



INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders
of Willamette Community Bank

Report on the Financial Statements

We have audited the accompanying financial statements of Willamette Community Bank, which comprise the statements of financial condition as of December 31, 2012 and 2011, and the related statements of income and comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, and implementation of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Willamette Community Bank as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Boldt Carlisle + Smith

Salem, Oregon
March 6, 2013

WILLAMETTE COMMUNITY BANK
STATEMENTS OF FINANCIAL CONDITION
December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
<u>ASSETS</u>		
Cash and due from banks	\$ 7,745,731	\$ 2,875,018
Investment securities available for sale	13,719,711	14,711,412
Mortgage loans held for sale	593,303	116,095
Loans, net	60,792,353	58,804,034
Pacific Coast Bankers' Bank (PCBB) stock	100,000	100,000
Federal Home Loan Bank (FHLB) stock	53,200	50,500
Premises and equipment, net	1,782,860	1,820,722
Prepaid FDIC assessment	121,735	169,513
Accrued interest and other assets	656,583	696,106
	<u>\$ 85,565,476</u>	<u>\$ 79,343,400</u>
<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>		
<u>LIABILITIES</u>		
Deposits:		
Demand	\$ 15,522,762	\$ 10,528,742
Interest-bearing demand	19,160,940	22,195,527
Money market	16,887,252	14,662,897
Savings	7,083,800	3,265,852
Time	18,343,104	21,210,971
	<u>76,997,858</u>	<u>71,863,989</u>
Total deposits	76,997,858	71,863,989
Accrued interest and other liabilities	<u>145,983</u>	<u>139,111</u>
Total liabilities	77,143,841	72,003,100
<u>SHAREHOLDERS' EQUITY</u>		
Common stock, 816,108 and 668,147 shares issued and outstanding at December 31, 2012 and December 31, 2011, respectively	7,526,977	6,736,481
Accumulated surplus	857,999	608,766
Accumulated other comprehensive income (loss)	36,659	(4,947)
	<u>8,421,635</u>	<u>7,340,300</u>
Total shareholders' equity	8,421,635	7,340,300
Total liabilities and shareholders' equity	<u>\$ 85,565,476</u>	<u>\$ 79,343,400</u>

See accompanying notes

WILLAMETTE COMMUNITY BANK
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
INTEREST INCOME		
Interest and fees on loans	\$ 3,774,475	\$ 3,671,370
Taxable interest on investment securities	159,805	309,745
Other interest income	<u>13,589</u>	<u>10,435</u>
Total interest income	<u>3,947,869</u>	<u>3,991,550</u>
INTEREST EXPENSE		
Deposits:		
Interest-bearing demand, money market and savings	301,404	403,580
Time	200,028	289,570
Borrowing	<u>464</u>	<u>-</u>
Total interest expense	<u>501,896</u>	<u>693,150</u>
Net interest income	3,445,973	3,298,400
Loan loss provision	<u>298,000</u>	<u>4,000</u>
Net interest income after loan loss provision	<u>3,147,973</u>	<u>3,294,400</u>
NON-INTEREST INCOME		
Service charges on deposit accounts	65,530	59,601
Mortgage-loan income	207,168	82,193
Interchange fee income	135,644	110,230
(Loss) on other real estate owned	(40,500)	-
Gains on sales and early redemptions of securities	9,250	942
Other	<u>32,447</u>	<u>39,382</u>
Total non-interest income	<u>409,539</u>	<u>292,348</u>
NON-INTEREST EXPENSE	<u>3,146,079</u>	<u>2,952,145</u>
Income before income taxes	411,433	634,603
Provision for income taxes	<u>162,200</u>	<u>234,700</u>
NET INCOME	<u>249,233</u>	<u>399,903</u>
OTHER COMPREHENSIVE INCOME		
Unrealized holding gains (losses) arising during period	53,100	(194,792)
Reclassification adjustment for gains (losses) included in net income	<u>14,850</u>	<u>(3,371)</u>
Other comprehensive income before income taxes	67,950	(198,163)
Income tax expense related to items of other comprehensive income	<u>26,344</u>	<u>(73,320)</u>
Other comprehensive income, net of tax	<u>41,606</u>	<u>(124,843)</u>
Comprehensive income	<u>\$ 290,839</u>	<u>\$ 275,060</u>
Basic earnings per common share	<u>\$ 0.33</u>	<u>\$ 0.60</u>
Diluted earnings per common share	<u>N/A</u>	<u>N/A</u>
Weighted average common shares outstanding:		
Basic	745,487	668,147
Diluted	N/A	N/A

See accompanying notes

WILLAMETTE COMMUNITY BANK
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31, 2012 and 2011

	<u>Number of shares</u>	<u>Common stock</u>	<u>Retained earnings</u>	<u>Accumulated other comprehensive income (loss)</u>	<u>Total shareholders' equity</u>
<u>2011</u>					
Balances at December 31, 2010	668,147	\$6,736,481	\$ 208,863	\$ 119,896	\$ 7,065,240
Comprehensive income:					
Net income			399,903		399,903
Other comprehensive income				(124,843)	<u>(124,843)</u>
Total comprehensive income					275,060
Issuance of common stock	<u>-</u>	<u>-</u>			<u>-</u>
Balances at December 31, 2011	668,147	6,736,481	608,766	(4,947)	7,340,300
<u>2012</u>					
Comprehensive income:					
Net income			249,233		249,233
Other comprehensive income				41,606	<u>41,606</u>
Total comprehensive income					290,839
Issuance of common stock	<u>147,961</u>	<u>790,496</u>			<u>790,496</u>
Balances at December 31, 2012	<u>816,108</u>	<u>\$7,526,977</u>	<u>\$ 857,999</u>	<u>\$ 36,659</u>	<u>\$ 8,421,635</u>

See accompanying notes

WILLAMETTE COMMUNITY BANK
STATEMENTS OF CASH FLOWS
Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 249,233	\$ 399,903
Adjustments to reconcile net income to net cash provided by operating activities:		
Loan loss provision	298,000	4,000
Deferred income taxes	14,121	(23,439)
Depreciation and amortization	183,364	176,751
Net amortization of premiums/discounts on investment securities	323,412	165,485
Gains on sales and early redemptions of securities	(9,250)	(942)
Loss on disposition of equipment	5,847	1,352
Mortgage loan originations, net	(477,208)	(116,095)
Changes in certain assets and liabilities:		
Accrued interest and other assets	(11,804)	(33,765)
Accrued interest and other liabilities	6,872	(4,419)
	<u>582,587</u>	<u>568,831</u>
Net cash provided by operating activities		
CASH FLOWS FROM INVESTING ACTIVITIES		
Certificates of deposits:		
Maturities	-	490,000
Investment securities available for sale:		
Purchases	(12,116,312)	(12,552,445)
Maturities, sales, early redemptions and principal reductions	12,861,802	10,206,130
Net (increase) in loans	(2,286,321)	(1,962,608)
Net decrease in other real estate owned	40,500	-
Purchases of premises and equipment	(130,544)	(88,539)
Purchases of computer software	(2,664)	(13,359)
Purchase of FHLB stock	(2,700)	-
	<u>(1,636,239)</u>	<u>(3,920,821)</u>
Net cash (used in) investing activities		
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in deposits	5,133,869	(6,165,805)
Issuance of common stock	790,496	-
	<u>5,924,365</u>	<u>(6,165,805)</u>
Net cash provided by financing activities		
Net increase (decrease) in cash and cash equivalents	4,870,713	(9,517,795)
Cash and cash equivalents at beginning of year	<u>2,875,018</u>	<u>12,392,813</u>
Cash and cash equivalents at end of year	<u>\$ 7,745,731</u>	<u>\$ 2,875,018</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	<u>\$ 559,008</u>	<u>\$ 720,954</u>
Cash paid for income taxes	<u>\$ 187,439</u>	<u>\$ 263,971</u>

See accompanying notes

WILLAMETTE COMMUNITY BANK

NOTES TO FINANCIAL STATEMENTS Years Ended December 31, 2012 and 2011

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Willamette Community Bank (the Bank) is a state-chartered, FDIC-insured institution headquartered at 333 Lyon St. SE, Albany, Oregon. The Bank offers a full range of traditional banking products and services, primarily to business, professional and consumer customers located in Linn and Benton counties of Oregon. The Bank is subject to the regulations of certain federal and state agencies and undergoes periodic examination by those regulatory authorities.

Method of accounting

The Bank prepares its financial statements in conformity with accounting principles generally accepted in the United States and prevailing practices within the banking industry. The Bank uses the accrual method of accounting, which recognizes income when earned and expenses when incurred. The preparation of financial statement in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the Bank's financial statements. Actual results could differ from those estimated.

Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and federal funds sold.

Investment securities available for sale

Investment securities available for sale are reported at fair value with changes in unrealized gains and losses excluded from earnings and reported in shareholders' equity as other comprehensive income or loss, net of income taxes.

Gains and losses on sales of investment securities available for sale are recognized on a specific identification basis. Premiums and discounts on investment securities available for sale are recognized into interest income using the interest method over the life of the security.

Declines in the fair value of investment securities available for sale below their cost that are other than temporary would result in write-downs of the individual securities to their fair value. Any write-downs would also be included in earnings as realized losses.

Loans

Loans are reported at their outstanding principal balance less the allowance for loan losses and unearned income (deferred loan fees).

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans (continued)

The Bank has established a systematic and consistently applied process to determine and maintain an adequate allowance for loan losses (allowance), also known as the loan loss reserve, in accordance with generally accepted accounting principles and regulatory guidance. The allowance amounts and related loss provisions are determined based on management's current assessment of loan portfolio quality and include consideration of all known relevant internal and external factors affecting loan quality. The Bank's methodology for evaluating allowance adequacy primarily involves following the requirements of Accounting Standards Codification ("ASC") topics *Loss Contingencies* and *Loan Impairment*. Certain loans are individually evaluated for impairment pursuant to ASC topic *Loan Impairment*. A loan is considered impaired when, based on current information and events, management believes it is probable that all amounts due will not be collected according to the contractual terms of the loan agreement. Loan impairment is measured based either on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the observable market price of the loan or the fair value of the collateral if the loan is collateral dependent. For purposes of determining the allowance for loan losses, all troubled-debt-restructured loans are treated as impaired. Loans that are individually impaired are excluded from the *Loss Contingencies* component of the allowance methodology. Under ASC topic *Loss Contingencies*, loans not individually impaired are pooled by assigned credit risk ratings and collectively evaluated for impairment by applying appropriate loss allocation factors to each risk-rating loan pool. Unfunded loan commitments ("commitments") are also evaluated for impairment under ASC topic *Loss Contingencies*. As with loans, commitments are pooled by assigned credit risk ratings with each pool evaluated for impairment by applying the same loss allocation factors as those applied to loans. The commitment reserve is maintained as a separate liability account. Beginning in 2012, the commitment loss provision was recognized into the reserve through non-interest expense rather than the loan loss provision, which was the prior practice. Certain 2011 amounts have been re-stated consistent with this change. The commitment loss provisions for 2012 and 2011 were (\$1,000) and \$15,000, respectively. The Bank's historical charge-off experience is the primary basis supporting the loss allocation factors used to estimate collective impairment. Because of the Bank's relatively short operating history and limited charge-off experience, as a prudent practice the Bank continued to maintain the reserve at no less than 1.25% of gross loans, adjusted for certain high-quality accounts.

In determining allowance adequacy, management subjectively evaluates certain current environmental factors, which may result in further adjustments to the allowance. Those factors include:

- Problem loan trends.
- Charge-off and recovery trends.
- Trends in volume and terms of loans.
- Effects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedures and practices.
- Experience, ability and depth of lending management and other relevant staff.
- National and local economic trends and conditions.
- Industry conditions.
- Effects and changes in credit concentrations.

The allowance is based on estimates, and ultimate losses may vary from current estimates. The allowance is increased by charges to income (loss provisions) and decreased by charge-offs, net of recoveries. Loans are charged against the allowance when management believes that collection of the principal is unlikely.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans (continued)

Regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance. Such agencies may require the Bank to recognize additions to the allowance based on their assessment of the information available to them at the time of their examination.

Loan origination fees, net of loan origination costs, are deferred and recognized as an adjustment of yield over the life of the related loan.

Interest income on all loans is accrued as earned using the simple interest method. Accrual of interest is discontinued when the repayment of principal and interest is doubtful or when a loan is 90 days past due unless it is well secured and in the process of collection. When the accrual of interest is discontinued, all unpaid, accrued interest is reversed. The interest on these loans is recognized on a cash basis until the loan qualifies for return to accrual status. Loans are returned to accrual status when principal and interest are contractually current and future payments are reasonably assured.

Mortgage loans, held for sale

The Bank's activities include the origination and sale of residential mortgage loans. Mortgage-loan originations and sales occur on a pre-sold basis pursuant to contractual arrangements with various wholesale lenders. Mortgage-loan sales include the servicing rights and are subject to certain repurchase risks.

Held-for-sale mortgage loans must be carried at the lower of cost or estimated market value. During 2012 and 2011 all such loans were carried at cost because of the contractual arrangements involved. If applicable, market value would be determined on an individual-loan basis.

Pacific Coast Bankers' Bank and Federal Home Loan Bank Stock

The Bank's investment in Pacific Coast Bankers' Bank (PCBB) and Federal Home Loan Bank (FHLB) stock is carried at cost, which approximates fair value.

PCBB stock is not publicly traded and is subject to resale restrictions. Ownership is limited by statute to depository institutions or holding companies of depository institutions.

FHLB stock is not publicly traded and is subject to redemption restrictions. Ownership is limited to FHLB member financial institutions.

Premises and equipment, computer software

Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of two to 39 years. For consistency with regulatory reporting requirements, most computer software is included in other assets at cost, less accumulated amortization. Software amortization is computed using the straight-line method over three years and is included in data processing expenses.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income taxes

Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities will be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Management has evaluated tax positions taken and has determined that any uncertainty in those positions would not have a material effect on the financial statements.

New accounting standards adopted

During 2012, the Bank adopted Accounting Standards Updates No. 2011-02 "A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring" and No. 2011-12 "Presentation of Comprehensive Income."

2. INVESTMENT SECURITIES AVAILABLE FOR SALE

Investment securities available for sale consisted of the following at December 31, 2012:

Description	Book value	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U.S. Government agency notes	\$ 1,000,000	\$ -	\$ (365)	\$ 999,635
U.S. agency mortgaged-backed securities	803,330	19,000	-	822,330
U.S. agency collateralized mortgage obligations	10,691,734	44,295	(20,762)	10,715,267
Corporate debt obligations	1,164,550	17,930	-	1,182,479
	<u>\$ 13,659,614</u>	<u>\$ 81,224</u>	<u>\$ (21,127)</u>	<u>\$ 13,719,711</u>

Investment securities available for sale consisted of the following at December 31, 2011:

Description	Book value	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U.S. government agency notes	\$ 1,499,325	\$ 3,632	\$ -	\$ 1,502,957
U.S. agency mortgage-backed securities	385,835	6,404	(831)	391,408
U.S. agency collateralized mortgage obligations	9,613,009	38,657	(33,588)	9,618,077
Corporate debt obligations	3,221,097	30,456	(52,582)	3,198,970
	<u>\$ 14,719,265</u>	<u>\$ 79,148</u>	<u>\$ (87,001)</u>	<u>\$ 14,711,412</u>

2. INVESTMENT SECURITIES AVAILABLE FOR SALE (Continued)

Investment securities with unrealized losses at December 31, 2012 were as follows:

Description	Continuous unrealized loss for less than 12 months		Continuous unrealized loss for more than 12 months		Total	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
Agency	\$ 999,635	\$ (365)	\$ --	\$ --	\$ 999,635	\$ (365)
Collateralized mortgage obligations	<u>5,010,658</u>	<u>(20,761)</u>	<u>614</u>	<u>(1)</u>	<u>5,011,273</u>	<u>(20,762)</u>
	<u>\$ 6,010,293</u>	<u>\$ (21,126)</u>	<u>\$ 614</u>	<u>\$ (1)</u>	<u>\$6,010,908</u>	<u>\$ (21,127)</u>

All securities held are investment grade with no credit losses anticipated. Management believes that unrealized losses are solely due to market conditions and temporary in nature. The Bank currently has the ability to hold these securities until maturity or until market conditions favorably affect value.

The amortized cost and estimated fair value of investment securities available for sale at December 31, 2012, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Book value	Estimated fair value
Due in one year or less	\$ 500,185	\$ 507,280
Due after one through five years	664,365	675,199
Due after five through ten years	--	--
Due after ten years	1,000,000	999,635
Collateralized mortgage obligations and mortgaged-backed	<u>11,495,064</u>	<u>11,537,597</u>
Total	<u>\$ 13,659,614</u>	<u>\$ 13,719,711</u>

At December 31, 2012 and 2011, no available-for-sale securities were pledged for any purpose.

3. LOANS

Loans consisted of the following at December 31, 2012 and 2011:

	2012	2011
Real estate	\$ 43,697,716	\$ 41,649,116
Commercial and agricultural	15,949,617	16,747,321
Consumer	1,663,889	992,108
Other	<u>427,617</u>	<u>308,746</u>
	61,738,839	59,697,291
Less unearned loan fees	(183,207)	(155,075)
Less allowance for loan losses	<u>(763,279)</u>	<u>(738,182)</u>
Loans, net	<u>\$ 60,792,353</u>	<u>\$ 58,804,034</u>

3. LOANS (Continued)

Transactions in the allowance for loan losses for the years ended December 31, 2012 and 2011 were as follows:

	<u>2012</u>	<u>2011</u>
Balance at beginning of year	\$ 738,182	\$ 800,909
Loan loss provision	298,000	4,000
Loans charged-off	(273,278)	(66,727)
Loan recoveries	<u>375</u>	<u>--</u>
Balance at end of year	<u>\$ 763,279</u>	<u>\$ 738,182</u>
Ending balance: individually evaluated for impairment	<u>\$ 1,000</u>	<u>\$ 700</u>
Ending balance: collectively evaluated for impairment	<u>\$ 762,279</u>	<u>\$ 737,482</u>

Loans on non-accrual status as of December 31, 2012 and 2011 were as follows:

	<u>2012</u>	<u>2011</u>
Real estate	<u>\$ 76,421</u>	<u>\$ --</u>

Lost interest income on non-accrual loans for 2012 amounted to \$35,532.

An aged analysis of past due loans as of December 31, 2012 and 2011 is as follows:

	Over			Current	Total Loans	Over 90 Days and Accruing
	30-89 Days Past Due	90 Days Past Due	Total Past Due			
<u>2012</u>						
Real estate	\$ -	\$ 521,159	\$ 521,159	\$ 43,176,557	\$ 43,697,716	\$ 444,101
Commercial and agricultural	-	-	-	15,949,617	15,949,617	-
Consumer	-	-	-	1,663,889	1,663,889	-
Other	-	-	-	427,617	427,617	-
Total	<u>\$ -</u>	<u>\$ 521,159</u>	<u>\$ 521,159</u>	<u>\$ 61,217,680</u>	<u>\$ 61,738,839</u>	<u>\$ 444,101</u>
<u>2011</u>						
Real estate	\$ -	\$ -	\$ -	\$ 41,649,116	\$ 41,649,116	\$ -
Commercial and agricultural	-	-	-	16,747,321	16,747,321	-
Consumer	-	-	-	992,108	992,108	-
Other	-	-	-	308,746	308,746	-
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 59,697,291</u>	<u>\$ 59,697,291</u>	<u>\$ -</u>

3. LOANS (Continued)

Impaired loans as of December 31, 2012 and 2011 were as follows:

<u>2012</u>	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Real estate	\$ 521,159	\$ 738,159	\$ -	\$ 698,181	\$ 56,359
Commercial and agricultural	721,890	721,890	-	736,662	51,976
With a related allowance recorded:					
Commercial and agricultural	34,050	34,050	1,000	38,881	2,722
	<u>\$ 1,277,099</u>	<u>\$ 1,494,099</u>	<u>\$ 1,000</u>	<u>\$ 1,473,724</u>	<u>\$ 111,057</u>
<u>2011</u>					
With no related allowance recorded:					
Real estate	\$ 294,829	\$ 294,829	\$ -	\$ 294,829	\$ 9,715
With a related allowance recorded:					
Commercial and agricultural	43,640	43,640	700	44,637	1,380
	<u>\$ 338,470</u>	<u>\$ 338,470</u>	<u>\$ 700</u>	<u>\$ 339,466</u>	<u>\$ 11,095</u>

Credit quality indicators - The Bank's risk-rating methodology assigns risk ratings ranging from 1 (lowest risk) to 8 (highest risk) with the categories generally described as follows:

Pass (risk rated 1 through 4) – These loans include those with minimal to acceptable levels of credit risk.

Special Mention (risk rated 5) – A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Bank's credit position at some future date. Special Mention loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

Substandard (risk rated 6) – Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful (risk rated 7) – Loans classified Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently know facts, conditions and values, highly questionable and improbable.

Loss (risk rated 8) – Loans classified Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future.

3. LOANS (Continued)

Loans by credit quality indicators as of December 31, 2012 and 2011 were as follows:

	<u>2012</u>	Real Estate	Commercial and Agricultural	Consumer	Other
Grade:					
Pass		\$ 39,881,927	\$ 13,728,815	\$ 1,663,889	\$ 427,617
Special mention		2,241,893	983,461	-	-
Substandard		1,573,896	1,237,341	-	-
Doubtful		-	-	-	-
Loss		-	-	-	-
Total		<u>\$ 43,697,716</u>	<u>\$ 15,949,617</u>	<u>\$ 1,663,889</u>	<u>\$ 427,617</u>
	<u>2011</u>				
Grade:					
Pass		\$ 38,309,744	\$ 14,820,196	\$ 992,108	\$ 308,746
Special mention		1,526,869	1,568,097	-	-
Substandard		1,812,503	359,028	-	-
Doubtful		-	-	-	-
Loss		-	-	-	-
Total		<u>\$ 41,649,116</u>	<u>\$ 16,747,321</u>	<u>\$ 992,108</u>	<u>\$ 308,746</u>

Troubled debt restructurings – A troubled debt restructuring occurs when a creditor, for economic or legal reasons related to the debtor's financial difficulties, makes a concession to a debtor that it would not otherwise consider. The concession may involve a settlement of the debt for less than its carrying value and/or a modification of the debt terms. At December 31, 2012 and 2011, \$832,361 and \$338,470 in loans were classified as troubled debt restructurings. Newly restructured loans during the years ended December 31, 2012 and 2011 were as follows:

	<u>2012</u>	Number of Contracts	Outstanding Recorded Investment Before Modification	Outstanding Recorded Investment After Modification	Concession(s) Granted	Impairment Amount at December 31st
Commercial and agricultural		5	\$ 721,890	\$ 721,890	Note term(s)	\$ -
	<u>2011</u>					
Commercial and agricultural		2	44,535	44,535	Note term(s)	700

4. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following at December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Land and improvements	\$ 336,939	\$ 336,939
Leasehold improvements	435,411	435,411
Building	1,093,374	1,092,779
Furniture and equipment	<u>797,620</u>	<u>691,648</u>
	2,663,344	2,556,777
Less accumulated depreciation	<u>(880,484)</u>	<u>(736,055)</u>
Premises and equipment, net	<u>\$ 1,782,860</u>	<u>\$ 1,820,722</u>

Depreciation expense was \$162,559 and \$155,106 for the years ended December 31, 2012 and 2011, respectively. Software amortization expense was \$20,805 and \$21,645 for the years ended December 31, 2012 and 2011, respectively.

5. TIME DEPOSITS

Time deposits of \$100,000 or more aggregated \$11,561,216 and \$13,181,676 at December 31, 2012 and 2011, respectively. At December 31, 2012, the scheduled annual maturities of all time deposits were as follows:

2013	\$ 10,638,050
2014	4,021,479
2015	2,923,122
2016	197,362
2017	<u>563,091</u>
Total	<u>\$ 18,343,104</u>

6. BORROWINGS

The Bank had no borrowings outstanding at December 31, 2012 and 2011.

At December 31, 2012, the Bank had borrowing availability of approximately \$1.5 million under its Cash Management Advance (“CMA”) facility with the Federal Home Loan Bank of Seattle. The CMA facility is secured by multifamily, residential-mortgage loans. In addition, the Bank maintains an unsecured \$2.5 million federal funds facility with its primary correspondent bank, Pacific Coast Bankers’ Bank. Both facilities were fully available at December 31, 2012. The Bank also maintains a discount window primary credit facility with the Federal Reserve Bank of San Francisco, which had a fully available borrowing limit of approximately \$1.3 million at December 31, 2012. The discount window facility is secured by commercial real estate loans.

7. NON-INTEREST EXPENSE

Non-interest expense consisted of the following for the years ended December 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Salaries and employee benefits	\$ 1,532,476	\$ 1,419,269
Premises and equipment	411,964	387,837
Data processing	466,430	430,301
Business development	108,917	107,725
Legal and professional	169,131	148,991
Other	<u>457,161</u>	<u>458,022</u>
Total non-interest expense	<u>\$ 3,146,079</u>	<u>\$ 2,952,145</u>

8. INCOME TAXES

The provision for income taxes in the statements of income was as follows:

	<u>2012</u>	<u>2011</u>
Current		
Federal	\$ 120,899	\$ 209,798
State	<u>27,180</u>	<u>48,341</u>
	<u>148,079</u>	<u>258,139</u>
Deferred		
Federal	11,132	(21,077)
State	<u>2,989</u>	<u>(2,362)</u>
	<u>14,121</u>	<u>(23,439)</u>
	<u>\$ 162,200</u>	<u>\$ 234,700</u>

Reconciliation between the provision for taxes on income and the expected provision from applying federal statutory rates to income before taxes is as follows:

	<u>2012</u>	<u>2011</u>
Expected tax at statutory rates	\$ 139,887	\$ 215,765
State taxes, net of federal benefit	20,638	27,643
Other	<u>1,675</u>	<u>(8,708)</u>
	<u>\$ 162,200</u>	<u>\$ 234,700</u>

8. INCOME TAXES (Continued)

The deferred tax effect of each significant item that created deferred benefits is as follows:

	<u>2012</u>	<u>2011</u>
Loan loss provision	\$ 267,095	\$ 279,529
Market adjustment on investment securities available for sale	(23,210)	3,055
Accrued interest receivable	(123,795)	(113,130)
Prepaid expenses	(37,735)	(37,426)
Difference in depreciation	(80,390)	(82,741)
Accrued interest payable	8,600	13,121
Accrued expenses	20,835	24,097
Valuation adjustment on other real estate owned	<u>16,800</u>	<u>--</u>
Total deferred tax benefits	<u>\$ 48,200</u>	<u>\$ 86,505</u>

If applicable, the Bank would recognize interest accrued for income-tax liabilities in interest expense and income-tax penalties in operating expenses. The Bank's tax years ending December 31, 2009, 2010, 2011 and 2012 remain subject to examination by major tax jurisdictions.

9. OFF-BALANCE-SHEET FINANCIAL INSTRUMENTS

In the ordinary course of business, the Bank enters into various transactions that currently include commitments to extend credit and standby letters of credit, which are not included in the accompanying statements of financial condition. The Bank applies the same credit standards to these commitments as it uses in all of its lending processes and includes these commitments in its lending risk evaluations. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments.

The Bank's off-balance-sheet financial instruments at December 31, 2012 and 2011 were as follows:

	<u>2012</u>	<u>2011</u>
Commitments to extend credit by type:		
Real estate	\$ 2,447,260	\$ 1,892,266
Commercial and agricultural	5,877,966	6,524,463
Consumer	269,692	191,366
Other	394,670	--
Standby letters of credit	17,000	17,000

Commitments to extend credit are agreements to lend to customers. These commitments have specified interest rates and generally have fixed expiration dates but may be terminated by the Bank if certain conditions of the contract are violated. Although subject to drawdown, some of these commitments may expire or terminate without funding. Therefore, the total commitment amounts do not necessarily represent future cash requirements. Collateral relating to these commitments varies, but may include cash, accounts receivable, inventories, equipment, securities and real estate.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party, and the credit risk involved is the possibility a customer may be unable to repay the Bank in the event the letter of credit is drawn down due to performance default. Collateral relating to these commitments varies, but may include cash, accounts receivable, inventories, equipment, securities and real estate.

9. OFF-BALANCE-SHEET FINANCIAL INSTRUMENTS (Continued)

The Bank maintains a reserve for off-balance-sheet credit exposure representing management's recognition of the assumed risks of extending credit. The reserve for off-balance-sheet credit exposure totaled \$25,000 and \$26,000 at December 31, 2012 and 2011, respectively, and is included with accrued interest and other liabilities in the accompanying statements of financial condition.

10. ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. The Bank uses third-party pricing vendors, quoted market prices or present value techniques to estimate the fair values of its fixed-rate financial instruments. These valuation techniques are based on observable and unobservable inputs, which create the following fair value hierarchy:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations based on observable inputs or value drivers.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liability. Unobservable inputs are used to measure fair value to the extent that observable inputs are not available.

During 2012 and 2011 there were no transfers of assets or liabilities among the three levels of the fair value hierarchy. Fair value measurements based on Level 3 inputs are produced internally by the Bank's CFO solely to satisfy disclosure requirements.

The carrying amounts of variable- and administered-rate financial instruments are generally considered reasonable estimates of fair value.

Valuation methods require considerable judgment, and the resulting estimates of fair value can be significantly affected by the assumptions made and methods used. Accordingly, the estimates provided herein do not necessarily indicate amounts that could be realized in a current market exchange.

In addition, as the Bank normally intends to hold the majority of its financial instruments until maturity, it does not expect to realize most of the estimated amounts disclosed. The disclosures also do not include estimated fair value amounts for items that are not defined as financial instruments but which have significant value. These include such off-balance-sheet items as core deposit intangibles.

Because the estimated fair value disclosures exclude certain financial instruments and all non-financial assets, any aggregation of the fair value amounts presented would not represent the underlying value of the Bank.

The Bank used the following methods and assumptions to estimate the fair value of its financial instruments:

Cash and cash equivalents: The carrying amount approximates the estimated fair value.

Investment securities available-for-sale: The estimated fair value was provided by the Bank's bond accounting service, Vining-Sparks IBG, L.P ("Vining Sparks"). To evaluate the Bank's bond-portfolio pricing, Vining Sparks uses third-party pricing vendors.

10. ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Loans: The fair value of fixed-rate loans was generally estimated by discounting their anticipated cash flows using the assumed current market rate applicable to the overall weighted-average years to re-pricing. Variable-rate loans, including those currently at contractual floor rates, were fair valued at par. Resulting amounts were adjusted to estimate the effects of changes in credit quality of borrowers since the loans were originated.

PCBB and FHLB stock: The carrying amounts approximated fair value.

Deposits: The estimated fair value of deposits with no defined maturities, consisting of transaction and savings accounts, is represented by the amounts payable on demand at the reporting date. The carrying amount of variable-rate time deposits approximated fair value. The estimated fair value of fixed-rate time deposits was calculated using a present-value technique applying FDIC-reported, national-average rates corresponding to the overall weighted-average maturity of the portfolio.

Interest receivable/payable: The carrying amounts approximated fair value.

The estimated fair values of the Bank's significant on-balance-sheet financial instruments at December 31, 2012 and 2011 were as follows:

	Carrying value	Fair value measurements at reporting date using		
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
<u>December 31, 2012</u>				
Financial assets:				
Cash and cash equivalents	\$ 7,745,731	\$7,745,731		
Available-for-sale securities	13,719,711		\$13,719,711	
Mtg. loans available for sale	593,303			\$ 593,303
Loans	60,792,353			61,002,353
Interest receivable	319,749			319,749
PCBB stock	100,000			100,000
FHLB stock	53,200			53,200
Financial liabilities:				
Deposits	76,997,858			77,121,858
Interest payable	22,246			22,246
<u>December 31, 2011</u>				
Financial assets:				
Cash and cash equivalents	\$ 2,875,018	\$ 2,875,018		
Available-for-sale securities	14,711,412		\$14,711,412	
Mtg. loans available for sale	116,095			\$ 116,095
Loans	58,804,034			59,214,034
Interest receivable	290,843			290,843
PCBB stock	100,000			100,000
FHLB stock	50,500			50,500
Financial liabilities:				
Deposits	71,863,989			72,022,989
Interest payable	34,866			34,866

11. TRANSACTIONS WITH RELATED PARTIES

Certain directors (and the companies with which they are associated) are customers of, and have had banking transactions with, the Bank in the ordinary course of business. In addition, the Bank expects to continue to have such banking transactions in the future. All loans and commitments to loan to such parties are generally made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons. In the opinion of management, these transactions do not involve more than normal credit risk or present any other unfavorable features.

Activity with respect to loans to directors and their affiliates for the years ended December 31, 2012 and 2011 were as follows:

Balance at December 31, 2010	\$ 732,012
Additions or renewals	--
Amounts collected	<u>(229,155)</u>
Balance at December 31, 2011	502,857
Additions or renewals	2,259,000
Amounts collected	<u>(56,848)</u>
Balance at December 31, 2012	<u>\$ 2,705,009</u>

At December 31, 2012 and 2011, the commitments in note 9 included \$71,000 and \$350,000, respectively, in unused commitments to extend credit to Directors and their affiliates.

At December 31, 2012 and 2011, time deposits of \$100,000 or more, as discussed in note 5 above, included \$465,318 and \$462,523, respectively, owned by Directors of the Bank.

12. STOCK WARRANTS

As part of the Bank's initial stock offering, common stock warrants were issued to each purchaser of the Bank's common stock at a rate of one warrant for every five shares purchased. Additionally, seed capital investors received warrants at a rate of one warrant for every share purchased to the extent of seed capital invested. The warrants entitle holders to purchase one additional share of common stock at a price of \$10.00 until expiration on May 5, 2013. In September 2011, the Bank's Board of Directors approved an extension of the expiry date to May 5, 2016. Warrants outstanding totaled 98,850 at December 31, 2012 and 2011.

13. BASIC AND DILUTED EARNINGS PER COMMON SHARE

The Bank's basic earnings per common share is computed by dividing net income by the weighted-average number of common shares outstanding during the period. The Bank's diluted earnings per common share is computed by dividing net income by the weighted-average number of common shares outstanding plus dilutive common shares related to stock warrants. The effect of common shares related to stock warrants outstanding at December 31, 2012 and 2011 was anti-dilutive.

13. BASIC AND DILUTED EARNINGS PER COMMON SHARE (Continued)

The numerator and denominator used in computing basic earnings per common share for the years ended December 31, 2012 and 2011 were as follows:

	<u>2012</u>	Net Income <u>(numerator)</u>	Shares <u>(denominator)</u>	Per-share <u>amount</u>
Basic earnings per common share		\$ 249,233	745,487	\$.33
	<u>2011</u>	Net Income <u>(numerator)</u>	Shares <u>(denominator)</u>	Per-share <u>amount</u>
Basic earnings per common share		\$ 399,903	668,147	\$ 0.60

14. REGULATORY MATTERS

The Bank is subject to the regulations of certain federal and state agencies, and receives periodic examinations by those regulatory authorities. In addition, the Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the tables below) of total and Tier I capital to risk-weighted assets, and of Tier I capital to average assets (all as defined in the regulation). Management believes, as of December 31, 2012, that the Bank met all regulatory capital adequacy requirements.

As of December 31, 2012, the Bank was well capitalized under the regulatory framework. There were no conditions or events that management believes would change the Bank's regulatory capital categorization.

The Bank's actual and required capital amounts and ratios are presented in the table below:

	<u>Actual</u>		<u>Regulatory minimum to be "adequately capitalized"</u>		<u>Regulatory minimum to be "well capitalized"</u>	
	Amounts <u>(In thousands)</u>	Ratios	Amounts <u>(In thousands)</u>	Ratios	Amounts <u>(In thousands)</u>	Ratios
<u>December 31, 2012</u>						
Total capital to risk-weighted assets	9,109	13.6%	5,349	8.0%	6,686	10.0%
Tier 1 capital to risk-weighted assets	8,321	12.5%	2,674	4.0%	4,012	6.0%
Tier 1 capital to average assets	8,321	9.7%	3,434	4.0%	4,292	5.0%
<u>December 31, 2011</u>						
Total capital to risk-weighted assets	7,994	11.9%	5,398	8.0%	6,747	10.0%
Tier 1 capital to risk-weighted assets	7,230	10.7%	2,699	4.0%	4,048	6.0%
Tier 1 capital to average assets	7,230	8.9%	3,236	4.0%	4,044	5.0%

15. COMMITMENTS AND CONTINGENCIES

The Bank has a non-cancelable operating lease for its Lebanon Branch facility. The lease commenced March 20, 2008 with an initial lease term of 10 years and four consecutive options to renew for five years each. At December 31, 2012, the minimum rental payments due under the lease were as follows:

2013	\$ 39,432
2014	40,998
2015	41,520
2016	43,284
2017	43,872
Thereafter	9,749

The lease includes additional contingent rental payments for the drive-up service area and the Bank's share of property taxes and operating expenses.

Total rent expense pursuant to operating leases was \$54,899 and \$54,978 in 2012 and 2011, respectively. The 2012 total included contingent rentals of \$13,004.

In the ordinary course of business, the Bank may become subject to certain claims and legal action. Management is not aware of any such matters that would have a material adverse effect on the financial condition of the Bank.

16. EMPLOYEE BENEFIT PLAN

The Bank has a defined contribution retirement plan (401(k)) that covers most full-time employees who meet plan eligibility requirements. The plan allows employees to make elective contributions within specified limits on a tax-deferred basis. The plan also allows the Bank to make matching as well as non-elective contributions to the plan. Except for "safe harbor" and non-discrimination purposes, Bank contributions are subject to a 20% per year vesting requirement. The Bank's contributions to the plan for the years ended December 31, 2012 and 2011 totaled \$39,236 and \$33,481, respectively.

17. SUBSEQUENT EVENTS

Management has reviewed events occurring through the date of the auditor's report, and no subsequent events occurred requiring accrual or disclosure.