Share market price and ___% of the Fund's most recent NAV, both on an annualized basis. The annual distribution rate under the Distribution Policy is reviewed periodically by the Board and generally will not exceed the annual long term performance of the Fund based on a rolling 5-year performance history, subject to the Board's discretion to suspend, modify or terminate the Distribution Policy at any time. For the five-year period ending December 31, 2007, the Fund returned 15.9% on its NAV on an annualized basis.

Exemptive relief from the SEC is not required in the near term in order to continue the Distribution Policy. The Fund has applied to the SEC for exemptive relief from Section 19(b) of the 1940 Act and Rule 19b-1 under the 1940 Act to enable the Fund to continue the Distribution Policy over the long term. Section 19(b) of the 1940 Act limits an investment company's ability to make multiple distributions of net realized long-term capital gains each year, subject to certain exceptions contained in Rule 19b-1. Historically, investment companies that wished to implement a managed distribution policy requiring multiple capital gain distributions per year routinely received exemptive relief from Section 19(b). However, as of the date of this Prospectus, the SEC has not responded either favorably or unfavorably to the Fund's request for exemptive relief originally filed in 2004 and amended in January 2007. It is generally believed that the SEC has imposed a moratorium on granting this type of request for exemptive relief over concerns that inadequate disclosures by investment companies regarding sources of distributions (e.g., net investment income, net long-term capital gain, return of capital) have resulted in fund investors not understanding that distributions may include a return of capital and do not necessarily represent a dividend yield.

For the fiscal year ended November 30, 2007, the Distribution Policy did not violate Section 19(b) because the Fund had capital loss carry-forwards that were used to offset the Fund's realized net capital gains and all gains not otherwise offset were paid to Common Stockholders in the calendar-year-end distribution. Accordingly, only one distribution was made pursuant to the Distribution Policy which consisted of net long-term capital gains in compliance with Section 19(b). The Fund may similarly have net realized gains for the fiscal year ending November 30, 2008. In such case, unless the Fund (i) realizes capital losses prior to November 30, 2008, in an amount sufficient to offset all realized gains for the Fund's fiscal year or (ii) obtains exemptive relief from the SEC from Section 19(b) of the 1940 Act and Rule 19b-1 under the 1940 Act prior to November 30, 2008, so it can characterize a portion of its previous distributions as realized capital gains, the Fund would be required to distribute the entire amount of its net realized capital gains for the fiscal year to its stockholders in December 2008. The per share amount of any such net realized capital gains distribution may be greater than the per share amount at which monthly distributions previously have been made pursuant to the Distribution Policy, and therefore could shrink the Fund's assets more quickly than would otherwise be the case.

There are certain risks and negative impacts associated with the Distribution Policy:

- The Distribution Policy may impact the way in which the Fund is managed. The Advisers do not expect to make significant changes to the makeup of the Fund's portfolio or seek to invest in "high yielding" securities as a result of the Distribution Policy. The Fund may carry a slightly higher cash balance from time to time in order to fulfill the distribution payments. If the Fund carries higher cash balances during rising equity markets, the Fund's performance may be negatively affected relative to other equity funds. Conversely, carrying higher cash balances during declining equity markets may positively affect the Fund's performance. To avoid Code and 1940 Act requirements to make distributions in excess of the Distribution Policy, the Advisers expect to manage the portfolio slightly differently than in the absence of the Distribution Policy, but in a manner consistent with the Fund's investment objective and policies. For example, the Advisers may realize a loss in a security by selling it in order to offset realized capital gains, whereas, absent the Distribution Policy, the Advisers may not have realized the loss. The Advisers also may increase the Fund's position in a security with an unrealized loss, and subsequently sell the tax lot with the higher tax cost basis 31 days or more after the purchase to avoid a wash sale, leaving the Fund with approximately the same position in the security but with a lower tax cost basis. The Advisers may also purchase stock of an issuer paying an unusually large dividend and, after the stock begins trading ex-dividend, sell the stock at a loss, thereby allowing the Fund to offset gains realized on other securities sold during the year. The Advisers enter into such transactions only when they believe that there is a high probability of realizing an economic profit for the Fund. The investment strategies described above were utilized by the Advisers prior to the implementation of the Distribution Policy to realize losses for the Fund in an effort to be tax efficient, and may result in slightly higher portfolio turnover and transaction costs. The Advisers will not hold positions with unrealized capital gains that they believe should be sold based on their fundamental analysis of the underlying issuer. The Advisers believe it would be better to discontinue the Distribution Policy than to see unrealized gains turn into unrealized losses. The Fund may have net realized gains for the fiscal year ending November 30, 2008. In such case, unless the Fund (i) realizes capital losses prior to November 30, 2008 in an amount sufficient to offset all realized gains for the Fund's fiscal year or (ii) obtains exemptive relief from the SEC from Section 19(b) of the 1940 Act and Rule 19b-1 under the 1940 Act prior to November 30, 2008, so it can characterize a portion of its previous distributions as realized capital gains, the Fund would be required to distribute the entire amount of its net realized capital gains for the fiscal year to its stockholders in December 2008. The per share amount of any such net realized capital gains distribution may be greater than the per share amount at which monthly distributions previously have been made pursuant to the Distribution Policy, and therefore could shrink the Fund's assets more quickly than would otherwise be the case. The Advisers may utilize the investment strategies described above to realize capital losses in an amount sufficient to offset the Fund's realized capital gains for the fiscal year.

- The Distribution Policy is subject to modification, suspension or termination at any time by the Board. Because the Distribution Policy was implemented without an exemption under Section 19(b) of the 1940 Act and Rule 19b-1, the Fund must have the flexibility to modify, suspend or terminate the Distribution Policy immediately if the Board deems such action to be in the best interests of the Fund and its stockholders.

  As discussed above, the annual distribution rate under the Distribution Policy is reviewed periodically by the Board and generally will not exceed the average annual long term performance of the Fund based on a rolling 5-year performance history. If the Fund's long term performance declines, the Board will make a corresponding reduction in the annual distribution rate under the Distribution Policy. In addition, the SEC may impose conditions on any grant of exemptive relief from Section 19(b) that require the Board to consider adjusting the annual distribution rate on a more frequent basis under certain circumstances.

- A modification, suspension or termination of the Distribution Policy could result in a concurrent reduction or cessation of the $0.115 per Share monthly distribution presently paid to Common Stockholders. If the Distribution Policy was suspended or terminated, the Fund would revert back to its prior practice of distributing only net investment income and net realized capital gains at the end of its fiscal year. A modification, suspension or termination of the Distribution Policy could have the effect of abruptly creating a trading discount (if the Fund is trading at or above NAV) or widening an existing trading discount.

- If the Fund's annual total return is less than the annual distribution, the Distribution Policy could have the effect of shrinking the assets of the Fund and thus increasing the Fund's expense ratio (i.e., the Fund's fixed expenses will be spread over a smaller pool of assets). The Board has determined that the annual distribution rate should not exceed the Fund's average annual long term performance of the Fund based on a rolling

5-year performance history. However, there may be interim periods where the annual distribution rate exceeds the short-term return on the Fund's NAV, which could shrink the assets of the Fund. In addition, if the Fund does not obtain exemptive relief from Section 19(b) prior to the end of its fiscal year and the Board elects to characterize the Fund's final distribution for the calendar year as including all net capital gain realized during the year, such distribution could shrink the Fund's assets more quickly than would otherwise be the case if the per share amount of any such net realized capital gains distribution is greater than per share amount at which monthly distributions previously have been made pursuant to the Distribution Policy.

- A distribution which contains a return of capital, which the Fund expects generally to be the case, will result in added record keeping for Common Stockholders. Return of capital is not taxable to Common Stockholders in the year it is paid. However, Common Stockholders will need to reduce the cost basis of their stock by the amount of the return of capital so that, when they sell the stock, they will have properly accounted for the return of capital. Such an adjustment will cause Common Stockholders' gain to be more, or their loss to be less, as the case may be. For example, if a Common Stockholder purchased stock in the Fund for $7.00 per Share and then receives dividends from the Fund which have $1.00 per Share return of capital, and then the stockholder subsequently sells his Shares for $7.50 per Share, his gain will be $1.50 per Share, since he would have adjusted his cost basis downward by $1.00 per Share (from $7.00 per Share to $6.00 per Share). Common Stockholders who hold their stock in non-taxable accounts such as IRA's will not need to make any such adjustments. Common Stockholders should contact their own tax advisor if they have questions regarding the tax treatment of the distributions under the Distribution Policy.

- The Fund may have a slightly higher portfolio turnover rate than other similar equity funds due to the periodic need to liquidate securities for the purpose of making payments under the Distribution Policy and the strategy of purchasing stocks paying unusually large dividends as discussed above. See "Dividends and Distributions - Level-Rate Distribution Policy" and "Investment Objective and Policies - Level-Rate Distribution Policy."

* Discount From NAV. The common stock of closed-end funds frequently trades at a market price that is less than the value of the net assets attributable to those shares (a "discount"). The possibility that the Shares will trade at a discount from NAV is a risk separate and distinct from the risk that the Fund's NAV will decrease. The risk of purchasing shares of a closed-end fund that might trade at a discount is more pronounced for investors who wish to sell their shares in a relatively short period of time because, for those investors, realization of a gain or loss on their investments is likely to be more dependent upon the existence of a premium or discount than upon portfolio performance.

* Premium Over NAV. The Shares may trade at a market price that is greater than the value of the net assets attributable to those Shares (a "premium"). The possibility that the Shares will trade at a premium over NAV is a risk separate and distinct from the risk that the Fund's NAV will decrease. For those Common Stockholders who acquire Shares at

a premium, such premium may be unsustainable. If the price of the Shares falls, the Common Stockholders will experience a loss on their investments.

* Size of the Fund. As of ___________________, the Fund had total net assets of approximately $_____ million, including $25 million in AMPS leverage. As a fund with a relatively small asset base, the Fund may be subject to certain operational inefficiencies including: higher expense ratio, less coverage by analysts and the marketplace in general which can contribute to a less active trading market for the Shares and consequently a wider discount, more limited ability to attract new investors and/or take advantage of investment opportunities and less ability to take advantage of lower transaction costs available to larger investors.

* Repurchase of the Shares. The Fund is authorized to repurchase Shares on the open market when the Shares are trading at a discount from NAV per Share as determined by the Board from time to time. Any acquisition of Shares by the Fund will decrease the total assets of the Fund and, therefore, have the effect of increasing the Fund's expense ratio and may adversely affect the ability of the Fund to achieve its investment objectives. Furthermore, the acquisition of Shares by the Fund may require the Fund to redeem the AMPS in order to maintain certain asset coverage requirements. To the extent the Fund may need to liquidate investments to fund the repurchase of Shares, this may result in portfolio turnover which will result in additional expenses being borne by the Fund.

* Dependence on Key Personnel. The Advisers are dependent upon the expertise of Stewart Horejsi in providing advisory services with respect to the Fund's investments. If the Advisers were to lose the services of Mr. Horejsi, their ability to service the Fund could be adversely affected. There can be no assurance that a suitable replacement could be found for Mr. Horejsi in the event of his death, resignation, retirement or inability to act on behalf of the Advisers.

* Issuer Risk. The value of the Fund's portfolio may decline for a number of reasons which directly relate to the issuers of the securities in the portfolio, such as management performance, financial leverage and reduced demand for an issuer's goods and services.

* Inflation Risk. Inflation risk is the risk that the value of assets or income from investments will be worth less in the future as inflation decreases the value of money. As inflation increases, the real value of the Fund's portfolio can decline.

* Repurchase Agreements. The use of repurchase agreements involves certain risks. For example, if the seller of securities under a repurchase agreement defaults on its obligation to repurchase the underlying securities, as a result of bankruptcy or otherwise, the Fund will seek to dispose of such securities, which action could involve costs or delays. If the seller becomes insolvent and subject to liquidation or reorganization under applicable bankruptcy or other laws, the Fund's ability to dispose of the underlying securities may be restricted. Finally, it is possible that the Fund may not be able to substantiate its interest in the underlying securities.

* Foreign Securities Risk. The Fund is permitted to invest in foreign securities without limitation. Investment in non-U.S. issuers may

involve unique risks compared to investing in securities of U.S. issuers. These risks are more pronounced to the extent that the Fund invests a significant portion of its non-U.S. investments in one region or in the securities of emerging market issuers. These risks may include:

- Less information about non-U.S. issuers or markets may be available due to less rigorous disclosure, accounting standards or regulatory practices.

- Many non-U.S. markets are smaller, less liquid and more volatile. In a changing market, the Advisers may not be able to sell the Fund's portfolio securities at times, in amounts and at prices they consider reasonable.

- Currency exchange rates or controls may adversely affect the value of the Fund's investments.

- The economies of non-U.S. countries may grow at slower rates than expected or may experience downturns or recessions.

- Withholdings and other non-U.S. taxes may decrease the Fund's return.

* Currency Risk. The Fund currently holds investments in foreign securities and thus a portion of the Fund's assets may be quoted or denominated in non-U.S. currencies. These securities may be adversely affected by fluctuations in relative currency exchange rates and by exchange control regulations. The Fund's investment performance may be negatively affected by a devaluation of a currency in which the Fund's investments are quoted or denominated. Further, the Fund's investment performance may be significantly affected, either positively or negatively, by currency exchange rates because the U.S. dollar value of securities quoted or denominated in another currency will increase or decrease in response to changes in the value of such currency in relation to the U.S. dollar. The Fund does not currently hedge against the potential decline in value of foreign currencies against the U.S. dollar and does not foresee hedging currency risk in the future, though it is not precluded from doing so.

* Sovereign Debt Risk. An investment in debt obligations of non-U.S. governments and their political subdivisions ("sovereign debt") involves special risks that are not present in corporate debt obligations. The non-U.S. issuer of the sovereign debt or the non-U.S. governmental authorities that control the repayment of the debt may be unable or unwilling to repay principal or interest when due, and the Fund may have limited recourse in the event of a default. During periods of economic uncertainty, the market prices of sovereign debt may be more volatile than prices of debt obligations of U.S. issuers. In the past, certain non-U.S. countries have encountered difficulties in servicing their debt obligations, withheld payments of principal and interest and declared moratoria on the payment of principal and interest on their sovereign debt.

* Liquidity Risk. Although the Fund invests primarily in securities traded on national exchanges, it may invest in less liquid assets from time to time that are not readily marketable and may be subject to restrictions on resale. Illiquid securities may be more difficult to value or may impair the Fund's ability to realize the full value of its assets in the event of a voluntary or involuntary liquidation of such assets and thus may cause a decline in the Fund's NAV. The Fund has no limitation on the amount of its assets that may be invested in

securities which are not readily marketable or are subject to restrictions on resale, although it may not invest more than 30% of the value of its total assets in securities which have been acquired through private placement. In certain situations, the Advisers could find it more difficult to sell such securities at times, in amounts and at prices they consider reasonable.

* Market Disruption Risk. The terrorist attacks in the United States on September 11, 2001 had a disruptive effect on the securities markets. The Fund cannot predict the effects of similar events in the future on the U.S. economy. These terrorist attacks and related events, including the war in Iraq, its aftermath, and continuing occupation of Iraq by coalition forces, have led to increased short-term market volatility and may have long-term effects on U.S. and world economies and markets. A similar disruption of the financial markets could impact interest rates, auctions, secondary trading, ratings, credit risk, inflation and other factors relating to the Common Stock and AMPS.

* Anti-Takeover Provisions Risk. The Fund's charter (the "Charter") and bylaws (the "Bylaws") include provisions that could limit the ability of other entities or persons to acquire control of the Fund or to change the composition of its Board. Such provisions could limit the ability of stockholders to sell their Shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control of the Fund. These provisions include advance notice requirements for stockholder proposals and super-majority voting requirements for certain transactions with affiliates, open-ending the Fund or a merger, liquidation, asset sale or similar transaction.

* Investments in RICs. The Fund may invest in securities issued by other closed-end funds (or RICs) subject to such limitations, restrictions and conditions as imposed by Federal law. Accordingly, the Fund will be subject to the particular risks associated with investing in other closed-end funds that are separate from risks associated with the underlying investments held such RICs. Both the Fund and any RICs in which it invests have management fees. In addition, the RICs in which the Fund invests will typically incur other operating expenses that are borne by their investors, including the Fund. As a result, Fund stockholders will bear not only the Fund's management fees and operating expenses, but also the fees and expenses of the RICs in which the Fund invests. Investors would bear less expense if they invested directly in the underlying RICs in which the Fund invests. The Fund may also invest in RICs that are not limited in their portfolio trading activity and thus may experience high portfolio turnover rates. Higher turnover rates generally result in correspondingly greater brokerage commissions and other transactional expenses which may be borne by the Fund, directly or through its investment in RICs. Higher turnover rates also may be more likely to generate capital gains that must be distributed to Fund stockholders, either as a result of the Fund's receipt of capital gains from RIC transactions or from the Fund's trading in RICs or other investments.

* Investments in Auction Rate Preferred Securities. From time to time the Fund invests in the ARPS of other closed-end investment companies which carry the highest credit rating from Moodys, S&P and Fitch. As of __________________, the Fund held approximately $_______ of such ARPS. Recently, the liquidity crisis in the credit market spilled over into the auction rate preferred market, disrupting trading in ARPS and resulting in widespread failed auctions. A failed auction occurs when

there are too few buyers willing to bid on and purchase ARPS at the periodic auction, typically held every 7 or 28 days. Generally in a failed auction, because there are too few buyers, holders of the ARPS are unable to sell their shares and therefore must remain holders of the ARPS although they continue to be paid interest on the shares they hold, typically at a higher interest rate (e.g., a "fail rate"). Although fail rates are intended in part to mitigate the inconvenience and temporary illiquidity of failed auctions, holders like the Fund must continue to hold the ARPS until a subsequent successful auction is conducted or the issuer redeems the ARPS. Consequently, holders of ARPS like the Fund will have to hold ARPS until liquidity returns to the auction rate preferred market and successful auctions are held, or until the issuers of the ARPS elect to redeem. The Fund cannot predict when or if the liquidity issues affecting the auction rate preferred market will be resolved and thus is not able to predict when it will be able to liquidate its ARPS holdings.

* Investments in mid- and small-cap securities. The Fund may invest in small- and mid-cap companies from time to time. Generally, small-cap stocks are those securities issued by companies with a total market capitalization of between $300 million to $2 billion, and mid-cap stocks are those securities issued by companies with a total market capitalization of between $2 billion to $10 billion. The small- and mid-cap stocks in which the Fund may invest may present greater opportunities for capital growth than larger companies, but also may be more volatile and subject to greater risk. This is because smaller companies generally may have limited financial resources, product lines and markets, and their securities may trade less frequently and in more limited volumes than the securities of larger companies, which could lead to higher transaction costs and reduced returns to holders of these securities, including potentially the Fund. In addition, there may be less publicly available information about smaller companies which can also lead to higher risk in terms of arriving at an accurate valuation for these smaller companies.

Investment Advisers

The Fund is co-advised by Boulder Investment Advisers, LLC ("BIA") and Stewart West Indies Trading Company, Ltd. d/b/a Stewart Investment Advisers ("SIA") (collectively, the "Advisers"). The Advisers have been providing advisory services to the Fund since January 2002, to the Boulder Total Return Fund, Inc. since March 1999, and to The Denali Fund Inc. since October 2007. As of _________________, the Advisers had a total of $____ million in assets under management. The Fund pays the Advisers an aggregate monthly fee at the annual rate of 1.25% of the Fund's average monthly total net assets (including the principal amount of leverage, if any) (the "Adviser Fee"). At a regular meeting of the Board held on January 25, 2008, the Advisers agreed to a waiver of advisory fees at certain "break-point" levels such that, in the future, the Adviser Fee would be calculated at the annual rate of 1.25% on asset levels up to $400 million, 1.10% on assets levels between $400-$600 million; and 1.00% on asset levels exceeding $600 million. The fee waiver agreement has a one-year term and is renewable annually.

Administrator, Custodian, Transfer Agent, Registrar and Dividend Disbursing Agent

Fund Administrative Services, LLC ("FAS") is an affiliate of the Advisers and serves as the Fund's co-administrator. Under its Administration Agreement with the Fund, FAS provides certain administrative and executive management services to the Fund including: providing the Fund's principal offices and executive officers, overseeing and administering all contracted service providers, making recommendations to the Board regarding policies of the Fund, conducting stockholder relations, authorizing expenses and other administrative tasks.

Under the Administration Agreement, FAS receives a monthly fee calculated at an annual rate of 0.20% of the value of the Fund's average monthly total net assets (including the principal amount of leverage, if any) up to $250 million; 0.18% of the Fund's average monthly total net assets on the next $150 million; and 0.15% on the value of the Fund's average monthly total net assets over $400 million. FAS has agreed to waive a portion of its fee in order to limit the Fund's total monthly administration expenses (including administration, co-administration, transfer agent and custodian fees) to 0.30% of the Fund's average monthly total net assets. The equity owners of FAS are Evergreen Atlantic, LLC and the Lola Brown Trust No. 1B (the "LB Trust"), each of which is considered to be an "affiliated person" of the Fund as that term is defined in the 1940 Act.

State Street Bank and Trust Company ("State Street") serves as the Fund's co-administrator and custodian. As compensation for its services, State Street receives certain out-of-pocket expenses, transaction fees and asset-based fees of 0.058% annually (or a minimum of $10,500 per month), which are accrued daily and paid monthly.

PFPC Inc. ("PFPC"), an indirect, majority-owned subsidiary of PNC Financial Services Group, Inc., serves as the Fund's transfer agent, dividend-paying agent and registrar for the Common Stock. As compensation for PFPC's services as such, the Fund pays PFPC a monthly fee plus certain out-of-pocket expenses.

Deutsche Bank Trust Company Americas serves as Auction Agent, transfer agent, dividend paying agent and registrar for the AMPS.

IMPORTANT TERMS OF THE OFFERING

Total number of Shares available for Primary Subscription	__________
Total number of Shares available in the Over-Allotment	___________
Number of Rights a Common Stockholder will receive for each outstanding Share owned by such Common Stockholder on the Record Date	One Right for each Share(+)
Number of Rights required to purchase one new Share	Three Rights for each new Share
Subscription Price	The NAV per Share as calculated at the c Date.
Estimated Subscription Price	$____. Since the Subscription Price

after printing and distribution of thi
Subscription Price" is an estimate of t
the Fund's per-share NAV at the end of
the Friday immediately preceding the
this Prospectus.

\+ The number of Rights to be issued to a Common Stockholder on the Record Date will be rounded up to the nearest whole number of Rights evenly divisible by three. See "The Offering - Over-Allotment and Over-Subscription Privilege" below.

IMPORTANT DATES FOR THE OFFERING

Record Date	_______________
Subscription Period	______________ to ______________
Expiration Date of the Offering	______________++
Deadline for delivery of Subscription Certificate and payment of Shares, or Notice of Guaranteed Delivery (*)	______________
Deadline for payment pursuant to Notice of Guaranteed Delivery (*)	______________
Confirmation to participants	______________
Deadline for final payment for Shares (if any)**	______________

++ Unless the Offering is extended to a date no later than ______________.

* Record Date Stockholders (defined below) exercising Rights must deliver to the Subscription Agent (defined below) by the Expiration Date either (i) the Subscription Certificate together with the estimated payment or (ii) a Notice of Guaranteed Delivery.

** Since the actual Subscription Price due from subscribing Common Stockholders (vis-a-vis the Estimated Subscription Price above) will not be determined until after printing and distribution of this Prospectus, additional monies may be owed by subscribers.

KEY ELEMENTS OF THE OFFERING

ONE-FOR-THREE OFFERING

The Offering will give Common Stockholders who own Common Stock on the Record Date ("Record Date Stockholders") the non-transferable right to purchase one new Share for every three Rights held. Common Stockholders will receive one Right for every Share owned on the Record Date. For example, if a Common Stockholder owns 300 Shares on the Record Date, such Common Stockholder will receive 300 Rights entitling such Common Stockholder to purchase 100 new Shares. Record Date Stockholders may exercise all or some of their Rights.

NON-TRANSFERABILITY OF RIGHTS

The Rights are non-transferable and may not be purchased or sold. Rights will expire without residual value at the Expiration Date. The Rights will not be listed for trading on the NYSE, and there will not be any market for trading Rights. The Shares to be issued pursuant to the Offering will be listed for trading on the NYSE, subject to the NYSE being officially notified of the issuance of those Shares.

SUBSCRIPTION PRICE

Under the Offering, new Shares will be sold at a price equal to the NAV per Share as calculated at the close of trading on the Expiration Date (the "Subscription Price"). Management believes that this pricing (versus a percentage discount relative to the market price or a pre-determined fixed price) will provide an incentive to Common Stockholders to participate in the Offering.

OVER-SUBSCRIPTION PRIVILEGE & OVER-ALLOTMENT SHARES

If all of the Rights initially issued are not exercised by Record Date Stockholders, any unsubscribed Shares will be offered to other Record Date Stockholders who have exercised all of their Rights (the "Over-Subscription Privilege"). However, to the extent there are insufficient unsubscribed Shares to satisfy all over-subscription requests, Record Date Stockholders who have exercised all of their Rights will have preference in the Over-Subscription Privilege as discussed below. Also see "The Offering - Over-Allotment and Over-Subscription Privilege".

If there are not enough unsubscribed Shares to honor all over-subscription requests, the Fund may, in its discretion, issue additional Shares up to 100% of the Shares available in the Offering to honor over-subscription requests with such additional Shares subject to the same terms and conditions of this Offering (the "Over-Allotment Shares"). The unsubscribed Shares and the Over-Allotment Shares are collectively referred to as the "Excess Shares".

If there are not enough Excess Shares to fully honor all over-subscription requests, Excess Shares will be allocated to Record Date Stockholders who have exercised all of their Rights in accordance with their over-subscription request. If there are not enough Excess Shares to fully honor all over-subscription requests by such Record Date Stockholders, the Excess Shares will be allocated pro-rata among such Record Date Stockholders based on the number of Rights originally issued to them by the Fund. See "The Offering - Over-Allotment and Over- Subscription Privilege".

The Horejsi Affiliates have indicated that they will fully subscribe i n the Primary Subscription on the same terms as other Common Stockholders. The Horejsi Affiliates may subscribe in the Over-Subscription Privilege. If the Horejsi Affiliates fully exercise their Rights in the Primary Subscription and the Over-Subscription

Privilege, under certain circumstances (e.g., low participation by Common Stockholders in the Offering), the Horejsi Affiliates could substantially increase their percentage ownership of the Fund at an advantageous price relative to the market price.

METHOD FOR EXERCISING RIGHTS

Except as described below, subscription certificates evidencing the Rights ("Subscription Certificates") will be sent to Record Date Stockholders or their nominees. If a Record Date Stockholder wishes to exercise Rights, it may do so in the following ways:

1. Complete and sign the Subscription Certificate. Enclose it in the envelope provided, together with payment in full and mail or deliver the envelope to Colbent Corporation (the "Subscription Agent") at the address indicated on the Subscription Certificate, calculating the total payment on the basis of the Estimated Subscription Price of $____ per Share (i.e., the estimated subscription price based on the Fund's NAV and market price on __________________. The completed and signed Subscription Certificate and payment must be received by the Expiration Date. PAYMENT PURSUANT TO THIS METHOD MUST BE IN UNITED STATES DOLLARS BY MONEY ORDER OR CHECK DRAWN ON A BANK LOCATED IN THE UNITED STATES, MUST BE PAYABLE TO THE BOULDER GROWTH & INCOME FUND, INC. AND MUST ACCOMPANY AN EXECUTED SUBSCRIPTION CERTIFICATE FOR SUCH SUBSCRIPTION CERTIFICATE TO BE ACCEPTED. Because the subscription price is estimated, each Record Date Shareholder participating in the Offering should be prepared to pay additional monies (if any) by the deadline for final payment for Shares as noted above under "Important Dates for the Offering."

2. A Record Date Stockholder participating in the Offering may contact its broker, banker or trust company, which can arrange, on such Record Date Stockholder's behalf, to guarantee delivery of payment and delivery of a properly completed and executed Subscription Certificate pursuant to a notice of guaranteed delivery ("Notice of Guaranteed Delivery") by the close of business on the third Business Day (defined below) after the Expiration Date. The broker, banker, or trust company may charge such Record Date Stockholder a fee for this service; the Fund is not responsible for paying any fees charged by any such broker, bank, or trust company.

Subscribing Record Date Stockholders will have no right to rescind a purchase after the Subscription Agent has received the Subscription Certificate or Notice of Guaranteed Delivery. See "The Offering - Method of Exercising Rights" and "The Offering - Payment for Shares."

The Subscription Agent will deposit all checks received by it prior to the final due date into a segregated interest bearing account at Eastern Bank pending distribution of the Shares from the Offering. All interest will accrue to the benefit of the Fund and investors will not earn interest on payments submitted or be able to credit such interest against any additional monies owed (if applicable).

STOCKHOLDER INQUIRIES SHOULD BE DIRECTED TO
MORROW & CO., INC., THE FUND'S INFORMATION AGENT,
AT (800) 607-0088

OFFERING FEES AND EXPENSES

The Fund expects to incur approximately $_____ of expenses in connection with the Offering. See "Expenses of the Fund" below.

RESTRICTIONS ON FOREIGN STOCKHOLDERS

The Fund will not mail Subscription Certificates to Common Stockholders whose record addresses are outside the United States or who have an APO or FPO address. However, Common Stockholders whose addresses are outside the United States or who have an APO or FPO address will receive written notice of the Offering and those who wish to subscribe to the Offering either partially or in full should contact the Subscription Agent by written instruction or recorded telephone conversation no later than three Business Days prior to the Expiration Date. If no instructions have been received by the Expiration Date, the Rights of those foreign Common Stockholders will expire. See "The Offering - Foreign Restrictions" below.

USE OF PROCEEDS

The net proceeds of the Offering are estimated to be approximately $__________. This figure is based on the Estimated Subscription Price per Share of $____ and assumes all Rights offered are exercised and that the expenses related to the Offering estimated at approximately $_______ are paid. If all Over-Allotment Shares are sold in addition to all Primary Subscription Shares, the gross proceeds of the Offering are estimated to be approximately $___________.

The Fund has conducted several rights offerings in the past and is likely to continue to conduct rights offerings in the future. The Fund conducted a one-for-one rights offering in 2002, which doubled the number of common shares outstanding at the time and resulted in approximately $24.35 million in net proceeds to the Fund. Over a period of approximately 4 1/2 months following the offering, the Fund invested the proceeds in accordance with its investment objectives. The Fund conducted a one-for-three rights offering in September 2007, which resulted in the issuance of approximately 3.8 million common shares and approximately $32.8 million in net proceeds to the Fund. As of April [ ], 2008, the Fund has invested approximately [48%] of these proceeds. During this period, the market has declined with the S&P 500 Index down over 13%. See "Investment Objective and Policies" and "Use of Proceeds" below. The Advisers anticipate that it may take up to six months for the Fund to invest substantially all of the net proceeds of this Offering in accordance with its investment objective and policies under current market conditions. Pending such investment, the Fund anticipates investing the proceeds in short-term securities issued by the U.S. government or its agencies or instrumentalities or in high quality, short-term or long-term debt obligations or money market instruments. Some of these investments have included investments in the ARPS (auction rate preferred securities) of other issuers. As of the date of this Prospectus, the Fund has invested approximately $17.9 million, or approximately 12% of its assets, in ARPS of three different issuers. Although the auctions for these ARPS have recently failed, the Fund continues to receive dividend payments from these securities which conform to the Advisers' expected return on these types of investments. See "Use of Proceeds" below.

The increase in assets raised from the Offering may also be used to help the Fund maintain the Distribution Policy. The Distribution Policy permits Common Stockholders to realize a predictable, but not assured, level of cash flow and some liquidity periodically with respect to their Common Stock without having to sell Shares. See the discussion regarding "Dividends and Distributions" below.

RISK FACTORS

See "Risk Factors" below.

FEE TABLE

STOCKHOLDER TRANSACTION EXPENSES	
Sales Load (as a percentage of the Offering price)	
Dividend Reinvestment and Cash Purchase Plan Fees	

ANNUAL FUND EXPENSES BEFORE THE RIGHTS OFFERING (as a percentage of net assets attributable to common shares)	
Preferred Stock broker commission and auction agent fees	
Administration, co administration and custodian fees	
Management Fees	
Other Expenses	
Legal and audit fees	0.16%
Directors fees and expenses	0.15%
Printing fees	0.05%
Insurance expenses	0.02%
Miscellaneous and other expenses	0.12%
Acquired Funds fees and expenses	
Total Annual Expenses	

EXAMPLE	1 YEAR	3 YEARS
A Common Stockholder would pay the following expenses on a $1,000 investment assuming a 5% annual return.	$23	$72

The purpose of the foregoing table and example is to assist Rights holders in understanding the various costs and expenses that an investor in the Fund bears, directly or indirectly, BUT SHOULD NOT BE CONSIDERED A REPRESENTATION OF PAST OR FUTURE EXPENSES OR RATES OF RETURN. THE ACTUAL EXPENSES OF THE FUND MAY BE GREATER OR LESS THAN THOSE SHOWN. The figures provided under "Other Expenses" are based upon estimated amounts for the current fiscal year. The 5% annual return shown in this example is used for illustrative purposes only and in no way should be construed as a guarantee of future performance of the Fund. For more complete descriptions of certain of the Fund's cost and expenses, see "Management of the Fund" in this Prospectus and the SAI. Also see "Expenses of the Fund" below.

FINANCIAL HIGHLIGHTS

The table below sets forth selected financial data for a Share outstanding throughout the period presented. The per Share operating performance and ratios for the Fund's fiscal year ended November 30, 2007 are derived from the Fund's 2007 annual financial statements, which were audited by Deloitte & Touche LLP, the Fund's publicly registered independent accounting firm, as stated in their report which is incorporated by reference into the SAI and available to Stockholders upon request. The per Share operating performance and ratios for the Fund's fiscal year ended November 30, 2006 are derived from the Fund's 2006 annual financial statements which were also audited by Deloitte & Touche LLP, as stated in their report which is incorporated by reference into the SAI. The per Share operating performance and ratios for the Fund's fiscal years ended November 30, 2005 and prior years were audited by the Fund's previous publicly registered independent accounting firm, KPMG LLP. The following information should be read in conjunction with the Financial Statements and Notes thereto, which are incorporated by reference into the SAI. The Table below contains per share operating performance data, total investment returns, ratios to average net assets, and other supplemental data.

FINANCIAL HIGHLIGHTS

[Insert table]

THE FUND

The Fund is a non-diversified, closed-end management investment company organized as a Maryland corporation in October 1972. From its inception, and prior to April 26, 2002, the Fund was named USLife Income Fund, Inc. and was virtually 100% invested in corporate bonds. In January 2002, the Fund's largest stockholder, the Ernest Horejsi Trust No. 1B (the "EH Trust"), succeeded in replacing the Board with a slate of its nominees. Soon thereafter, in April 2002, stockholders approved changing the Fund's investment objective and corporate name, changing the Fund's classification from diversified to non-diversified and changing or eliminating a number of the Fund's fundamental investment restrictions. Thereafter, the Fund began the process of liquidating its corporate bond portfolio and began investing in common equities consistent with the new investment objective.

As of __________________, the Fund had ___________ Shares outstanding. The Common Stock is traded on the NYSE under the symbol "BIF." The average weekly trading volume of the Common Stock on the NYSE during the period from January 1, 2008 through ____________, 2008 was ____ Shares. As of __________________, the total net assets of the Fund, including $25 million in AMPS leverage, were approximately $_____________.

The following provides information about the Fund's outstanding Shares as of _________________________:

Title of Class	Amount Authorized	Amount held by the Fund or for its Account	A Outs

; margin-bottom: 0pt; margin-

1,601

1,374

3,236

2,761

Total non-interest expenses

5,229

4,892

10,679

9,975

Income before provision for income taxes

4,709

4,165

9,144

7,437

Provision for Income Taxes

1,264

1,624

2,419

2,832

Net income

$
3,445

$
2,541

$
6,725

$
4,605

Basic earnings per share

$
0.67

$
0.51

$
1.32

$
0.93

Diluted earnings per share

$
0.66

$
0.49

$
1.29

$
0.89

See notes to unaudited condensed consolidated financial statements.

PLUMAS BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	$3,445	$2,541	$6,725	$4,605
Other comprehensive income:				
Change in net unrealized gain/loss	(783)	780	(3,372)	1,283
Reclassification adjustments for net losses included in net income	-	-	8	17
Net unrealized holding (loss) gain	(783)	780	(3,364)	1,300
Related tax effect:				
Change in net unrealized gain/loss	232	(322)	997	(529)
Reclassification of net losses included in net income	-	-	(2)	(7)
Income tax effect	232	(322)	995	(536)
Other comprehensive (loss) income	(551)	458	(2,369)	764
Total comprehensive income	$2,894	$2,999	$4,356	$5,369

See notes to unaudited condensed consolidated financial statements.

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PLUMAS BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	For the Six Months Ended June 30, 2018	2017
Cash Flows from Operating Activities:		
Net income	$6,725	$4,605
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	500	400
Change in deferred loan origination costs/fees, net	(948)	(459)
Depreciation and amortization	489	520
Stock-based compensation expense	98	86
Loss on sale of investments	8	17
Amortization of investment security premiums	343	295
Gain on equity securities with no readily determinable fair value	(209)	-
Gain on sale of OREO and other vehicles	(75)	(7)
Gain on sale of loans held for sale	(1,199)	(1,314)
Loans originated for sale	(22,584)	(19,681)
Proceeds from loan sales	22,202	22,260
Provision from change in OREO valuation	38	9
Earnings on bank-owned life insurance	(165)	(167)
Increase in accrued interest receivable and other assets	(350)	(106)
Increase (decrease) in accrued interest payable and other liabilities	434	(1,230)
Net cash provided by operating activities	5,307	5,228
Cash Flows from Investing Activities:		
Proceeds from principal repayments from available-for-sale government-sponsored mortgage-backed securities	6,970	6,073
Purchases of available-for-sale securities	(35,509)	(20,287)
Proceeds from sale of available-for-sale securities	4,157	4,221
Net increase in loans	(28,455)	(16,722)
Proceeds from Bank owned life insurance	338	-
Proceeds from sale of OREO	550	75
Proceeds from sale of other vehicles	275	114
Purchase of premises and equipment	(2,900)	(179)
Net cash used in investing activities	(54,574)	(26,705)

Continued on next page.

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PLUMAS BANCORP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

(Continued)

	For the Six Months Ended June 30,	
	2018	**2017**
Cash Flows from Financing Activities:		
Net increase in demand, interest bearing and savings deposits	$21,287	$36,978
Net decrease in time deposits	(4,878)	(3,172)
Principal payment on note payable	-	(2,375)
Net decrease in securities sold under agreements to repurchase	(1,349)	(3,222)
Cash dividends paid on common stock	(920)	(691)
Proceeds from exercise of stock options	263	164
Net cash provided by financing activities	14,403	27,682
(Decrease) increase in cash and cash equivalents	(34,864)	6,205
Cash and Cash Equivalents at Beginning of Year	87,537	62,646
Cash and Cash Equivalents at End of Period	$52,673	$68,851
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for:		
Interest expense	$549	$502
Income taxes	$2,856	$3,490
Non-Cash Investing Activities:		
Real estate and vehicles acquired through foreclosure	$375	$288
Non-Cash Financing Activities:		
Common stock retired in connection with the exercise of stock options	$29	$10
Common stock issued in connection with the cashless exercise of stock warrant	$-	$787

See notes to unaudited condensed consolidated financial statements.

PLUMAS BANCORP

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. THE BUSINESS OF PLUMAS BANCORP

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

<u>Consolidation and Basis of Presentation</u>

The condensed consolidated financial statements include the accounts of the Company and the accounts of its wholly-owned subsidiary, Plumas Bank. Plumas Statutory Trust I and Plumas Statutory Trust II are not consolidated into the Company’s consolidated financial statements and, accordingly, are accounted for under the equity method. In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the Company’s financial position at June 30, 2018 and the results of its operations and its cash flows for the three-month and six-month periods ended June 30, 2018 and 2017. Our condensed consolidated balance sheet at December 31, 2017 is derived from audited financial statements.

The unaudited condensed consolidated financial statements of the Company have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) for interim reporting on Form 10-Q. Accordingly, certain disclosures normally presented in the notes to the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been omitted. The Company believes that the disclosures are adequate to make the information not misleading. These interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2017 Annual Report to Shareholders on Form 10-K. The results of operations for the three-month and six-month periods ended June 30, 2018 may not necessarily be indicative of future operating results. In preparing such financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the periods reported. Actual results could differ significantly from those estimates.

Reclassifications

Certain reclassifications have been made to prior years’ balances to conform to the classifications used in 2018. These reclassifications had no impact on the Company’s consolidated financial position, results of operations or net change in cash and cash equivalents.

Segment Information

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

Revenue from Contracts with Customers

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

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

Income Taxes

On December 22, 2017, the Tax Cuts and Jobs Act (the “TCJ Act”) was enacted into law. The TCJ Act provides for significant changes to the U.S. Internal Revenue Code of 1986, as amended (the “Code”), that impact corporate taxation requirements, such as the reduction of the top federal tax rate for corporations from 35% to 21% and changes or limitations to certain tax deductions. As a result of the TCJ Act, we re-measured certain deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future. However, we are still analyzing certain aspects of the TCJ Act and refining our calculations, which could potentially affect the measurement of these balances or potentially give rise to new deferred tax amounts. The provisional amount recorded in 2017 related to the re-measurement of our deferred tax asset was $1.4 million, and no further adjustments were made during the six months ended June 30, 2018.

Recently Adopted Accounting Pronouncements

In February 2018, the FASB issued ASU No. 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (“AOCI”). ASU No.2018-02 allows entities to elect to reclassify stranded tax effects on items within AOCI, resulting from the new tax bill signed into law on December 22, 2017, to retained earnings. The

Company elected to early adopt this new standard in 2017 and recorded a reclassification from AOCI to retained earnings in the amount of $94,000.

In May 2014, the FASB issued ASU No. 2014-09 Revenue from Contracts with Customers ("ASU 2014-09"), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU replaces most existing revenue recognition guidance in GAAP. The new standard was effective for the Company on January 1, 2018. Adoption of ASU 2014-09 did not have a material impact on the Company's consolidated financial statements and related disclosures as the Company's primary sources of revenues are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of ASU 2014-09. The Company's revenue recognition pattern for revenue streams within the scope of ASU 2014-09, including but not limited to service charges on deposit accounts and gains/losses on the sale of loans, did not change significantly from current practice. The standard permits the use of either the full retrospective or modified retrospective transition method. The Company elected to use the modified retrospective transition method which requires application of ASU 2014-09 to uncompleted contracts at the date of adoption however, periods prior to the date of adoption will not be retrospectively revised as the impact of the ASU on uncompleted contracts at the date of adoption was not material.

On January 5, 2016, the FASB issued ASU No. 2016-01, Financial Instruments–Overall: Recognition and Measurement of Financial Assets and Financial Liabilities. Changes made to the current measurement model primarily affect the accounting for equity securities with readily determinable fair values, where changes in fair value will impact earnings instead of other comprehensive income. The accounting for other financial instruments, such as loans, investments in debt securities, and financial liabilities is largely unchanged. The Update also changes the presentation and disclosure requirements for financial instruments including a requirement that public business entities use exit price when measuring the fair value of financial instruments measured at amortized cost for disclosure purposes. This Update is generally effective for public business entities in fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company adopted ASU No. 2016-01 on January 1, 2018 and recorded a $209,000 gain related to adjusting the carrying value of equity securities without a readily determinable fair market to $662,000 in accordance with this standard. Additionally, we refined the calculation used to determine the disclosed fair value of our loans held for investment as part of adopting this standard. The refined calculation did not have a significant impact on our fair value disclosures.

Pending Accounting Pronouncements

On February 25, 2016, the FASB issued ASU 2016-02, Leases. The most significant change for lessees is the requirement under the new guidance to recognize right-of-use assets and lease liabilities for all leases not considered short-term leases, which is generally defined as a lease term of less than 12 months. This change will result in lessees recognizing right-of-use assets and lease liabilities for most leases currently accounted for as operating leases under current lease accounting guidance. ASU 2016-02 is effective for interim and annual periods beginning after December 15, 2018. The Company has several lease agreements, including two branch locations, which are currently considered operating leases, and therefore, not recognized on the Company's consolidated statements of condition. The Company expects the new guidance will require some of these lease agreements to now be recognized on the consolidated statements of condition as a right-of-use asset and a corresponding lease liability. The Company has performed a preliminary evaluation of the provisions of ASU No. 2016-02. Based on this evaluation, the Company has determined that ASU No. 2016-02 is not expected to have a material impact on the Company's Consolidated Financial Statements. However, the Company continues to evaluate the extent of potential impact the new guidance will have on the Company's Consolidated Balance Sheet.

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

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

3. INVESTMENT SECURITIES AVAILABLE FOR SALE

The amortized cost and estimated fair value of investment securities at June 30, 2018 and December 31, 2017 consisted of the following, in thousands:

Available-for-Sale	June 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities:				
U.S. Government-sponsored agencies collateralized by mortgage obligations- residential	$125,804	$ 21	$ (3,631)	$122,194
Obligations of states and political subdivisions	36,160	101	(663)	35,598
	$161,964	$ 122	$ (4,294)	$157,792

Net unrealized loss on available-for-sale investment securities totaling $4,172,000 were recorded, net of $1,233,000 in tax benefit, as accumulated other comprehensive loss within shareholders' equity at June 30, 2018. During the six months ended June 30, 2018 the Company sold eighteen available-for-sale investment securities for total proceeds of $4,157,000 recording a $8,000 loss on sale. The Company realized a gain on sale from eight of these securities totaling $4,000 and a loss on sale on ten securities of $12,000. No securities were sold during the three months ended June 30, 2018.

Available-for-Sale	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities:				
U.S. Government-sponsored agencies collateralized by mortgage obligations- residential	$104,935	$ 26	$ (1,173)	$103,788
Obligations of states and political subdivisions	33,340	482	(144)	33,678
	$138,275	$ 508	$ (1,317)	$137,466

Unrealized loss on available-for-sale investment securities totaling $809,000 were recorded, net of $239,000 in tax benefits, as accumulated other comprehensive loss within shareholders' equity at December 31, 2017. During the six months ended June 30, 2017 the Company sold seven available-for-sale investment securities for total proceeds of $4,221,000 recording a $17,000 loss on sale. The Company realized a gain on sale from four of these securities totaling $4,000 and a loss on sale on three securities of $21,000. No securities were sold during the three months ended June 30, 2017.

There were no transfers of available-for-sale investment securities during the six months ended June 30, 2018 and twelve months ended December 31, 2017. There were no securities classified as held-to-maturity at June 30, 2018 or December 31, 2017.

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Investment securities with unrealized losses at June 30, 2018 and December 31, 2017 are summarized and classified according to the duration of the loss period as follows, in thousands:

June 30, 2018	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Government-sponsored agencies collateralized by mortgage obligations-residential	$88,404	$ 2,209	$28,186	$ 1,422	$116,590	$ 3,631
Obligations of states and political subdivisions	20,901	420	3,269	243	24,170	663
	$109,305	$ 2,629	$31,455	$ 1,665	$140,760	$ 4,294

December 31, 2017	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Debt securities:						
U.S. Government-sponsored agencies collateralized by mortgage obligations-residential	$60,070	$ 441	$31,213	$ 732	$91,283	$ 1,173
Obligations of states and political subdivisions	2,621	31	3,403	113	6,024	144
	$62,691	$ 472	$34,616	$ 845	$97,307	$ 1,317

At June 30, 2018, the Company held 199 securities of which 160 were in a loss position. Of the securities in a loss position, 124 were in a loss position for less than twelve months. Of the 199 securities 87 are U.S. Government-sponsored agencies collateralized by residential mortgage obligations and 112 were obligations of states and political subdivisions. The unrealized losses relate principally to market rate conditions. All the securities continue to pay as scheduled. When analyzing an issuer's financial condition, management considers the length of time and extent to which the market value has been less than cost; the historical and implied volatility of the security; the financial condition of the issuer of the security; and the Company's intent and ability to hold the security to recovery. As of June 30, 2018, management does not have the intent to sell these securities nor does it believe it is more likely than not that it will be required to sell these securities before the recovery of its amortized cost basis. Based on the Company's evaluation of the above and other relevant factors, the Company does not believe the securities that are in an unrealized loss position as of June 30, 2018 are other than temporarily impaired.

The amortized cost and estimated fair value of investment securities at June 30, 2018 by contractual maturity are shown below, in thousands.

	Amortized Cost	Estimated Fair

		Value
Within one year	$ -	$ -
After one year through five years	2,932	2,927
After five years through ten years	16,891	16,642
After ten years	16,337	16,029
Investment securities not due at a single maturity date:		
Government-sponsored mortgage-backed securities	125,804	122,194
	$ 161,964	$ 157,792

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

Investment securities with amortized costs totaling $91,031,000 and $82,059,000 and estimated fair values totaling $88,166,000 and $81,006,000 at June 30, 2018 and December 31, 2017, respectively, were pledged to secure deposits and repurchase agreements.

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4. LOANS AND THE ALLOWANCE FOR LOAN LOSSES

Outstanding loans are summarized below, in thousands:

	June 30, 2018	December 31, 2017
Commercial	$49,698	$39,620
Agricultural	63,701	58,908
Real estate – residential	14,789	16,624
Real estate – commercial	251,608	240,257
Real estate – construction and land development	25,325	25,181
Equity lines of credit	39,462	41,798
Auto	67,184	60,438
Other	3,981	3,808
Total loans	515,748	486,634
Deferred loan costs, net	2,927	2,283
Allowance for loan losses	(6,698)	(6,669)
Total net loans	$511,977	$482,248

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

	June 30, 2018	December 31, 2017
Balance, beginning of year	$6,669	$ 6,549
Provision charged to operations	500	600
Losses charged to allowance	(763)	(879)
Recoveries	292	399
Balance, end of period	$6,698	$ 6,669

The recorded investment in impaired loans totaled $1,929,000 and $2,270,000 at June 30, 2018 and December 31, 2017, respectively. The Company had specific allowances for loan losses of $81,000 on impaired loans of $469,000 at June 30, 2018 as compared to specific allowances for loan losses of $82,000 on impaired loans of $475,000 at December 31, 2017. The balance of impaired loans in which no specific reserves were required totaled $1,460,000 and $1,795,000 at June 30, 2018 and December 31, 2017, respectively. The average recorded investment in impaired loans for the six months ended June 30, 2018 and June 30, 2017 was $1,871,000 and $4,890,000, respectively. The

Company recognized $36,000 and $79,000 in interest income for impaired loans during the six months ended June 30, 2018 and 2017, respectively. No interest was recognized on nonaccrual loans accounted for on a cash basis during the six months ended June 30, 2018 and 2017.

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

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

The carrying value of troubled debt restructurings at June 30, 2018 and December 31, 2017 was $1,105,000 and $1,111,000, respectively. The Company has allocated $59,000 and $63,000 of specific reserves on loans to customers whose loan terms have been modified in troubled debt restructurings as of June 30, 2018 and December 31, 2017. The Company has not committed to lend additional amounts on loans classified as troubled debt restructurings at June 30, 2018 and December 31, 2017.

There were no troubled debt restructurings that occurred during the six months ending June 30, 2018 or June 30, 2017. There were no troubled debt restructurings for which there was a payment default within twelve months following the modification during the six months ended June 30, 2018 and 2017, respectively.

At June 30, 2018 and December 31, 2017, nonaccrual loans totaled $882,000 and $1,226,000, respectively. Interest foregone on nonaccrual loans totaled $29,000 and $89,000 for the six months ended June 30, 2018 and 2017, respectively. Interest foregone on nonaccrual loans totaled $14,000 and $38,000 for the three months ended June 30, 2018 and 2017, respectively. At December 31, 2017 there were three loans to one customer totaling $1.8 million that were 90 days past due and still accruing interest. These loans were well secured and in process of collection at December 31, 2017. As of June 30, 2018, the Company had received payment, in full, of principal and interest on these loans.

Salaries and employee benefits totaling $1,234,000 and $936,000 have been deferred as loan origination costs during the six months ended June 30, 2018 and 2017, respectively. Salaries and employee benefits totaling $736,000 and $541,000 have been deferred as loan origination costs during the three months ended June 30, 2018 and 2017, respectively.

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

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

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

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

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

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

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

June 30, 2018 **Commercial Credit Exposure**
Credit Risk Profile by Internally Assigned Grade

	Commercial	Agricultural	Real Estate-Residential	Real Estate-Commercial	Real Estate-Construction	Equity LOC	Total
Grade:							
Pass	$48,738	$ 63,447	$ 14,508	$ 247,866	$ 25,228	$39,421	$439,208
Special Mention	705	254	122	3,462	-	-	4,543
Substandard	255	-	159	280	97	41	832
Doubtful	-	-	-	-	-	-	-
Total	$49,698	$ 63,701	$ 14,789	$ 251,608	$ 25,325	$39,462	$444,583

December 31, 2017 **Commercial Credit Exposure**

Credit Risk Profile by Internally Assigned Grade

	Commercial	Agricultural	Real Estate-Residential	Real Estate-Commercial	Real Estate-Construction	Equity LOC	Total
Grade:							
Pass	$38,851	$ 56,859	$ 16,218	$ 239,944	$ 25,081	$41,636	$418,589
Special Mention	238	253	125	26	-	-	642
Substandard	531	1,796	281	287	100	162	3,157
Doubtful	-	-	-	-	-	-	-
Total	$39,620	$ 58,908	$ 16,624	$ 240,257	$ 25,181	$41,798	$422,388

Consumer Credit Exposure Credit Risk Profile Based on Payment Activity	**Consumer Credit Exposure Credit Risk Profile Based on Payment Activity**

	June 30, 2018			**December 31, 2017**		
	Auto	Other	Total	Auto	Other	Total
Grade:						
Performing	$66,888	$3,981	$70,869	$60,060	$3,788	$63,848
Non-performing	296	-	296	378	20	398
Total	$67,184	$3,981	$71,165	$60,438	$3,808	$64,246

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

	Commercial	Agricultural	Real Estate- Residential	Real Estate- Commercial	Real Estate- Construction	Equity LOC	Auto	Other	Total
<u>Six months ended 6/30/18:</u>									
<u>Allowance for Loan Losses</u>									
Beginning balance	$ 725	$ 623	$ 231	$ 2,729	$ 783	$ 533	$ 946	$ 99	$ 6,669
Charge-offs	(266)	-	-	-	-	-	(476)	(21)	(763)
Recoveries	15	-	91	18	2	3	155	8	292
Provision	379	(77)	(127)	(48)	(5)	(55)	419	14	500
Ending balance	$ 853	$ 546	$ 195	$ 2,699	$ 780	$ 481	$ 1,044	$ 100	$ 6,698
<u>Three months ended 6/30/18:</u>									
<u>Allowance for Loan Losses</u>									
Beginning balance	$ 772	$ 494	$ 212	$ 2,759	$ 791	$ 510	$ 977	$ 107	$ 6,622
Charge-offs	(1)	-	-	-	-	-	(311)	(2)	(314)
Recoveries	8	-	-	1	-	2	73	6	90
Provision	74	52	(17)	(61)	(11)	(31)	305	(11)	300
Ending balance	$ 853	$ 546	$ 195	$ 2,699	$ 780	$ 481	$ 1,044	$ 100	$ 6,698
<u>Six months ended 6/30/17:</u>									
<u>Allowance for Loan Losses</u>									
Beginning balance	$ 655	$ 466	$ 280	$ 2,740	$ 927	$ 575	$ 815	$ 91	$ 6,549
Charge-offs	(67)	-	-	-	-	-	(90)	(18)	(175)
Recoveries	19	-	2	3	-	2	50	5	81
Provision	98	48	(30)	69	144	(16)	70	17	400
Ending balance	$ 705	$ 514	$ 252	$ 2,812	$ 1,071	$ 561	$ 845	$ 95	$ 6,855
<u>Three months ended 6/30/17:</u>									
<u>Allowance for Loan Losses</u>									
Beginning balance	$ 788	$ 473	$ 268	$ 2,919	$ 838	$ 561	$ 806	$ 90	$ 6,743
Charge-offs	(67)	-	-	-	-	-	(40)	(13)	(120)
Recoveries	11	-	1	1	-	2	16	1	32
Provision	(27)	41	(17)	(108)	233	(2)	63	17	200

Ending balance	$ 705	$ 514	$ 252	$ 2,812	$ 1,071	$ 561	$ 845	$ 95	$ 6,855
June 30, 2018:									
Allowance for Loan Losses									
Ending balance: individually evaluated for impairment	$ 7	$ -	$ 45	$ -	$ 29	$ -	$ -	$ -	$ 81
Ending balance: collectively evaluated for impairment	$ 846	$ 546	$ 150	$ 2,699	$ 751	$ 481	$ 1,044	$ 100	$ 6,617
Loans									
Ending balance	$ 49,698	$ 63,701	$ 14,789	$ 251,608	$ 25,325	$ 39,462	$ 67,184	$ 3,981	$ 515,748
Ending balance: individually evaluated for impairment	$ 19	$ 254	$ 810	$ 280	$ 217	$ 42	$ 304	$ 3	$ 1,929
Ending balance: collectively evaluated for impairment	$ 49,679	$ 63,447	$ 13,979	$ 251,328	$ 25,108	$ 39,420	$ 66,880	$ 3,978	$ 513,819
December 31, 2017:									
Allowance for Loan Losses									
Ending balance: individually evaluated for impairment	$ 2	$ -	$ 48	$ -	$ 32	$ -	$ -	$ -	$ 82
Ending balance: collectively evaluated for impairment	$ 723	$ 623	$ 183	$ 2,729	$ 751	$ 533	$ 946	$ 99	$ 6,587
Loans									
Ending balance	$ 39,620	$ 58,908	$ 16,624	$ 240,257	$ 25,181	$ 41,798	$ 60,438	$ 3,808	$ 486,634
Ending balance: individually evaluated for impairment	$ 14	$ 253	$ 934	$ 287	$ 224	$ 162	$ 377	$ 19	$ 2,270
Ending balance: collectively evaluated for impairment	$ 39,606	$ 58,655	$ 15,690	$ 239,970	$ 24,957	$ 41,636	$ 60,061	$ 3,789	$ 484,364

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

June 30, 2018	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due and Nonaccrual	Current	Total
Commercial	$996	$ -	$ 5	$ 1,001	$48,697	$49,698
Agricultural	480	-	-	480	63,221	63,701
Real estate – residential	165	-	159	324	14,465	14,789
Real estate – commercial	153	-	280	433	251,175	251,608
Real estate - construction & land	-	-	96	96	25,229	25,325
Equity Lines of Credit	341	-	42	383	39,079	39,462
Auto	702	-	297	999	66,185	67,184
Other	29	-	3	32	3,949	3,981
Total	$2,866	$ -	$ 882	$ 3,748	$512,000	$515,748

December 31, 2017	30-89 Days Past Due	90 Days and Still Accruing	Nonaccrual	Total Past Due and Nonaccrual	Current	Total
Commercial	$1,869	$ -	$ -	$ 1,869	$37,751	$39,620
Agricultural	-	1,796	-	1,796	57,112	58,908
Real estate – residential	130	-	281	411	16,213	16,624
Real estate - commercial	-	-	287	287	239,970	240,257
Real estate - construction & land	38	-	100	138	25,043	25,181
Equity Lines of Credit	345	-	162	507	41,291	41,798
Auto	1,047	-	377	1,424	59,014	60,438
Other	20	-	19	39	3,769	3,808
Total	$3,449	$ 1,796	$ 1,226	$ 6,471	$480,163	$486,634

The following tables show information related to impaired loans at the dates indicated, in thousands:

As of June 30, 2018:	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ -	$ -		$ -	$ -
Agricultural	254	254		254	9
Real estate – residential	577	588		580	18
Real estate – commercial	280	280		284	-
Real estate – construction & land	-	-		-	-
Equity Lines of Credit	42	42		51	-
Auto	304	304		232	-
Other	3	3		1	-
With an allowance recorded:					
Commercial	$ 19	$ 19	$ 7	$ 14	$ 1
Agricultural	-	-	-	-	-
Real estate – residential	233	233	45	235	4
Real estate – commercial	-	-	-	-	-
Real estate – construction & land	217	217	29	220	4
Equity Lines of Credit	-	-	-	-	-
Auto	-	-	-	-	-
Other	-	-	-	-	-
Total:					
Commercial	$ 19	$ 19	$ 7	$ 14	$ 1
Agricultural	254	254	-	254	9
Real estate – residential	810	821	45	815	22
Real estate – commercial	280	280	-	284	-
Real estate – construction & land	217	217	29	220	4
Equity Lines of Credit	42	42	-	51	-
Auto	304	304	-	232	-
Other	3	3	-	1	-
Total	$ 1,929	$ 1,940	$ 81	$ 1,871	$ 36

As of December 31, 2017:	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ -	$ -		$ -	$ -
Agricultural	253	253		255	19
Real estate – residential	697	708		548	38
Real estate – commercial	287	287		184	-
Real estate – construction & land	-	-		-	-
Equity Lines of Credit	162	162		180	-
Auto	377	377		144	-
Other	19	19		1	-
With an allowance recorded:					
Commercial	$ 14	$ 14	$ 2	$ 15	$ 1
Agricultural	-	-	-	-	-
Real estate – residential	237	237	48	203	7
Real estate – commercial	-	-	-	-	-
Real estate – construction & land	224	224	32	230	8
Equity Lines of Credit	-	-	-	-	-
Auto	-	-	-	-	-
Other	-	-	-	-	-
Total:					
Commercial	$ 14	$ 14	$ 2	$ 15	$ 1
Agricultural	253	253	-	255	19
Real estate – residential	934	945	48	751	45
Real estate – commercial	287	287	-	184	-
Real estate – construction & land	224	224	32	230	8
Equity Lines of Credit	162	162	-	180	-
Auto	377	377	-	144	-
Other	19	19	-	1	-
Total	$ 2,270	$ 2,281	$ 82	$ 1,760	$ 73

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5. COMMITMENTS AND CONTINGENCIES

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

In the normal course of business, there are various outstanding commitments to extend credit, which are not reflected in the financial statements, including loan commitments of $117.3 million and $107.4 million and stand-by letters of credit of $417 thousand and $477 thousand at June 30, 2018 and December 31, 2017, respectively.

Of the loan commitments outstanding at June 30, 2018, $26.5 million are real estate construction loan commitments that are expected to fund within the next twelve months. The remaining commitments primarily relate to revolving lines of credit or other commercial loans, and many of these are expected to expire without being drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements. Each loan commitment and the amount and type of collateral obtained, if any, are evaluated on an individual basis. Collateral held varies, but may include real property, bank deposits, debt or equity securities or business assets.

Stand-by letters of credit are conditional commitments written to guarantee the performance of a customer to a third party. These guarantees are primarily related to the purchases of inventory by commercial customers and are typically short-term in nature. Credit risk is similar to that involved in extending loan commitments to customers and accordingly, evaluation and collateral requirements similar to those for loan commitments are used. The deferred liability related to the Company's stand-by letters of credit was not significant at June 30, 2018 or December 31, 2017.

6. EARNINGS PER SHARE

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

(In thousands, except per share data)	**For the Three Months Ended June 30, 2018**	**2017**	**For the Six Months Ended June 30, 2018**	**2017**
Net Income:				
Net income	$3,445	$2,541	$6,725	$4,605
Earnings Per Share:				
Basic earnings per share	$0.67	$0.51	$1.32	$0.93
Diluted earnings per share	$0.66	$0.49	$1.29	$0.89
Weighted Average Number of Shares Outstanding:				
Basic shares	5,107	5,001	5,089	4,956
Diluted shares	5,222	5,180	5,216	5,173

Shares of common stock issuable under stock options for which the exercise prices were greater than the average market prices were not included in the computation of diluted earnings per share due to their antidilutive effect. Stock options not included in the computation of diluted earnings per share, due to shares not being in-the-money and having an antidilutive effect, were approximately 71,000 and 0 for the three-month periods ended June 30, 2018 and 2017, respectively. Stock options not included in the computation of diluted earnings per share, due to shares not being in-the-money and having an antidilutive effect, were approximately 71,000 and 0 for the six-month periods ended June 30, 2018 and 2017, respectively.

7. STOCK-BASED COMPENSATION

Stock Options

In 2001, the Company established a Stock Option Plan for which 21,393 shares of common stock remain reserved for issuance to employees and directors and no shares are available for future grants as of June 30, 2018.

As of June 30, 2018, all remaining shares in this plan have vested and no compensation cost remains unrecognized.

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

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term in Years	Intrinsic Value
Options outstanding at January 1, 2018	46,293	$ 2.95		
Options exercised	(24,900)	2.95		
Options outstanding at June 30, 2018	21,393	$ 2.95	0.7	$540,000
Options exercisable at June 30, 2018	21,393	$ 2.95	0.7	$540,000

In May 2013, the Company established the 2013 Stock Option Plan for which 436,200 shares of common stock are reserved and 236,100 shares are available for future grants as of June 30, 2018. The Plan requires that the option price may not be less than the fair market value of the stock at the date the option is granted, and that the stock must be paid in full at the time the option is exercised. Payment in full for the option price must be made in cash, with Company common stock previously acquired by the optionee and held by the optionee for a period of at least six months, in options of the Optionee that are fully vested and exercisable or in any combination of the foregoing. The options expire on dates determined by the Board of Directors, but not later than ten years from the date of grant.

During the six months ended June 30, 2018 the Company granted options to purchase 76,000 shares of common stock. The fair value of each option was estimated on the date of grant using the following assumptions. No options were granted during the six months ended June 30, 2017. The fair value of each option was estimated on the date of grant using the following assumptions.

	2018
Expected life of stock options (in years)	5.1
Risk free interest rate	2.38%
Volatility	30.4%
Dividend yields	1.39%
Weighted-average fair value of options granted during the six months ended June 30, 2018	$6.54

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

A summary of the activity within the 2013 Plan follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term in Years	Intrinsic Value
Options outstanding at January 1, 2018	160,600	$ 7.72		
Options granted	76,000	24.40		
Options cancelled	(6,500)	20.55		
Options exercised	(30,000)	7.29		
Options outstanding at June 30, 2018	200,100	$ 13.71	5.9	$2,899,000
Options exercisable at June 30, 2018	83,400	$ 7.30	4.6	$1,743,000
Expected to vest after June 30, 2018	103,583	$ 18.28	6.9	$1,027,000

As of June 30, 2018, there was $555,000 of total unrecognized compensation cost related to non-vested, share-based compensation. That cost is expected to be recognized over a weighted average period of 2.9 years.

The total fair value of options vested during the six months ended June 30, 2018 and 2017 was $150,000 and $161,000, respectively. The total intrinsic value of options at time of exercise was $1,104,000 and $531,000 for the six months ended June 30, 2018 and 2017, respectively.

Compensation cost related to stock options recognized in operating results under the stock option plans was $98,000 and $86,000 for the six months ended June 30, 2018 and 2017, respectively. The associated income tax benefit recognized was $7,000 for the six months ended June 30, 2018 and $10,000 for the six months ended June 30, 2017. Compensation cost related to stock options recognized in operating results under the stock option plans was $51,000 and $43,000 for the three months ended June 30, 2018 and 2017, respectively. The associated income tax benefit recognized was $3,000 for the three months ended June 30, 2018 and $5,000 for the three months ended June 30, 2017.

Cash received from option exercises under the plans for the six months ended June 30, 2018 and 2017 were $263,000 and $164,000, respectively. The tax benefit realized for the tax deductions from option exercise totaled $99,000 and $45,000 for the six months ended June 30, 2018 and 2017, respectively.

8. INCOME TAXES

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

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

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

Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the consolidated income statement. There have been no significant changes to unrecognized tax benefits or accrued interest and penalties for the three months ended June 30, 2018.

9. FAIR VALUE MEASUREMENT

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

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

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

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

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

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

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

The methods of determining the fair value of assets and liabilities presented in this note as of June 30, 2018 are consistent with Note 3 of the Company's 2017 Form 10-K except for the valuation of loans held for investment at June 30, 2018. We refined the calculation used to determine the disclosed fair value of our loans held for investment to estimate the fair value of our loan portfolio based on an exit price concept as part of adopting ASU 2016-01.

Fair Value of Financial Instruments

The carrying amounts and estimated fair values of financial instruments, at June 30, 2018 follows, in thousands:

		Fair Value Measurements at June 30, 2018 Using:			
	Carrying Value	Level 1	Level 2	Level 3	Total Fair Value
Financial assets:					
Cash and cash equivalents	$52,673	$52,673			$52,673
Investment securities	157,792		$157,792		157,792
Loans, net	511,977			$525,040	525,040
FHLB stock	3,027				N/A
Accrued interest receivable	2,568	7	606	1,955	2,568
Financial liabilities:					
Deposits	679,066	637,904	41,153		679,057
Repurchase agreements	8,724		8,724		8,724
Junior subordinated deferrable interest debentures	10,310			8,122	8,122
Accrued interest payable	61	10	35	16	61

The carrying amounts and estimated fair values of financial instruments, at December 31, 2017 follows, in thousands:

		Fair Value Measurements at December 31, 2017 Using:			
	Carrying Value	Level 1	Level 2	Level 3	Total Fair Value
Financial assets:					
Cash and cash equivalents	$87,537	$87,537			$87,537
Investment securities	137,466		$137,466		137,466
Loans, net	482,248			$484,269	484,269
FHLB stock	2,685				N/A
Accrued interest receivable	2,582	31	522	2,029	2,582
Financial liabilities:					
Deposits	662,657	616,617	46,061		662,678
Repurchase agreements	10,074		10,074		10,074
Junior subordinated deferrable interest debentures	10,310			7,829	7,829
Accrued interest payable	64	10	39	15	64

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

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

The following tables present information about the Company’s assets and liabilities measured at fair value on a recurring and non-recurring basis as of June 30, 2018 and December 31, 2017, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

Assets and liabilities measured at fair value on a recurring basis at June 30, 2018 are summarized below, in thousands:

	Total Fair Value	Fair Value Measurements at June 30, 2018 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
U.S. Government-sponsored agencies collateralized by mortgage obligations- residential	$122,194	$-	$122,194	$ -
Obligations of states and political subdivisions	35,598		35,598	
	$157,792	$-	$157,792	$ -

Assets and liabilities measured at fair value on a recurring basis at December 31, 2017 are summarized below, in thousands:

	Total Fair Value	Fair Value Measurements at December 31, 2017 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
U.S. Government-sponsored agencies collateralized by mortgage obligations- residential	$ 103,788	$ -	$ 103,788	$ -
Obligations of states and political subdivisions	33,678		33,678	
	$ 137,466	$ -	$ 137,466	$ -

The fair value of securities available-for-sale equals quoted market price, if available. If quoted market prices are not available, fair value is determined using quoted market prices for similar securities or matrix pricing. There were no changes in the valuation techniques used during 2018 or 2017. Transfers between hierarchy measurement levels are recognized by the Company as of the beginning of the reporting period. Changes in fair market value are recorded in other comprehensive income.

Assets and liabilities measured at fair value on a non-recurring basis at June 30, 2018 are summarized below, in thousands:

		Fair Value Measurements at June 30, 2018 Using			
	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (losses) Six Months Ended June 30, 2018
Assets:					
Impaired loans:					
Construction and land	$80	$-	$ -	$ 80	$ 3
Total impaired loans	80	-	-	80	3
Other real estate:					
Real estate – residential	76	-	-	76	(38)
Real estate – commercial	285	-	-	285	-
Construction and land	592	-	-	592	-
Total other real estate	953	-	-	953	(38)
	$1,033	$-	$ -	$ 1,033	$ (35)

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Assets and liabilities measured at fair value on a non-recurring basis at December 31, 2017 are summarized below, in thousands:

		Fair Value Measurements at December 31, 2017 Using			
	Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses) Six Months Ended June 30, 2017
Assets:					
Impaired loans:					
Real estate – commercial	$-	$-	$ -	$ -	$ 5
Construction and land	80	-	-	80	-
Equity lines of credit	-	-	-	-	(19)
Total impaired loans	80	-	-	80	(14)
Other real estate:					
Real estate – commercial	285	-	-	285	(9)
Construction and land	969	-	-	969	-
Equity lines of credit	90	-	-	90	-
Total other real estate	1,344	-	-	1,344	(9)
	$1,424	$-	$ -	$ 1,424	$ (23)

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

The following methods were used to estimate fair value.

<u>Collateral-Dependent Impaired Loans:</u> The Bank does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect partial write-downs, through charge-offs or specific reserve allowances, that are based on fair value estimates of the underlying collateral. The fair

value estimates for collateral-dependent impaired loans are generally based on recent real estate appraisals or broker opinions, obtained from independent third parties, which are frequently adjusted by management to reflect current conditions and estimated selling costs (Level 3). Net gains (losses) of $3,000 and $(14,000) represent changes in impairment charges recognized during the six-months ended June 30, 2018 and 2017, respectively, related to the above impaired loans.

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

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

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at June 30, 2018 and December 31, 2017 (dollars in thousands):

Description	Fair Value 6/30/2018	Fair Value 12/31/2017	Valuation Technique	Significant Unobservable Input	Range (Weighted Average) 6/30/2018			Range (Weighted Average) 12/31/2017		
<u>Impaired Loans:</u>										
Construction and land	$ 80	$ 80	Third Party appraisals	Management Adjustments to Reflect Current Conditions and Selling Costs		8%	(8%)		8%	(8%)
<u>Other Real Estate:</u>										
RE – Residential	$ 76	$ -	Third Party appraisals	Management Adjustments to Reflect Current Conditions and Selling Costs		10%	(10%)		N/A	
RE – Commercial	$ 285	$ 285	Third Party appraisals	Management Adjustments to Reflect Current Conditions and Selling Costs	17% -	31%	(22%)	17% -	31%	(22%)
Construction and land	$ 592	$ 969	Third Party appraisals	Management Adjustments to Reflect Current Conditions and Selling Costs		10%	(10%)		10%	(10%)
Equity Lines of Credit	$ -	$ 90	Third Party appraisals	Management Adjustments to Reflect Current Conditions and Selling Costs		10%	(10%)		10%	(10%)

PART I – FINANCIAL INFORMATION

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

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

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

INTRODUCTION

The following discussion and analysis sets forth certain statistical information relating to the Company as of June 30, 2018 and December 31, 2017 and for the six and three-month periods ended June 30, 2018 and 2017. This discussion should be read in conjunction with the condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and the consolidated financial statements and notes thereto included in Plumas Bancorp’s Annual Report filed on Form 10-K for the year ended December 31, 2017.

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

There have been no changes to the Company's critical accounting policies from those disclosed in the Company's 2017 Annual Report to Shareholders on Form 10-K.

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

OVERVIEW - SIX MONTHS ENDED JUNE 30, 2018

Net income increased by $2.1 million from $4.6 million during the six months ended June 30, 2017 to $6.7 million during the current six-month period. Earnings benefited from increases of $2.2 million in net interest income and $327 thousand in non-interest income and a decrease of $413 thousand in income tax expense. These items were partially offset by increases of $704 thousand in non-interest expense and $100 thousand in the provision for loan losses. Diluted earnings per share increased to $1.29 for the six months ended June 30, 2018 compared to $0.89 during the six months ended June 30, 2017.

Total assets at June 30, 2018 were $765 million, an increase of $19.3 million from December 31, 2017. Net loans increased by $29.7 million from $482.2 million at December 31, 2017 to $511.9 million at June 30, 2018. Investment securities increased by $20.3 million from $137.5 million at December 31, 2017 to $157.8 million at June 30, 2018. Cash and cash equivalents totaled $52.7 million at June 30, 2018 down $34.8 million from $87.5 million at December 31, 2017.

Deposits totaled $679 million at June 30, 2018, an increase of $16.4 million from $663 million at December 31, 2017. Non-interest-bearing demand deposits increased by $5.8 million, NOW accounts increased by $4.4 million and savings and money market accounts increased by $11.0 million. These increases were partially offset by a decline of $4.8 million in time deposits.

Shareholders' equity increased by $3.8 million from $55.7 million at December 31, 2017 to $59.5 million at June 30, 2018.

The annualized return on average assets was 1.85% for the six months ended June 30, 2018 up from 1.40% for the six months ended June 30, 2017. The annualized return on average equity increased from 18.3% during the first six months of 2017 to 23.6% during the current six-month period.

The following is a detailed discussion of each component affecting change in net income and the composition of our balance sheet.

RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2018

Net interest income before provision for loan losses. Net interest income, on a nontax-equivalent basis, for the six months ended June 30, 2018 was $15.6 million, an increase of $2.2 million from the $13.4 million earned during the same period in 2017. The increase in net interest income includes an increase of $2.2 million in interest income partially offset by an increase of $44 thousand in interest expense. Net interest margin, which benefited from a 23 basis points increase in average yield on interest-earning assets, increased 22 basis points to 4.63%, up from 4.41% for the same period in 2017.

Interest income increased by 16% to $16.1 million for the six months ended June 30, 2018, up from $13.9 million during the same period in 2017. Related to increases in average loan balances and loan yield, interest and fees on loans increased by $1.5 million to $14.0 million for the six months ended June 30, 2018; compared to $12.5 million during the first half of 2017. The Company's average loan balances were $495 million for the six months ended June 30, 2018, up $29 million, or 6%, from $466 million for the same period in 2017.

The following table compares loan balances by type at June 30, 2018 and 2017.

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

	06/30/18	to Total Loans 06/30/18		06/30/17	to Total Loans 06/30/17	
Commercial	$49,698	9.6	%	$39,394	8.3	%
Agricultural	63,701	12.4	%	54,974	11.5	%
Real estate – residential	14,789	2.9	%	18,952	4.0	%
Real estate – commercial	251,608	48.8	%	236,791	49.7	%
Real estate – construction	25,325	4.9	%	24,819	5.2	%
Equity Lines of Credit	39,462	7.6	%	42,211	8.9	%
Auto	67,184	13.0	%	55,255	11.6	%
Other	3,981	0.8	%	3,695	0.8	%
Total Gross Loans	$515,748	100	%	$476,091	100	%

The average rate earned on the Company’s loan balances increased by 27 basis points to 5.70% during the first six months of 2018 compared to 5.43% during the first six months of 2017. We attribute this increase in yield to an increase in the prime interest rate and a decrease in net loan costs of $87 thousand. Loan pricing continues to be extremely competitive in our service area.

Interest on investment securities increased by $672 thousand related to an increase in yield of 38 basis points, from 2.15% during the first half of 2017 to 2.53% during the six months ended June 30, 2018, and an increase in average balance from $109.1 million during the first half of 2017 to $146.2 million during the six months ended June 30, 2018. We attribute the increase in yield during the current period primarily to market conditions. See "Investment Portfolio and Federal Funds Sold" for additional information related to the Company's investment portfolio. Interest earned on other interest earning assets increased by $110 thousand to $289 thousand during the six months ended June 30, 2018 related to an increase in yield of 65 basis points from 0.97% during the six months ended June 30, 2017 to 1.62% during the current six-month period. Other interest earning assets mostly related to balances held at the Federal Reserve Bank of San Francisco.

Interest expense on deposits increased by $24 thousand to $304 thousand for the six months ended June 30, 2018, up from $280 thousand during the 2017 period. This increase relates to an increase in the average balance of NOW, Money Market and Savings accounts partially offset by a decrease in the average balance of time deposits.

Interest on time deposits declined by $7 thousand. Average time deposits declined by $5.0 million from $47.9 million during the six months ended June 30, 2017 to $42.9 million during the current period. We attribute much of the reduction in time deposit to the unusually low interest rate environment as we have seen a movement out of time into more liquid deposit types. The average rate paid on time deposits was 0.31% during the six months ended June 30, 2018 and 2017.

The largest increase in interest expense on deposits was a $18 thousand increase in interest on savings accounts related to growth in this deposit category. Average savings balances increased from $152.6 million during the six months ended June 30, 2017 to $174.0 million during the current six-month period. Plumas Bank's savings accounts provide an attractive interest rate, in the current rate environment, and we have seen continued growth in savings accounts for the last few years. The average rate paid on savings accounts was 17 basis points during the six months ended June 30, 2018 and 2017.

Interest expense on other interest-bearing liabilities increased by $20 thousand from $222 thousand during the six months ended June 30, 2017 to $242 thousand during the current six-month period. Interest expense on note payable was $28 thousand during the six months ended June 30, 2017. The note payable was paid off in April of 2017 resulting in a decrease in expense in the comparison periods of $28 thousand. Interest expense on junior subordinated debentures, which increased by $47 thousand to $239 thousand, fluctuates with changes in the 3-month London Interbank Offered Rate (LIBOR) .

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

	For the Six Months Ended June 30, 2018			**For the Six Months Ended June 30, 2017**		
	Average Balance (in thousands)	**Interest (in thousands)**	**Yield/ Rate**	**Average Balance (in thousands)**	**Interest (in thousands)**	**Yield/ Rate**
Interest-earning assets:						
Loans (1) (2) (3)	$495,151	$ 13,987	5.70 %	$466,155	$ 12,541	5.43 %
Investment securities (1)	146,203	1,836	2.53 %	109,130	1,164	2.15 %
Interest-bearing deposits	36,018	289	1.62 %	37,243	179	0.97 %
Total interest-earning assets	677,372	16,112	4.80 %	612,528	13,884	4.57 %
Cash and due from banks	21,309			18,347		
Other assets	36,252			32,370		
Total assets	$734,933			$663,245		
Interest-bearing liabilities:						
NOW deposits	$102,113	47	0.09 %	$95,047	43	0.09 %
Money market deposits	65,797	48	0.15 %	55,289	39	0.14 %
Savings deposits	173,968	143	0.17 %	152,615	125	0.17 %
Time deposits	42,917	66	0.31 %	47,943	73	0.31 %
Total deposits	384,795	304	0.16 %	350,894	280	0.16 %
Note payable	-	-	- %	1,412	28	4.00 %
Junior subordinated debentures	10,310	239	4.67 %	10,310	192	3.76 %
Other interest-bearing liabilities	7,967	3	0.08 %	6,531	2	0.06 %
Total interest-bearing liabilities	403,072	546	0.27 %	369,147	502	0.27 %
Non-interest-bearing deposits	267,925			237,033		
Other liabilities	6,515			6,339		
Shareholders' equity	57,421			50,726		

Total liabilities & equity	$734,933			$663,245		
Cost of funding interest-earning assets (4)			0.17 %			0.16 %
Net interest income and margin (5)		$ 15,566	4.63 %		$ 13,382	4.41 %

(1) Not computed on a tax-equivalent basis.
(2) Average nonaccrual loan balances of $1.0 million for 2018 and $2.9 million for 2017 are included in average loan balances for computational purposes.
(3) Net loan costs included in loan interest income for the six-month periods ended June 30, 2018 and 2017 were $131,000 and $218,000, respectively.
(4) Total annualized interest expense divided by the average balance of total earning assets.
(5) Annualized net interest income divided by the average balance of total earning assets.

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

	2018 over 2017 change in net interest income for the six months ended June 30 (in thousands)			
	Volume (1)	**Rate (2)**	**Mix (3)**	**Total**
Interest-earning assets:				
Loans	$780	$627	$39	$1,446
Investment securities	396	206	70	672
Interest bearing deposits	(6)	120	(4)	110
Total interest income	1,170	953	105	2,228
Interest-bearing liabilities:				
NOW deposits	3	1	-	4
Money market deposits	8	1	-	9
Savings deposits	18	-	-	18
Time deposits	(8)	1	-	(7)
Note payable	(28)	-	-	(28)
Junior subordinated debentures	-	47	-	47
Other	1	-	-	1
Total interest expense	(6)	50	-	44
Net interest income	$1,176	$903	$105	$2,184

(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.

Provision for loan losses. During the six months ended June 30, 2018 and 2017 we recorded a provision for loan losses of $500 thousand and $400 thousand, respectively. See “Analysis of Asset Quality and Allowance for Loan Losses” for further discussion of loan quality trends and the provision for loan losses.

The allowance for loan losses is maintained at a level that management believes will be appropriate to absorb probable incurred losses on existing loans based on an evaluation of the collectability of the loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to repay their loan. The allowance for loan losses is based on estimates, and ultimate losses may vary from the current estimates. These estimates are reviewed not less than quarterly and, as adjustments become necessary, they are reported in earnings in the periods in which they become known.

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

Non-interest income. During the six months ended June 30, 2018, non-interest income totaled $4.8 million, an increase of $327 thousand from the six months ended June 30, 2017. The largest component of this increase was a $209 thousand gain recorded upon the prospective adoption of a newly effective accounting pronouncement impacting the measurement of equity securities, which in our case consists of stock in our correspondent banks, without a readily determinable fair market value. Other significant increases included $67 thousand in service charges on deposit accounts, $98 thousand in interchange income and $49 thousand in loan service fees. We attribute these increases primarily to growth in the bank.

Gains on sale of SBA loans decreased by $115 thousand from $1.3 million during the six months ended June 30, 2017 to $1.2 million during the current period. Proceeds from SBA loan sales totaled $22.2 million during the current period and $22.3 million for the six months ended June 30, 2017. Loans originated for sale totaled $22.6 million during the six months ended June 30, 2018 and $19.7 million during the six months ended June 30, 2017. The decline in gain on sale mostly relates to a decline in the average premium received on sale. As market rates increase, rates on SBA loans which are variable rate and tied to Prime increase which typically results in an increase in prepay speed on these loans which adversely effects the premium received on sale.

The following table describes the components of non-interest income for the six-month periods ended June 30, 2018 and 2017, dollars in thousands:

	For the Six Months Ended June 30			
	2018	**2017**	**Dollar Change**	**Percentage Change**
Service charges on deposit accounts	$1,294	$1,227	$ 67	5.5 %
Gain on sale of loans, net	1,199	1,314	(115)	(8.8 %)
Interchange income	1,044	946	98	10.4 %
Loan servicing fees	386	337	49	14.5 %
Gain on equity securities with no readily determinable fair value	209	-	209	100 %
Earnings on life insurance policies	165	167	(2)	(1.2 %)
Loss on sale of investments	(8)	(17)	9	52.9 %
Other	468	456	12	2.6 %
Total non-interest income	$4,757	$4,430	$ 327	7.4 %

Non-interest expense. During the six months ended June 30, 2018, total non-interest expense increased by $704 thousand to $10.7 million. The three largest components of this increase were increases of $245 thousand or 4.2%, in salaries and benefits, $148 thousand in professional fees and $226 thousand in other. The largest components of the increase in salary and benefit expense were increases of $241 thousand or 5.5%, in salary expense and $177 thousand in accrued bonus expense. Salary expense increased to $4.6 million related to additions to staff and merit and promotion increases. Bonus expense is mostly a function of pretax income; the increase during the 2018 period is primarily related to the increase in pretax income. These items were partially offset by an increase in the deferral of loan origination costs of $298 thousand to $1.2 million related mostly to an increase in loan origination activity.

Professional fees increased by $148 thousand related primarily to an $89 thousand increase in consulting expense and a $51 thousand increase in legal expense. The increase in consulting costs includes costs related to an external review of our compliance management system and ongoing bank compliance consulting and $21 thousand related to our pending acquisition of Mutual Omaha Bank's Carson City Nevada branch. See "Recent Developments." The increase in legal expense includes costs associated with the above-mentioned branch acquisition and costs associated with litigation brought by a third-party municipality against one of our borrowers which could adversely affect our collateral position. The increase in other non-interest expense included a $50 thousand increase in the reserve for undisbursed loan commitments and costs associated with the pending termination of our lease at our Tahoe City, California branch. Recently we purchased a building in Tahoe City which, after remodeling is complete, will become the new home of our Tahoe City Branch. Our lease obligation at our current location includes a termination penalty that has been accrued into other expense. This accrual along with the increase in the reserve for undisbursed loan commitments account for most of the increase in other expense.

The largest decrease in non-interest expense was a $72 thousand reduction in director compensation and retirement expense related to the reversal of accrued retirement costs related to our former director John Flournoy who elected not to run for reelection and instead allowed his board term to expire as of May 16, 2018. Mr. Flournoy did not meet the minimum years of service required under his agreement to receive benefits.

The following table describes the components of non-interest expense for the six-month periods ended June 30, 2018 and 2017, dollars in thousands:

	For the Six Months Ended June 30 2018	2017	Dollar Change	Percentage Change
Salaries and employee benefits	$6,036	$5,791	$ 245	4.2 %
Occupancy and equipment	1,407	1,423	(16)	(1.1)%
Outside service fees	1,156	1,084	72	6.6 %
Professional fees	437	289	148	51.2 %
Telephone and data communication	266	257	9	3.5 %
Advertising and shareholder relations	210	182	28	15.4 %
Business development	196	185	11	5.9 %
Armored car and courier	159	133	26	19.5 %
Loan and collection expenses	135	94	41	43.6 %
Deposit insurance	119	112	7	6.3 %
Director compensation and retirement	85	157	(72)	(45.9)%
Stationery and supplies	52	55	(3)	(5.5)%
OREO expenses	38	22	16	72.7 %
Provision from change in OREO valuation	38	9	29	322.2 %
Gain on sale of OREO	(63)	-	(63)	(100.0)%
Other	408	182	226	124.2 %
Total non-interest expense	$10,679	$9,975	$ 704	7.1 %

Provision for income taxes. The Company recorded an income tax provision of $2.4 million, or 26.5% of pre-tax income for the six months ended June 30, 2018. This compares to an income tax provision of $2.8 million, or 38.1% of pre-tax income for the six months ended June 30, 2017. The decline from 38.1% to 26.5% mostly relates from a change in the Federal corporate tax rate, under the Tax Cuts and Jobs Act, from 34% to 21%. The percentages for 2018 and 2017 differ from statutory rates as tax exempt items of income such as earnings on Bank owned life insurance and municipal loan and securities interest decrease taxable income. In addition, the 2018 and 2017 provision include income tax benefits related to the exercise of stock options of $99 thousand and $45 thousand, respectively.

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amount of assets and liabilities and their tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax asset will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Based upon the analysis of available evidence, management has determined that it is "more likely than not" that all deferred income tax assets as of June 30, 2018 and December 31, 2017 will be fully realized and therefore no valuation allowance was recorded. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2018

Net Income. The Company recorded net income of $3.4 million for the three months ended June 30, 2018 up $904 thousand from net income of $2.5 million for the three months ended June 30, 2017. An increase of $1.1 million in net interest income and a reduction of $360 thousand in income tax expense were partially offset by increases of $337 thousand in non-interest expense and $100 thousand in the provision for loan losses and a decrease of $157 thousand in non-interest income.

The following is a detail discussion of each component of the change in net income.

Net interest income before provision for loan losses. Net interest income, on a nontax-equivalent basis, was $8.0 million for the three months ended June 30, 2018 an increase of $1.1 million, or 17%, from $6.9 million for the same period in 2017. The increase in net interest income includes an increase of $1.2 million in interest income; the largest component of which was an increase in interest and fees on loans of $776 thousand. Net interest margin for the three months ended June 30, 2018 increased by 24 basis points from 4.51% during the second quarter of 2017 to 4.75% during the current quarter.

Interest income increased by 17%, to $8.3 million for the three months ended June 30, 2018, up from $7.1 million during the same period in 2017. Related to an increase in average loan balances and an increase in yield, interest and fees on loans increased $776 thousand to $7.2 million for the three months ended June 30, 2018 as compared to $6.4 million during the second quarter of 2017. The Company's average loan balances were $501 million for the three months ended June 30, 2018, up $31 million, or 7%, from $470 million for the same period in 2017. The average yield on loans was 5.77% during the second quarter of 2018 up from 5.48% for same quarter in 2017. We attribute this increase in yield primarily to an increase in the prime interest rate as well as a decrease in net loan costs of $70 thousand.

Interest on investment securities increased by $377 thousand because of an increase in yield of 43 basis points from 2.15% during the second quarter of 2017 to 2.58% during the three months ended June 30, 2018 and an increase in average balance from $112.3 million in 2017 to $152.3 million in 2018. During the current period yield benefited from market conditions.

Interest expense on deposits increased by $13 thousand to $153 thousand for the three months ended June 30, 2018, up from $140 thousand during the 2017 quarter. The largest increase in interest expense on deposits was an increase of $8 thousand in interest on savings accounts related to growth in this deposit category. Average savings balances increased from $153.6 million during the three months ended June 30, 2017 to $172.8 million during the current quarter. Plumas Bank's savings accounts provide an attractive interest rate in the current rate environment and we have seen continued growth in savings accounts for the last few years. The average rate paid on savings accounts was 16 basis points during both periods.

Interest on time deposits declined by $3 thousand. Average time deposits declined by $5.4 million from $47.3 million during the three months ended June 30, 2017 to $41.9 million during the current quarter. We attribute much of the reduction in time deposits to the unusually low interest rate environment as we have seen a movement out of time into more liquid deposit types. The average rate paid on time deposits was 0.31% during the three-months ended June 30, 2017 and 0.32% during the current quarter.

Interest expense on other interest-bearing liabilities increased by $24 thousand from $104 thousand during the three months ended June 30, 2017 to $128 thousand during the current quarter. This increase was related to an increase in rate paid on junior subordinated debentures; interest expense on this debt, which fluctuates with changes in the 3-month LIBOR rate, increased by $28 thousand to $127 thousand.

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

	For the Three Months Ended June 30, 2018			**For the Three Months Ended June 30, 2017**		
	Average Balance (in thousands)	**Interest (in thousands)**	**Yield/ Rate**	**Average Balance (in thousands)**	**Interest (in thousands)**	**Yield/ Rate**
Interest-earning assets:						
Loans (1) (2) (3)	$501,400	$ 7,209	5.77 %	$470,451	$ 6,433	5.48 %
Investment securities (1)	152,288	980	2.58 %	112,326	603	2.15 %
Other	23,534	105	1.79 %	28,948	83	1.15 %
Total interest-earning assets	677,222	8,294	4.91 %	611,725	7,119	4.67 %
Cash and due from banks	22,680			18,364		
Other assets	37,456			32,177		
Total assets	$737,358			$662,266		
Interest-bearing liabilities:						
NOW deposits	$103,736	24	0.09 %	$94,459	22	0.09 %
Money market deposits	68,350	25	0.15 %	53,285	19	0.14 %
Savings deposits	172,786	71	0.16 %	153,649	63	0.16 %
Time deposits	41,924	33	0.32 %	47,295	36	0.31 %
Total deposits	386,796	153	0.16 %	348,688	140	0.16 %
Note payable	-	-	- %	470	4	3.41 %
Junior subordinated debentures	10,310	127	4.94 %	10,310	99	3.85 %
Other interest-bearing liabilities	6,378	1	0.06 %	3,238	1	0.12 %
Total interest-bearing liabilities	403,484	281	0.28 %	362,706	244	0.27 %
Non-interest-bearing deposits	269,067			239,261		
Other liabilities	6,451			8,459		
Shareholders' equity	58,356			51,840		
Total liabilities & equity	$737,358			$662,266		

Cost of funding interest-earning assets (4)		0.16 %		0.16 %
Net interest income and margin (5)	$ 8,013	4.75 %	$ 6,875	4.51 %

(1) Not computed on a tax-equivalent basis.
(2) Average nonaccrual loan balances of $0.9 million for 2018 and $3.0 million for 2017 are included in average loan balances for computational purposes.
(3) Net loan costs included in loan interest income for the three-month periods ended June 30, 2018 and 2017 were $23,000 and $93,000, respectively.
(4) Total annualized interest expense divided by the average balance of total earning assets.
(5) Annualized net interest income divided by the average balance of total earning assets.

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

	2018 over 2017 change in net interest income for the three months ended June 30 (in thousands)			
	Volume (1)	**Rate (2)**	**Mix (3)**	**Total**
Interest-earning assets:				
Loans	$417	$331	$28	$776
Investment securities	215	120	42	377
Interest bearing deposits	(16)	46	(8)	22
Total interest income	616	497	62	1,175
Interest-bearing liabilities:				
NOW deposits	2	-	-	2
Money market deposits	5	1	-	6
Savings deposits	8	-	-	8
Time deposits	(4)	1	-	(3)
Note payable	(4)	-	-	(4)
Junior subordinated debentures	-	28	-	28
Other	1	(1)	-	-
Total interest expense	8	29	-	37
Net interest income	$608	$468	$62	$1,138

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

Provision for loan losses. During the three months ended June 30, 2018 and 2017 we recorded a provision for loan losses of $300 thousand and $200 thousand, respectively. See "Analysis of Asset Quality and Allowance for Loan Losses" for a discussion of loan quality trends and the provision for loan losses.

Non-interest income. During the three months ended June 30, 2018, non-interest income totaled $2.2 million, a decrease of $157 thousand from the three months ended June 30, 2017. The largest component of this decrease was a $253 thousand decrease in gains on sale of SBA loans from $786 thousand during the three months ended June 30, 2017 to $533 thousand during the current quarter. Proceeds from SBA loan sales totaled $10.3 million during the current quarter and $13.1 million during the 2017 quarter. Loans originated for sale totaled $10.0 million during the three months ended June 30, 2018 and $8.5 million during the three months ended June 30, 2017. The decline in gain on sale includes the decrease in loans sold as well as a decline in the average premium received on sale. Partially offsetting the decline in gain on sale of SBA loans were increases of $25 thousand in service charge income, $63 thousand in interchange income and $28 thousand in loan servicing fees.

The following table describes the components of non-interest income for the three-month periods ended June 30, 2018 and 2017, dollars in thousands:

	For the Three Months Ended June 30			
	2018	2017	Dollar Change	Percentage Change
Service charges on deposit accounts	$653	$628	$ 25	4.0 %
Interchange income	553	490	63	12.9 %
Gain on sale of loans, net	533	786	(253)	(32.2)%
Loan serving fees	197	169	28	16.6 %
Earnings on life insurance policies	82	85	(3)	(3.5)%
Other	207	224	(17)	(7.6)%
Total non-interest income	$2,225	$2,382	$ (157)	(6.6)%

Non-interest expense. During the three months ended June 30, 2018, total non-interest expense increased by $337 thousand, or 7%, to $5.2 million, up from $4.9 million for the comparable period in 2017. The three largest components of this increase were increases of $59 thousand or 2.1%, in salaries and benefits, $88 thousand in professional fees and $142 thousand in other. Salary expense increased by $140 thousand or 6.3%, to $2.4 million and bonus expense increased by $72 thousand. These items were partially offset by an increase in deferred loan origination costs of $195 thousand.

The increase in professional fees is mostly related to an increase in consulting costs and legal fees as previously discussed in the six-month comparison. The increase in Other expense includes the accrual of lease termination costs associated with our Tahoe City branch and an increase in charge-offs on overdraft accounts.

The largest decrease in non-interest expense was a $82 thousand reduction in director compensation and retirement expense related to the reversal of John Flournoy's accrued retirement costs as previously discussed in the six-month comparison.

The following table describes the components of non-interest expense for the three-month periods ended June 30, 2018 and 2017, dollars in thousands:

For the Three Months

	Ended June 30, 2018	2017	Dollar Change	Percentage Change
Salaries and employee benefits	$2,923	$2,864	$ 59	2.1 %
Occupancy and equipment	705	654	51	7.8 %
Outside service fees	583	552	31	5.6 %
Professional fees	218	130	88	67.7 %
Advertising and shareholder relations	132	105	27	25.7 %
Telephone and data communication	130	124	6	4.8 %
Business development	117	111	6	5.4 %
Armored car and courier	82	68	14	20.6 %
Loan and collection expenses	46	44	2	4.5 %
Deposit insurance	45	50	(5)	(10.0)%
Provision from change in OREO valuation	38	-	38	100.0 %
Stationery and supplies	24	26	(2)	(7.7)%
OREO expenses	(3)	6	(9)	(150.0)%
Director compensation and retirement	(5)	77	(82)	(106.5)%
Gain on sale of OREO	(29)	-	(29)	(100.0)%
Other	223	81	142	175.3 %
Total non-interest expense	$5,229	$4,892	$ 337	6.9 %

Provision for income taxes. The Company recorded an income tax provision of $1.3 million, or 26.8% of pre-tax income for the three months ended June 30, 2018. This compares to an income tax provision of $1.6 million, or 39.0% of pre-tax income for the three months ended June 30, 2017. The decline from 39.0% to 26.8% mostly relates to a change in the Federal corporate tax rate, under the Tax Cuts and Jobs Act, from 34% to 21%. The percentages for 2018 and 2017 differ from statutory rates as tax exempt items of income such as earnings on Bank owned life insurance and municipal loan and securities interest decrease taxable income. In addition, the 2018 and 2017 provision include income tax benefits related to the exercise of nonqualified stock options of $35 thousand and $0, respectively.

FINANCIAL CONDITION

Loan Portfolio. Loans increased by $29.1 million from $487 million at December 31, 2017 to $516 million at June 30, 2018. The increase in loan balances includes increases of $11.4 million in commercial real estate loans, $10.1 million in commercial loans, $6.7 million in automobile loans, $4.8 million in agricultural loans, and $0.2 in other loans partially offset by declines of $2.3 million in equity lines of credit and $1.8 million in residential real estate loans. The Company continues to manage the mix of its loan portfolio consistent with its identity as a community bank serving the financing needs of all sectors of the area it serves. Although the Company offers a broad array of financing options, it continues to concentrate its focus on small to medium sized commercial businesses. These loans offer diversification as to industries and types of businesses, thus limiting material exposure in any industry concentrations. The Company offers both fixed and floating rate loans and obtains collateral in the form of real property, business assets and deposit accounts, but looks to business and personal cash flows as its primary source of repayment.

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

(dollars in thousands)	Balance at End of Period **6/30/18**	Percent of Loans in Each Category to Total Loans **6/30/18**		Balance at End of Period **12/31/17**	Percent of Loans in Each Category to Total Loans **12/31/17**	
Commercial	$49,698	9.6	%	$39,620	8.1	%
Agricultural	63,701	12.4	%	58,908	12.1	%
Real estate – residential	14,789	2.9	%	16,624	3.4	%
Real estate – commercial	251,608	48.8	%	240,257	49.4	%
Real estate – construction & land	25,325	4.9	%	25,181	5.2	%
Equity Lines of Credit	39,462	7.6	%	41,798	8.6	%
Auto	67,184	13.0	%	60,438	12.4	%
Other	3,981	0.8	%	3,808	0.8	%
Total Gross Loans	$515,748	100	%	$486,634	100	%

Construction and land development loans represented 4.9% and 5.2% of the loan portfolio as of June 30, 2018 and December 31, 2017, respectively. The construction and land development portfolio component has been identified by Management as a higher-risk loan category. The quality of the construction and land development category is highly dependent on property values both in terms of the likelihood of repayment once the property is transacted by the current owner as well as the level of collateral the Company has securing the loan in the event of default. Loans in this category are characterized by the speculative nature of commercial and residential development properties and can include property in various stages of development from raw land to finished lots. The Company has reduced its holdings in construction and land development loans from over 21% of its loan portfolio at December 31, 2007 to less than 6% during the last two years.

The Company’s real estate related loans, including real estate mortgage loans, real estate construction and land development loans, consumer equity lines of credit, and agricultural loans secured by real estate comprised 70% of the total loan portfolio at June 30, 2018. Moreover, the business activities of the Company currently are focused in the California counties of Plumas, Nevada, Placer, Lassen, Modoc, Shasta, and Sierra and in Washoe County in Northern Nevada. Consequently, the results of operations and financial condition of the Company are dependent upon the general trends in these economies and, in particular, the residential and commercial real estate markets. In addition, the concentration of the Company's operations in these areas of Northeastern California and Northwestern Nevada exposes it to greater risk than other banking companies with a wider geographic base in the event of catastrophes, such as earthquakes, fires and floods in these regions.

The rates of interest charged on variable rate loans are set at specific increments in relation to the Company's lending rate or other indexes such as the published prime interest rate or U.S. Treasury rates and vary with changes in these indexes. The frequency in which variable rate loans reprice can vary from one day to several years. At June 30, 2018 and December 31, 2017, approximately 75% of the Company's loan portfolio was comprised of variable rate loans. At June 30, 2018 approximately 34% of these variable rate loans were tied to the Prime interest rate and reprice within 3 months. At June 31, 2018 and December 31, 2017, 37% and 40%, respectively of the variable loans were at their respective floor rate. While real estate mortgage, commercial and consumer lending remain the foundation of the Company's historical loan mix, some changes in the mix have occurred due to the changing economic environment and the resulting change in demand for certain loan types. The most significant change has been an increase in indirect auto lending with automobile loans increasing from 2.5% of gross loans at December 31, 2011 to 13.0% of gross loans at June 30, 2018. The automobile portfolio provides diversification to the loan portfolio in terms of rate, term and balance as these loans tend to have a much shorter term and balance than commercial real-estate loans and are fixed rate. In addition, the Company remains committed to the agricultural industry in Northeastern California and will continue to pursue high quality agricultural loans. Recently we hired a loan officer to service the Carson City and surrounding areas in Northwestern Nevada. We expect to generate commercial, commercial real-estate and agricultural loans in this region. Agricultural loans include both commercial and commercial real estate loans. The Company’s agricultural loan balances totaled $64 million at June 30, 2018 and $59 million at December 31, 2017. Agricultural loans include both commercial and commercial real estate loans. The Company’s agricultural loan balances totaled $64 million at June 30, 2018 and $59 million at December 31, 2017.

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

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

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

The allowance for loan losses is established through charges to earnings in the form of the provision for loan losses. Loan losses are charged to and recoveries are credited to the allowance for loan losses. The allowance for loan losses is maintained at a level deemed appropriate by management to provide for known and inherent risks in the loan portfolio. The adequacy of the allowance for loan losses is based upon management's continuing assessment of various factors affecting the collectability of loans; including current economic conditions, maturity of the portfolio, size of the portfolio, industry concentrations, borrower credit history, collateral, the existing allowance for loan losses, independent credit reviews, current charges and recoveries to the allowance for loan losses and the overall quality of the portfolio as determined by management, regulatory agencies, and independent credit review consultants retained by the Company. There is no precise method of predicting specific losses or amounts which may ultimately be charged off on particular segments of the loan portfolio. The collectability of a loan is subjective to some degree, but must relate to the borrower’s financial condition, cash flow, quality of the borrower’s management expertise, collateral and guarantees, and strength of the local economy.

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

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

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

(dollars in thousands)	**For the Six Months Ended June 30, 2018**	**2017**	**For the Year Ended December 31 2017**	**2016**	**2015**
Balance at beginning of period	$6,669	$6,549	$6,549	$6,078	$5,451
Charge-offs:					
Commercial and agricultural	266	67	202	268	91
Real estate mortgage	-	-	48	292	132
Real estate construction & land	-	-	-	5	55
Consumer (includes equity LOC & Auto)	497	108	629	414	549
Total charge-offs	763	175	879	979	827
Recoveries:					
Commercial and agricultural	15	19	89	53	173
Real estate mortgage	109	5	118	45	8
Real estate construction & land	2	-	-	389	-
Consumer (includes equity LOC & Auto)	166	57	192	163	173
Total recoveries	292	81	399	650	354
Net charge-offs	471	94	480	329	473
Provision for loan losses	500	400	600	800	1,100
Balance at end of period	$6,698	$6,855	$6,669	$6,549	$6,078
Net charge-offs during the period to average loans (annualized for the six-month periods)	0.19 %	0.04 %	0.10 %	0.08 %	0.12 %
Allowance for loan losses to total loans	1.30 %	1.44 %	1.37 %	1.42 %	1.52 %

During the six months ended June 30, 2018 and 2017 we recorded a provision for loan losses of $500 thousand and $400 thousand, respectively. Net charge-offs totaled $471 thousand during the six months ended June 30, 2018, an increase of $377 thousand from $94 thousand during the six months ended June 30, 2017. The increase is mostly related to a charge-off on a commercial loan in which the borrower filed bankruptcy and an increase in charge-offs on automobile loans.

The following table provides a breakdown of the allowance for loan losses at June 30, 2018 and December 31, 2017:

(dollars in thousands)

	Balance at End of Period 2018	Percent of Loans in Each Category to Total Loans 2018	Balance at End of Period 2017	Percent of Loans in Each Category to Total Loans 2017
Commercial and agricultural	$ 1,399	22.0 %	$ 1,348	20.2 %
Real estate mortgage	2,894	51.7 %	2,960	52.8 %
Real estate construction & land	780	4.9 %	783	5.2 %
Consumer (includes equity LOC & Auto)	1,625	21.4 %	1,578	21.8 %
Total	$ 6,698	100.0 %	$ 6,669	100.0 %

The allowance for loan losses totaled $6.7 million at June 30, 2018 and December 31, 2017. Specific reserves related to impaired loans decreased by $1 thousand from $82 thousand at December 31, 2017 to $81 thousand at June 30, 2018. At least quarterly the Company evaluates each specific reserve and if it determines that the loss represented by the specific reserve is uncollectable it records a charge-off for the uncollectable portion. General reserves were $6.6 million at June 30, 2018 and December 31, 2017. The allowance for loan losses as a percentage of total loans decreased from 1.37% at December 31, 2017 to 1.30% at June 30, 2018. The percentage of general reserves to unimpaired loans totaled 1.29% and 1.36% at June 30, 2018 and December 31, 2017, respectively.

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. Included in nonperforming loans at December 31, 2017 were three loans to one customer totaling $1.8 million that were 90 days past due and still accruing interest. These loans were well secured and in process of collection at December 31, 2017. As of June 30, 2018, we had collected all principal and interest due on these loans. When a loan is placed on nonaccrual status the Company's general policy is to reverse and charge against current income previously accrued but unpaid interest. Interest income on such loans is subsequently recognized only to the extent that cash is received and future collection of principal is deemed by management to be probable. Where the collectability of the principal or interest on a loan is considered to be doubtful by management, it is placed on nonaccrual status prior to becoming 90 days delinquent.

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

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

Loans restructured (TDRs) and not included in nonperforming loans in the following table totaled $1.1 million, $1.1 million, $2.6 million, $2.0 million and $2.0 million at June 30, 2018, December 31, 2017, 2016, 2015 and 2014, respectively.

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

	At June 30,	**At December 31,**			
	2018	**2017**	**2016**	**2015**	**2014**
		(dollars in thousands)			

Nonaccrual loans	$882	$1,226	$2,724	$4,546	$6,625
Loans past due 90 days or more and still accruing	-	1,796	-	-	-
Total nonperforming loans	882	3,022	2,724	4,546	6,625
Other real estate owned	953	1,344	735	1,756	3,590
Other vehicles owned	32	35	12	30	13
Total nonperforming assets	$1,867	$4,401	$3,471	$6,332	$10,228
Interest income forgone on nonaccrual loans	$29	$50	$164	$303	$345
Interest income recorded on a cash basis on nonaccrual loans	$-	$-	$29	$-	$31
Nonperforming loans to total loans	0.17 %	0.62 %	0.59 %	1.13 %	1.79 %
Nonperforming assets to total assets	0.24 %	0.59 %	0.53 %	1.06 %	1.90 %

Nonperforming loans at June 30, 2018 were $0.9 million, a decrease of $2.1 million from the $3.0 million balance at December 31, 2017. Specific reserves on nonaccrual loans totaled $24 thousand at June 30, 2018 and December 31, 2017. Performing loans past due thirty to eighty-nine days were $2.9 million at June 30, 2018 and $3.4 million at December 31, 2017.

A substandard loan is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Total substandard loans decreased by $2.4 million from $3.2 million at December 31, 2017 to $0.8 million at June 30, 2018. Loans classified as special mention increased by $3.9 million from $642 thousand at December 31, 2017 to $4.5 million at June 30, 2018. At June 30, 2018, $0.3 million of performing loans were classified as substandard. Further deterioration in the credit quality of individual performing substandard loans or other adverse circumstances could result in the need to place these loans on nonperforming status.

At June 30, 2018 and December 31, 2017, the Company's recorded investment in impaired loans totaled $1.9 million and $2.3 million, respectively. The specific allowance for loan losses related to impaired loans totaled $81 thousand and $82 thousand at June 30, 2018 and December 31, 2017, respectively. Additionally, $11 thousand had been charged off against the impaired loans at June 30, 2018 and December 31, 2017.

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 June 30, 2018 is appropriate. However, the determination of the amount of the allowance is judgmental and subject to economic conditions which cannot be predicted with certainty. Accordingly, the Company cannot predict whether charge-offs of loans in excess of the allowance may occur in future periods.

OREO represents real property acquired by the Bank either through foreclosure or through a deed in lieu thereof from the borrower. Repossessed assets include vehicles and other commercial assets acquired under agreements with delinquent borrowers. OREO holdings represented six properties totaling $953 thousand at June 30, 2018 and six properties totaling $1.3 million at December 31, 2017. Nonperforming assets as a percentage of total assets were 0.24% at June 30, 2018 and 0.59% at December 31, 2017.

The following table provides a summary of the change in the number and balance of OREO properties for the six months ended June 30, 2018 and 2017, dollars in thousands:

	Six Months Ended June 30,			
	#	**2018**	**#**	**2017**
Beginning Balance	6	$1,344	6	$735
Additions	1	133	1	193
Dispositions	(1)	(486)	(1)	(75)
Provision from change in OREO valuation	-	(38)	-	(9)
Ending Balance	6	$953	6	$844

The dispositions in 2018 includes $377 thousand related to the sale of a portion of a property.

Investment Portfolio and Federal Funds Sold. Total investment securities were $157.8 million as of June 30, 2018 and $137.5 million as of December 31, 2017. Unrealized loss on available-for-sale investment securities totaling $4.1 million were recorded, net of $1.2 million in tax benefits, as accumulated other comprehensive loss within shareholders' equity at June 30, 2018. Unrealized loss on available-for-sale investment securities totaling $809 thousand were recorded, net of $239 thousand in tax benefits, as accumulated other comprehensive loss within shareholders' equity at December 31, 2017.

During the six months ended June 30, 2018 the Company sold eighteen available-for-sale investment securities for total proceeds of $4.2 million recording a $8 thousand loss on sale. During the six months ended June 30, 2017 the Company sold seven available-for-sale investment securities for total proceeds of $4.2 million recording a $17 thousand loss on sale.

The investment portfolio at June 30, 2018 consisted of $122.2 million in securities of U.S. Government-sponsored agencies and 112 municipal securities totaling $35.6 million. The investment portfolio at December 31, 2017 consisted of $103.8 million in securities of U.S. Government-sponsored agencies and 115 municipal securities totaling $33.7 million.

There were no Federal funds sold at June 30, 2018 and December 31, 2017; however, the Bank maintained interest earning balances at the Federal Reserve Bank of San Francisco (FRB) totaling $23.1 million at June 30, 2018 and $62.2 million at December 31, 2017. The balances, at June 30, 2018, earn interest at the rate of 1.95%.

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

Deposits. Total deposits increased by $16.4 million, or 2.5%, from $662.7 million at December 31, 2017 to $679.1 million at June 30, 2018. Non-interest-bearing demand deposits increased by $5.8 million, NOW accounts increased by $4.4 million and savings and money market accounts increased by $11.0 million. These increases were partially offset by a decline of $4.8 million in time deposits. The Company continues to manage the mix of its deposits consistent with its identity as a community bank serving the financial needs of its customers.

The following table shows the distribution of deposits by type at June 30, 2018 and December 31, 2017.

(dollars in thousands)	Balance at End of Period 6/30/18	Percent of Deposits in Each Category to Total Deposits 6/30/18		Balance at End of Period 12/31/17	Percent of Deposits in Each Category to Total Deposits 12/31/17	
Non-interest bearing	$288,068	42.4	%	$282,239	42.6	%
NOW	103,631	15.3	%	99,195	15.0	%
Money Market	67,831	10.0	%	60,757	9.2	%
Savings	178,374	26.3	%	174,426	26.3	%
Time	41,162	6.0	%	46,040	6.9	%
Total Deposits	$679,066	100	%	$662,657	100	%

Deposits represent the Bank's primary source of funds. Deposits are primarily core deposits in that they are demand, savings and time deposits generated from local businesses and individuals. These sources are considered to be relatively stable, long-term relationships thereby enhancing steady growth of the deposit base without major fluctuations in overall deposit balances. The Company experiences, to a small degree, some seasonality with the slower growth period between November through April, and the higher growth period from May through October. To assist in meeting any funding demands, the Company maintains a secured borrowing arrangement with the FHLB. There were no brokered deposits at June 30, 2018 or December 31, 2017.

Short-term Borrowing Arrangements. The Company is a member of the FHLB and can borrow up to $198 million from the Federal Home Loan Bank of San Francisco (FHLB) secured by commercial and residential mortgage loans with carrying values totaling $314.7 million. The Company is required to hold FHLB stock as a condition of membership. At June 30, 2018 the Company held $3.0 million of FHLB stock which is recorded as a component of other assets. Based on this level of stock holdings at June 30, 2018, the Company can borrow up to $112.1 million. To borrow the $198 million in available credit the Company would need to purchase $2.3 million in additional FHLB stock. In addition to its FHLB borrowing line, the Company has unsecured short-term borrowing agreements with three of its correspondent banks in the amounts of $20 million, $11 million and $10 million. There were no outstanding borrowings to the FHLB or the correspondent banks under these agreements at June 30, 2018 or December 31, 2017.

Note Payable and Term Loan. On October 1, 2015, the Company entered into a $5.0 million term loan (the “Term Loan”), which was scheduled to mature on October 1, 2018. On April 20, 2017 Plumas Bancorp paid off the $2.3 million remaining balance on the Term Loan. The payment was funded through a $4 million dividend from Plumas Bank.

On October 1, 2017 the Company renewed its line of credit, for a one-year term, with the same lender (the “Note”). The maximum amount outstanding at any one time on the Note cannot exceed $5 million. There were no balances outstanding on the Note as of June 30, 2018 or December 31, 2017. The Note bears interest at a rate of the U.S. "Prime Rate" plus one-quarter percent per annum and is secured by 100 shares of Plumas Bank stock representing the Company's 100% ownership interest in Plumas Bank. Under the Note, the Bank is subject to several negative and affirmative covenants including, but not limited to providing timely financial information, maintaining specified levels of capital, restrictions on additional borrowings, and meeting or exceeding certain capital and asset quality ratios. The Bank was in compliance with all such covenants related to the Note at June 30, 2018 and December 31, 2017. Interest expense related to the Note and the Term Loan for the six months ended June 30, 2018 and 2017 totaled $0 thousand and $28 thousand, respectively.

Repurchase Agreements. In 2011 the Bank introduced a product for its larger business customers which use securities sold under agreements to repurchase as an alternative to interest-bearing deposits. Securities sold under agreements to repurchase totaling $8.7 million and $10.1 million at June 30, 2018 and December 31, 2017, respectively are secured by U.S. Government agency securities with a carrying amount of $15.2 million and $16.8 million at June 30, 2018 and December 31, 2017, respectively. Interest paid on this product is like that which is paid on the Bank’s premium money market account; however, these are not deposits and are not FDIC insured.

Junior Subordinated Deferrable Interest Debentures. Plumas Statutory Trust I and II are business trust subsidiaries formed by the Company with capital of $333, thousand and $171 thousand, respectively, for the sole purpose of issuing trust preferred securities fully and unconditionally guaranteed by the Company.

During 2002, Trust I issued 6,000 Floating Rate Capital Trust Pass-Through Securities ("Trust Preferred Securities"), with a liquidation value of $1,000 per security, for gross proceeds of $6 million. During 2005, Trust II issued 4,000 Trust Preferred Securities with a liquidation value of $1,000 per security, for gross proceeds of $4 million. The entire proceeds were invested by Trust I in the amount of $6.2 million and Trust II in the amount of $4.1 million in Floating Rate Junior Subordinated Deferrable Interest Debentures (the "Subordinated Debentures") issued by the Company, with identical maturity, repricing and payment terms as the Trust Preferred Securities. The Subordinated Debentures represent the sole assets of Trusts I and II.

Trust I’s Subordinated Debentures mature on September 26, 2032, bear a current interest rate of 5.74% (based on 3-month LIBOR plus 3.40%), with repricing and payments due quarterly. Trust II’s Subordinated Debentures mature on September 28, 2035, bear a current interest rate of 3.82% (based on 3-month LIBOR plus 1.48%), with repricing and payments due quarterly. The interest rate of the Trust Preferred Securities issued by Trust I adjust on each quarterly anniversary date to equal the 3-month LIBOR plus 3.40%. The Trust Preferred Securities issued by Trust II adjust on each quarterly anniversary date to equal the 3-month LIBOR plus 1.48%. Both Trusts I and II have the option to defer payment of the distributions for a period of up to five years, as long as the Company is not in default on the payment of interest on the Subordinated Debentures.

Interest expense recognized by the Company for the six months ended June 30, 2018 and 2017 related to the subordinated debentures was $239 thousand and $192 thousand, respectively. Interest expense recognized by the Company for the three months ended June 30, 2018 and 2017 related to the subordinated debentures was $127 thousand and $99 thousand, respectively.

Warrant. On April 15, 2013 the Company issued a $7.5 million subordinated debenture (“subordinated debt”). The subordinated debt was issued to an unrelated third-party pursuant to a subordinated debenture purchase agreement, subordinated debenture note, and stock purchase warrant. On April 16, 2015 the Company paid off the subordinated debt. The subordinated debt had an interest rate of 7.5% per annum and a term of 8 years with no prepayment allowed during the first two years and was made in conjunction with an eight-year warrant to purchase up to 300,000 shares of the Bancorp’s common stock, no par value at an exercise price, subject to anti-dilution adjustments, of $5.25 per share. In May of 2016 the Company repurchased a portion of the warrant, representing the right to purchase 150,000 shares of the registrant’s common stock at a cost of $862 thousand. The remaining warrant represented the right to purchase 150,000 shares of Plumas Bancorp common stock at an exercise price of $5.25 per share was scheduled to expire on April 15, 2021. In May 2017 the warrant was exercised in a cashless exercise resulting in the issuance of 108,112 common shares.

Capital Resources

Shareholders’ equity increased by $3.8 million from $55.7 million at December 31, 2017 to $59.5 million at June 30, 2018. The $3.8 million increase was related to earnings during the first six months of 2018 of $6.7 million and $0.4

million representing stock option activity partially offset by an increase of $2.4 million in the unrealized loss on investment securities and a common stock dividend payment of $0.9 million.

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

On October 20, 2016 the Company announced that its Board of Directors approved the reinstatement of semi-annual cash dividends. On May 15, 2018 the Company paid a $0.18 per share semi-annual cash dividend totaling $920 thousand. This represents an increase of $0.04 or 29%, from the $0.14 per share semi-annual cash dividend paid on May 15, 2017.

Capital Standards. The Company uses a variety of measures to evaluate its capital adequacy. Management reviews these capital measurements monthly and takes appropriate action to ensure that they are within established internal and external guidelines. 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.

In July 2013, the federal bank regulatory agencies approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks, sometimes called "Basel III". The phase-in period for the final rules began in 2015, with certain of the rules' requirements phased in over a multi-year schedule. Under the final rules minimum requirements increased for both the quantity and quality of capital held by the Company and the Bank. The new capital rules include a new minimum "common equity Tier 1" ratio of 4.5%, a Tier 1 capital ratio of 6.0% (increased from 4.0%), a total risk-based capital ratio of 8.0%, and a minimum leverage ratio of 4.0% (calculated as Tier 1 capital to average consolidated assets). The effective date of these requirements was January 1, 2015. In addition, the new capital rules include a capital conservation buffer of 2.5% above each of these levels (to be phased in over three years which beginning at 0.625% on January 1, 2016 and increasing by that amount on each subsequent January 1, until reaching 2.5% on January 1, 2019) will be required for banking institutions to avoid restrictions on their ability to pay dividends, repurchase stock or pay discretionary bonuses. Including the capital conservation buffer of 2.5%, the New Capital Rules would result in the following minimum ratios to be considered well capitalized: (i) a Tier 1 capital ratio of 8.5%, (ii) a common equity Tier 1 capital ratio of 7.0%, and (iii) a total capital ratio of 10.5%. The final rules also implement strict eligibility criteria for regulatory capital instruments.

The Board of Governors of the Federal Reserve System has adopted final amendments to the Small Bank Holding Company Policy Statement (Regulation Y, Appendix C) (the "Policy Statement") that, among other things, raised from $500 million to $1 billion the asset threshold to qualify for the Policy Statement. Plumas Bancorp qualifies for treatment under the Policy Statement and is no longer subject to consolidated capital rules at the bank holding company level. On May 24, 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the Act) was signed into law. The Act included a provision to increase the threshold for qualifying for the Policy Statement from $1 billion to $3 billion in total assets.

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

			Amount of Capital Required			
	Actual		For Capital Adequacy Purposes		To be Well-Capitalized Under Prompt Corrective Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
June 30, 2018						
Common Equity Tier 1 Ratio	$70,986	12.1 %	$26,417	4.5 %	$ 38,157	6.5 %

Tier 1 Leverage Ratio	$70,986	9.6 %	$29,609	4.0 %	$ 37,011	5.0 %
Tier 1 Risk-Based Capital Ratio	$70,986	12.1 %	$35,222	6.0 %	$ 46,963	8.0 %
Total Risk-Based Capital Ratio	$77,935	13.3 %	$46,963	8.0 %	$ 58,704	10.0 %
December 31, 2017						
Common Equity Tier 1 Ratio	$65,085	12.0 %	$24,453	4.5 %	$ 35,321	6.5 %
Tier 1 Leverage Ratio	$65,085	8.8 %	$29,663	4.0 %	$ 37,079	5.0 %
Tier 1 Risk-Based Capital Ratio	$65,085	12.0 %	$32,604	6.0 %	$ 43,472	8.0 %
Total Risk-Based Capital Ratio	$71,878	13.2 %	$43,472	8.0 %	$ 53,340	10.0 %

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

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

Off-Balance Sheet Arrangements

Loan Commitments. In the normal course of business, there are various commitments outstanding to extend credits that are not reflected in the financial statements. Commitments to extend credit and letters of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Annual review of commercial credit lines, letters of credit and ongoing monitoring of outstanding balances reduces the risk of loss associated with these commitments. As of June 30, 2018, the Company had $117.3 million in unfunded loan commitments and $417 thousand in letters of credit. This compares to $107.4 million in unfunded loan commitments and $477 thousand in letters of credit at December 31, 2017. Of the $117.3 million in unfunded loan commitments, $70.6 million and $46.7 million represented commitments to commercial and consumer customers, respectively. Of the total unfunded commitments at June 30, 2018, $69.9 million were secured by real estate, of which $33.6 million was secured by commercial real estate and $36.3 million was secured by residential real estate in the form of equity lines of credit. The commercial loan commitments not secured by real estate primarily represent business lines of credit, while the consumer loan commitments not secured by real estate primarily represent revolving credit card lines and overdraft protection lines. Since some of the commitments are expected to expire without being drawn upon the total commitment amounts do not necessarily represent future cash requirements.

Operating Leases. The Company leases two depository branches and four lending offices and two non-branch automated teller machine locations. Total rental expenses under all operating leases were $183,000 and $91,000 during the six and three months ended June 30, 2018 and $165,000 and $83,000 during the same period in 2017. The expiration dates of the leases vary, with the first such lease expiring during 2018 and the last such lease expiring during 2021.

Liquidity

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

The Company is a member of the FHLB and can borrow up to $198 million from the FHLB secured by commercial and residential mortgage loans with carrying values totaling $314.7 million. See "Short-term Borrowing Arrangements" for additional information on our FHLB borrowing capacity. In addition to its FHLB borrowing line, the Company has unsecured short-term borrowing agreements with three of its correspondent banks in the amounts of $20 million, $11 million and $10 million. There were no outstanding borrowings under the FHLB or the correspondent bank borrowing lines at June 30, 2018 or December 31, 2017.

Customer deposits are the Company's primary source of funds. Total deposits increased by $16.4 million, or 2.5%, from $662.7 million at December 31, 2017 to $679.1 million at June 30, 2018. Deposits are held in various forms with varying maturities. The Company's securities portfolio, Federal funds sold, FHLB advances, and cash and due from banks serve as the primary sources of liquidity, providing adequate funding for loans during periods of high loan demand. During periods of decreased lending, funds obtained from the maturing or sale of investments, loan payments, and new deposits are invested in short-term earning assets, such as cash held at the FRB, Federal funds sold and investment securities, to serve as a source of funding for future loan growth. Management believes that the Company's available sources of funds, including borrowings, will provide adequate liquidity for its operations in the foreseeable future.

Recent Developments. On May 22, 2018 the Company announced that Plumas Bank had signed a purchase and assumption agreement to acquire the Carson City, Nevada branch of Mutual of Omaha Bank. The transaction, will result in the acquisition of approximately $50 million in deposits and less than $2 million in loans. Plumas Bank has received regulatory approval for the transaction which is expected to close later in 2018.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not required.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company's management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of June 30, 2018. The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of June 30, 2018.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended June 30, 2018 that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

Item 1A RISK FACTORS

There have been no material changes to the principal risks that we believe are material to our business, results of operations and financial condition, from the risk factors previously disclosed in the 2017 Annual Report on Form 10-K. For a discussion on these risk factors, please see “Item 1A. Risk Factors” contained in the 2017 Annual Report on Form 10-K.

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

(a) None.

(b) None.

(c) None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

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

3.1	Articles of Incorporation as amended of Registrant included as exhibit 3.1 to the Registrant's Form S-4, File No. 333-84534, which is incorporated by reference herein.
3.2	Bylaws of Registrant as amended on March 16, 2011 included as exhibit 3.2 to the Registrant's Form 10-K for December 31, 2010, which is incorporated by this reference herein.
3.3	Amendment of the Articles of Incorporation of Registrant dated November 1, 2002, is included as exhibit 3.3 to the Registrant's 10-Q for September 30, 2005, which is incorporated by this reference herein.
3.4	Amendment of the Articles of Incorporation of Registrant dated August 17, 2005, is included as exhibit 3.4 to the Registrant's 10-Q for September 30, 2005, which is incorporated by this reference herein.
4	Specimen form of certificate for Plumas Bancorp included as exhibit 4 to the Registrant's Form S-4, File No. 333-84534, which is incorporated by reference herein.
10.1	Executive Salary Continuation Agreement of Andrew J. Ryback dated December 17, 2008, is included as exhibit 10.1 to the Registrant's 10-K for December 31, 2008, which is incorporated by this reference herein.
10.2	Split Dollar Agreement of Andrew J. Ryback dated August 23, 2005, is included as Exhibit 10.2 to the Registrant's 8-K filed on October 17, 2005, which is incorporated by this reference herein.
10.4	Stock Purchase Warrant dated April 15, 2013, is included as Exhibit 10.4 to the Registrant's 10-Q filed on May 10, 2013, which is incorporated by this reference herein.
10.8	Director Retirement Agreement of John Flournoy dated March 21, 2007, is included as Exhibit 10.8 to Registrant's 10-Q for March 31, 2007, which is incorporated by this reference herein.
10.9	Amendment to Salary Continuation Agreement of Andrew J. Ryback dated April 1, 2016, is included as Exhibit 10.1 to the Registrant's 8-K filed on April 4, 2016, which is incorporated by this reference herein.
10.10	Salary Continuation Agreement of Richard L. Belstock dated April 1, 2016, is included as Exhibit 10.2 to the Registrant's 8-K filed on April 4, 2016, which is incorporated by this reference herein.
10.11	Salary Continuation Agreement of Kerry D. Wilson dated April 1, 2016, is included as Exhibit 10.3 to the Registrant's 8-K filed on April 4, 2016, which is incorporated by this reference herein.
10.12	Salary Continuation Agreement of BJ North dated April 1, 2016, is included as Exhibit 10.4 to the Registrant's 8-K filed on April 4, 2016, which is incorporated by this reference herein.
10.13	

	Director Retirement Agreement of Steven M. Coldani dated December 21, 2016, is included as Exhibit 10.13 to the Registrant's 10-K filed on March 17, 2017, which is incorporated by this reference herein.
10.18	Amended and Restated Director Retirement Agreement of Daniel E. West dated May 10, 2000, is included as Exhibit 10.18 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
10.19	Consulting Agreement of Daniel E. West dated May 10, 2000, is included as Exhibit 10.19 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
10.24	Amended and Restated Director Retirement Agreement of Gerald W. Fletcher dated May 10, 2000, is included as Exhibit 10.24 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
10.25	Consulting Agreement of Gerald W. Fletcher dated May 10, 2000, is included as Exhibit 10.25 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
10.33	Amended and Restated Director Retirement Agreement of Terrance J. Reeson dated April 19, 2000, is included as Exhibit 10.33 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.

10.34	Consulting Agreement of Terrance J. Reeson dated May 10, 2000, is included as Exhibit 10.34 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
10.41	Form of Indemnification Agreement (Plumas Bancorp) is included as Exhibit 10.41 to the Registrant's 10-Q for March 31, 2009, which is incorporated by this reference herein.
10.42	Form of Indemnification Agreement (Plumas Bank) is included as Exhibit 10.42 to the Registrant's 10-Q for March 31, 2009, which is incorporated by this reference herein.
10.47	2013 Stock Option Plan is included as exhibit 99.1 of the Form S-8 filed September 12, 2013, which is incorporated by this reference herein.
10.48	Specimen Form of Incentive Stock Option Agreement under the 2013 Stock Option Plan is included as exhibit 99.2 of the Form S-8 filed September 12, 2013, which is incorporated by this reference herein.
10.49	Specimen Form of Nonqualified Stock Option Agreement under the 2013 Stock Option Plan is included as exhibit 99.3 of the Form S-8 filed September 12, 2013, which is incorporated by this reference herein.
10.51	First Amendment to Split Dollar Agreement of Andrew J. Ryback, is included as exhibit 10.51 to the Registrant's 10-K for December 31, 2008, which is incorporated by this reference herein.
10.66	Director Retirement Agreement of Robert McClintock, is included as Exhibit 10.66 to the Registrant's 10-K filed on March 23, 2012, which is incorporated by this reference herein.
10.67	First Amendment to the Plumas Bank Amended and Restated Director Retirement Agreement for Terrance J. Reeson adopted on September 19, 2007, is included as Exhibit 10.67 to the Registrant's 8-K filed on September 25, 2007, which is incorporated by this reference herein.
10.69	First Amendment to the Plumas Bank Amended and Restated Director Retirement Agreement for Daniel E. West adopted on September 19, 2007, is included as Exhibit 10.69 to the Registrant's 8-K filed on September 25, 2007, which is incorporated by this reference herein.
10.70	First Amendment to the Plumas Bank Amended and Restated Director Retirement Agreement for Gerald W. Fletcher adopted on October 9, 2007, is included as Exhibit 10.70 to the Registrant's 10-Q for September 30, 2007, which is incorporated by this reference herein.
31.1*	Rule 13a-14(a) [Section 302] Certification of Principal Financial Officer dated August 2, 2018.
31.2*	Rule 13a-14(a) [Section 302] Certification of Principal Executive Officer dated August 2, 2018.
32.1*	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 dated August 2, 2018.
32.2*	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 dated August 2, 2018.
101.INS*	XBRL Instance Document.

101.SCH*	XBRL Taxonomy Schema.
101.CAL*	XBRL Taxonomy Calculation Linkbase.
101.DEF*	XBRL Taxonomy Definition Linkbase.
101.LAB*	XBRL Taxonomy Label Linkbase.
101.PRE*	XBRL Taxonomy Presentation Linkbase.
*	Filed herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PLUMAS BANCORP
(Registrant)
Date: August 2, 2018

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

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

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