REPORT OF INDEPENDENT AUDITORS
AND FINANCIAL STATEMENTS FOR

WILLAMETTE COMMUNITY BANK

December 31, 2017 and 2016

MOSSADAMS

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Report of Independent Auditors

To the Board of Directors and Shareholders
of Willamette Community Bank

Report on the Financial Statements

We have audited the accompanying financial statements of Willamette Community Bank, which comprise the balance sheets as of December 31, 2017 and 2016, and the related statements of income, 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, implementation, and maintenance 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the 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, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Portland, Oregon
February 22, 2018

Willamette Community Bank
Balance Sheets

	December 31, 2017	December 31, 2016
ASSETS		
Cash and cash equivalents	$ 2,790,931	$ 10,172,246
Investment securities available-for-sale, at fair value	14,216,398	6,849,499
Investment securities held-to-maturity, at amortized cost	5,289,117	5,312,932
Restricted equity securities	218,000	218,700
Loans, net	91,000,157	73,487,030
Premises and equipment, net	1,657,640	1,392,164
Bank-owned life insurance	2,766,485	-
Accrued interest and other assets	947,682	848,876
Total assets	$ 118,886,410	$ 98,281,447
LIABILITIES		
Non-interest bearing demand deposits	$ 29,041,581	$ 22,320,671
Interest-bearing demand deposits	10,876,200	9,396,876
Money market and savings accounts	61,095,459	49,541,267
Time deposits	6,202,302	5,855,472
Total deposits	107,215,542	87,114,286
Federal funds purchased	145,000	-
Accrued interest and other liabilities	116,567	97,274
Total liabilities	107,477,109	87,211,560
COMMITMENTS AND CONTINGENCIES (Note 10 and 12)		
SHAREHOLDERS' EQUITY		
Common stock, no par value, 10,000,000 shares authorized 1,039,663 shares issued and outstanding at December 31, 2017 and 2016	9,016,184	8,816,839
Retained earnings	2,516,072	2,275,816
Accumulated other comprehensive loss	(122,955)	(22,768)
Total shareholders' equity	11,409,301	11,069,887
Total liabilities and shareholders' equity	$ 118,886,410	$ 98,281,447

See accompanying notes.

Willamette Community Bank
Statements of Income

	Years Ended December 31, 2017	2016
INTEREST INCOME		
Interest and fees on loans	$ 4,387,962	$ 4,124,161
Interest on investment securities	405,266	310,327
Other interest income	96,798	29,916
Total interest income	4,890,026	4,464,404
INTEREST EXPENSE		
Interest-bearing demand, money market, and savings deposits	236,733	154,421
Time and other borrowings	48,440	31,666
Total interest expense	285,173	186,087
NET INTEREST INCOME	4,604,853	4,278,317
LOAN LOSS PROVISION	36,000	20,000
Net interest income after loan loss provision	4,568,853	4,258,317
NON-INTEREST INCOME		
Interchange fee income	110,065	120,160
Service charges on deposit accounts	74,044	79,175
Gains on sales and early redemptions of securities	-	11,277
Other	61,183	47,572
Total non-interest income	245,292	258,184
NON-INTEREST EXPENSE		
Salaries and employee benefits	2,116,769	2,014,153
Premises and equipment	530,284	574,331
Legal and professional	528,855	209,030
Data processing	342,081	402,923
Advertising, marketing and business development	109,465	60,374
Director fees	100,000	96,000
FDIC assessment	70,023	65,683
Other	349,067	295,488
Total non-interest expenses	4,146,544	3,717,982
Income before income taxes	667,601	798,519
Provision for income taxes	228,000	240,000
NET INCOME	$ 439,601	$ 558,519
Basic earnings per common share	$ 0.42	$ 0.54
Diluted earnings per common share	$ 0.42	$ 0.54

See accompanying notes.

Statements of Comprehensive Income

	Years Ended December 31, 2017	Years Ended December 31, 2016
NET INCOME	$ 439,601	$ 558,519
OTHER COMPREHENSIVE INCOME		
Unrealized holding losses during period	(119,196)	(14,446)
Reclassification adjustment for amounts included in net income	-	(11,277)
Other comprehensive loss before income taxes	(119,196)	(25,723)
Income tax benefit related to items of other comprehensive loss	(19,009)	(8,746)
Other comprehensive loss, net of tax	(100,187)	(16,977)
Comprehensive income	$ 339,414	$ 541,542

Statements of Changes in Shareholders' Equity

	Number of Shares	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
December 31, 2015	998,999	$ 8,681,680	$ 1,852,456	$ (5,791)	$10,528,345
2% stock dividend	20,113	135,159	(135,159)	-	-
Net income	-	-	558,519	-	558,519
Other comprehensive loss	-	-	-	(16,977)	(16,977)
December 31, 2016	1,019,112	8,816,839	2,275,816	(22,768)	11,069,887
2% stock dividend	20,551	199,345	(199,345)	-	-
Net income	-	-	439,601	-	439,601
Other comprehensive loss	-	-	-	(100,187)	(100,187)
December 31, 2017	1,039,663	$ 9,016,184	$ 2,516,072	$ (122,955)	$11,409,301

Willamette Community Bank
Statements of Cash Flows

	Years Ended December 31, 2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 439,601	$ 558,519
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	179,356	135,938
Loan loss provision	36,000	20,000
Net amortization of premiums/discounts on investment securities	60,355	87,940
Gains on sales and early redemptions of securities	-	(11,277)
Net appreciation of bank-owned life insurance	(16,485)	-
Loss on disposition of equipment	-	554
Deferred income taxes	6,657	(2,381)
Changes in certain assets and liabilities:		
Accrued interest and other assets	(86,454)	38,133
Accrued interest and other liabilities	19,293	41,012
Net cash from operating activities	638,323	868,438
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of available-for-sale securities	(10,629,590)	(2,505,735)
Proceeds from sales, maturities, calls, and principal payments received on available-for-sale securities	3,106,955	6,815,362
Purchases of held-to-maturity securities	-	(833,140)
Proceeds from redemption (purchase) of Federal Home Loan Bank stock	700	(5,400)
Net increase in loans	(17,549,127)	(642,571)
Purchase of bank-owned life insurance	(2,750,000)	-
Purchases of computer software	-	(4,499)
Purchases of premises and equipment	(444,832)	(71,242)
Net cash from investing activities	(28,265,894)	2,752,775
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in deposits	20,101,256	(1,183,078)
Federal funds purchased	145,000	-
Net cash from financing activities	20,246,256	(1,183,078)
Net (decrease) increase in cash and cash equivalents	(7,381,315)	2,438,135
Cash and cash equivalents at beginning of year	10,172,246	7,734,111
Cash and cash equivalents at end of year	$ 2,790,931	$ 10,172,246
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	$ 283,412	$ 184,433
Cash paid for income taxes	$ 167,000	$ 210,000
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Changes in fair value of available-for-sale investment securities, net of tax	$ (100,187)	$ (16,977)
Issuance of stock dividend	$ 199,345	$ 135,159

See accompanying notes.

Note 1 – Organization and Summary of Significant Accounting Policies

Organization – Willamette Community Bank (the Bank) is a state-chartered, FDIC-insured institution headquartered in Albany, Oregon, with branches in Albany, Lebanon and Salem, 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.

The Bank declared a 2% stock dividend during 2017. All per share amounts and calculations in the accompanying financial statements have been restated to reflect the effects of the stock dividend.

Method of accounting and use of estimates – The financial statements have been prepared in accordance with generally accepted accounting principles and reporting practices applicable to the banking industry. In preparing the 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 during the reporting period. Actual results could differ from those estimates. The most significant estimates or assumptions made by management relate to the adequacy of the allowance for loan losses, the fair value of available-for-sale investment securities and other financial instruments, and the useful lives and methods of depreciating premises and equipment.

Cash and cash equivalents – For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits at other financial institutions with original maturities of 90 days or less and Federal Funds sold overnight. From time to time, the Bank holds cash deposits at other financial institutions in excess of FDIC insured limits. However, as the Bank places these deposits with large, well-capitalized financial institutions, management believes the risk of loss to be minimal due to the financial strength of the correspondent banks. The Bank processes transactions through correspondent accounts with Pacific Coast Bankers' Bank (PCBB), United Bankers' Bank (UBB), and The Independent Bankers' Bank (TIB). PCBB requires that the Bank maintain a reserve in the form of deposit balances, which was $245,000 as of December 31, 2017 and 2016. UBB requires the Bank maintain a nominal reserve account balance. TIB requires that the Bank maintain a deposit balance reserve, which was $100,000 as of December 31, 2017 and 2016.

Investment securities – The Bank is required to specifically identify its investment securities as "available-for-sale," "held-to-maturity," or "trading accounts." The Bank had no securities classified as trading as of December 31, 2017 and 2016. Debt securities that management has the positive intent and ability to hold to maturity are classified as "held-to-maturity," and such securities are reported at amortized cost. Securities are classified as "available-for-sale" if the instrument may be sold in response to such factors as: (1) changes in market interest rates and related changes in prepayment risk, (2) needs for liquidity, (3) changes in the availability of and the yield on alternative instruments, and (4) changes in funding sources and terms.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Gains or losses on the sale of available-for-sale securities are determined using the specific-identification method. Unrealized holding gains and losses, net of tax, on available-for-sale securities are carried as accumulated other comprehensive income or loss within shareholders' equity until realized. Fair values for these investment securities are generally based on quoted market prices for the same or similar instruments. Declines in the fair value of individual available-for-sale securities below their cost that are other-than-temporary result in write-downs of the individual securities to their fair value. Such related write-downs would be included in earnings as other-than-temporary impairment losses.

Premiums and discounts are recognized in interest income using the effective interest method over the period to maturity.

Management reviews investment securities on an ongoing basis for the presence of other-than-temporary impairment (OTTI) or permanent impairment, taking into consideration current market conditions; fair value in relationship to cost; extent and nature of the change in fair value; issuer rating changes and trends; whether management intends to sell a security or if it is likely that the Bank will be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity; and other factors. For debt securities, if management intends to sell the security or it is likely that the Bank will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If management does not intend to sell the security and it is not likely that the Bank will be required to sell the security, but management does not expect to recover the entire carrying value of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings.

The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, representing the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income or loss.

Restricted equity securities – The Bank's investment in Federal Home Loan Bank of Des Moines (FHLB) stock is a restricted investment carried at par value, which approximates its fair value. As a member of the FHLB system, the Bank is required to maintain a minimum level of investment in FHLB stock, based on specific percentages of its assets. The Bank may request redemption at par value of any stock in excess of the amount the Bank is required to hold. Stock redemptions are at the discretion of the FHLB.

Stock in the FHLB is classified as restricted stock and is evaluated for impairment at each reporting date. The determination of whether the investment is impaired is based on the Bank's assessment of the ultimate recoverability of par value rather than by recognizing temporary declines in value. The Bank has concluded that its FHLB stock investment was not impaired as of December 31, 2017 and 2016.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

The Bank's investment in PCBB stock is a restricted investment carried at par value, which approximates its fair value. PCBB operates under a special purpose charter to provide wholesale correspondent banking services to depository institutions. By statute, 100% of PCBB's outstanding stock is held by depository institutions that utilize its correspondent banking services. Stock redemptions are made at the discretion of the PCBB.

Loans, net – Loans are stated at the amount of unpaid principal, reduced by an allowance for loan losses and unearned loan fees. Interest on loans is calculated by the simple-interest method on daily balances of the principal amount outstanding. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment to yield over the contractual life of the related loan.

The allowance for loan losses is established through a provision for loan losses charged as an expense to the statement of income. Loans are charged against the allowance for loan losses when management believes that the collectability of principal is unlikely. The allowance is an amount that management believes will be adequate to absorb probable losses on existing loans that may become uncollectible, based on prior loss experience and evaluations of the collectability of loans. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. Various regulatory agencies, as a routine part of their examination process, will periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on their judgment of information available to them at the time of examinations.

A loan is considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due (both interest and principal) according to the contractual terms of the loan agreement. Specific loans evaluated for impairment are adjusted to the lower of cost or fair value. As a practical expedient, fair value may be measured based on a loan's observable market price or the fair value of the underlying collateral securing the loan. Collateral may be real estate or business assets, including equipment. The value of collateral is determined based on independent appraisals. Accrual of interest is discontinued on impaired loans when management believes, after considering economic and business conditions, collection efforts, and collateral position, that the borrower's financial condition is such that collection of interest is doubtful.

When the accrual of interest is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized, and the accrual of interest is reinstated, only after scheduled cash payments are received and the collection of principal in full is assured.

A troubled debt restructuring is a formal reorganization of a loan whereby the Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower. Concessions may be granted in various forms, including reduction in the stated interest rate, reduction in the loan balance or accrued interest, and extension of the maturity date. Troubled debt restructurings are evaluated at the time of restructure for impairment, and, if impaired, are subjected to the Bank's impaired loan accounting policy.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Premises and equipment, net – Leasehold improvements, furniture and equipment are recorded at cost, less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the expected useful lives of the assets, ranging from two to ten years. Leasehold improvements are amortized using the straight-line method over the terms of the related leases or the estimated lives of the improvements, whichever is shorter. The costs of maintenance and repairs are expensed as they are incurred, while major expenditures for leasehold improvements and betterments are capitalized.

Other real estate owned – Other real estate owned, which represents property acquired through foreclosure or deeds in lieu of foreclosure, is carried at the lower of cost or estimated net realizable value. Any excess of the loan balance over the estimated fair value of the property at the time of transfer, less estimated disposition costs, is charged to the allowance for loan losses and any excess estimated fair value over the loan's carrying value is recognized first as a recovery to the allowance for loan losses, to the extent that amounts have been charged-off for that loan. Then, any fair value in excess of the loan's carrying value is recognized as a reduction in noninterest expense. Subsequent write-downs to fair value, if any, or any disposition gains or losses are included in noninterest expense.

Bank-owned life insurance – The Bank holds life insurance policies that provide protection against the adverse financial effects that could result from the death of current employees, and provide tax deferred income. Although the lives of individual current management-level employees are insured, the Bank is the owner and is split beneficiary on certain policies. The Bank is exposed to credit risk to the extent an insurance company is unable to fulfill its financial obligations under a policy. Split-dollar life insurance is recorded as an asset at cash surrender value. Increases in the cash value of these policies, as well as insurance proceeds received, are recorded in other non-interest income and are not subject to income tax.

Income taxes – Income taxes are accounted for using an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement and tax basis of assets and liabilities at the applicable enacted tax rates. The effect on deferred taxes of a change in tax rates is recognized in income in the period of the enactment date. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Bank evaluates the realizability of its deferred tax assets by assessing the need for a valuation allowance and by adjusting the amount of such allowance, if necessary.

The Tax Cuts and Jobs Act of 2017 was enacted December 22, 2017, and changed the federal corporate tax rate to 21% from 34%, effective January 1, 2018, and preserved the full deductibility of state corporate taxes. Accordingly, the Bank has recognized the effects of changes in tax laws and rates on the deferred tax assets and liabilities as of December 31, 2017 (see Note 8 – Income Taxes). The resulting adjustment of $37,157 to decrease the value of the net deferred tax asset was recognized by the Bank in December 2017 as tax expense.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

The Bank recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by the taxing authorities, based on the technical merits of the position. A tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Bank recognizes interest and penalties related to income tax matters in income tax expense. The Bank does not anticipate that the amount of unrecognized tax benefits will significantly increase or decrease in the next 12 months.

There were no interest and penalties related to income taxes recognized for the years ended December 31, 2017 and 2016. The Bank files U.S. federal and Oregon state income tax returns, which are subject to examination by the taxing authorities for years 2014 and later.

Advertising – The Bank expenses advertising and marketing costs as they are incurred. Advertising and marketing costs were $109,465 and $60,374 for the years ended December 31, 2017 and 2016, respectively.

Earnings per share of common stock – Basic earnings per share of common stock is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share of common stock is computed similarly to basic earnings per share of common stock, except that the denominator is increased to include the number of additional common shares related to stock warrants that would have been outstanding if such dilutive potential common shares had been issued, unless they are determined to be anti-dilutive.

Off-balance sheet financial instruments – In the ordinary course of business, the Bank enters into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit. These financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received. The Bank maintains an allowance for off-balance sheet items, established as an accrued liability through charges to noninterest expense. The allowance is an amount that management believes will be adequate to absorb possible losses associated with off-balance sheet credit risk. The evaluations take into consideration such factors as changes in the nature and volume of the commitments to extend credit and undisbursed balances of existing lines of credit and letters of credit.

Fair value of assets and liabilities – 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 determines fair value based upon quoted prices when available or through the use of alternative approaches, such as matrix or model pricing, when market quotes are not readily accessible or available. The valuation techniques used are based on observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Bank's market assumptions.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

These two types of inputs 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 whose inputs are observable or whose significant value drivers are observable.

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. The Bank's own data used to develop unobservable inputs may be adjusted for market consideration when reasonably available.

The Bank used the following methods and significant assumptions to estimate fair value for certain assets measured and carried at fair value on a recurring or non-recurring basis in the financial statements:

Available-for-sale investment securities – For these securities, the Bank obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. When market quotes are not readily accessible or available, alternative approaches are utilized, such as matrix or model pricing. The Bank has determined this is a Level 2 input.

Impaired loans – Impaired loans are carried at the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's market price, or the fair value of the collateral, less costs to sell (5-10% discount), if the loan is collateral dependent. The Bank has determined this is a Level 3 input.

Other real estate owned – These assets represent impaired real estate that has been adjusted to its estimated fair value as a result of management's periodic impairment evaluation using property appraisals from independent real estate appraisers, less costs to sell (5-10% discount). The Bank has determined this is a Level 3 input.

The following methods and assumptions were used by the Bank in estimating fair values of assets and liabilities for disclosure purposes:

Cash and cash equivalents – The carrying amounts of these short-term instruments approximate their fair value. Therefore, the measurement of fair value of cash and cash equivalents is derived from Level 1 inputs.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Held-to-maturity investment securities – The fair values of these securities are based on quoted market prices or dealer quotes, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. When market quotes are not readily accessible or available, alternative approaches are utilized, such as matrix or model pricing. The Bank has determined these are Level 2 inputs.

Restricted equity securities – Due to significant restrictions on these securities, the fair value of Federal Home Loan Bank (FHLB) and Pacific Coast Bankers' Bank (PCBB) stock is considered to be equivalent to the value it has if redeemed by the FHLB or PCBB, respectively. However, there is no active market for exchanging these securities to a willing party other than the FHLB or PCBB; as such, the Bank has determined these are Level 2 inputs.

Loans receivable – For variable rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. Fair values for fixed-rate loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable. The Bank has determined these are Level 3 inputs.

Deposit liabilities – The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (their carrying amounts), which is determined using Level 1 inputs. The carrying amounts of variable rate, fixed-term money market accounts, and certificates of deposit (CDs) approximate their fair values at the reporting date. Fair values for fixed-rate CDs are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits. The Bank has determined these are Level 2 inputs.

Lines of credit and other borrowings – The fair value of the Bank's borrowings is estimated using a discounted cash flow analysis based on the Bank's current incremental borrowing rate for similar types of borrowing arrangements. The Bank has determined these are Level 2 inputs.

Off-balance sheet instruments – The Bank's off-balance sheet instruments include unfunded commitments to extend credit, and standby letters of credit. The fair value of these instruments is not considered practicable to estimate because of the lack of quoted market prices and the inability to estimate fair value without incurring excessive costs. Given the uncertainty of a commitment being drawn upon, it is not reasonable to estimate the fair value of these commitments; therefore, the Bank has not made any disclosure on the fair value of off-balance sheet financial instruments.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Subsequent events – Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. The Bank recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including estimates inherent in the process of preparing the financial statements. The Bank's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet, but arose after the balance sheet date and before financial statements are available to be issued.

The Bank has evaluated subsequent events through February 22, 2018, which is the date the financial statements became available for issuance.

Note 2 – Investment Securities

The amortized cost and estimated fair values of available-for-sale and held-to-maturity investment securities at December 31, 2017 and 2016:

December 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale investment securities				
U.S. Government treasury notes	$ 999,027	$ -	$ (8,402)	$ 990,625
U.S. Government agency notes	7,541,996	-	(96,601)	7,445,395
U.S. Government agency mortgage-backed securities	3,741,746	-	(38,251)	3,703,495
U.S. Government/agency collateralized mortgage obligations	2,087,322	2,508	(12,947)	2,076,883
	$ 14,370,091	$ 2,508	$ (156,201)	$ 14,216,398
Held-to-maturity investment securities				
Municipal bonds - general obligations	$ 3,617,951	$ 162,712	$ -	$ 3,780,663
Municipal bonds - revenue	1,671,166	95,191	-	1,766,357
	$ 5,289,117	$ 257,903	$ -	$ 5,547,020

December 31, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale investment securities				
U.S. Government treasury notes	$ 500,000	$ -	$ (156)	$ 499,844
U.S. Government agency notes	2,505,415	637	(40,126)	2,465,926
U.S. Government agency mortgage-backed securities	360,830	-	(1,137)	359,693
U.S. Government/agency collateralized mortgage obligations	3,517,751	15,444	(9,159)	3,524,036
	$ 6,883,996	$ 16,081	$ (50,578)	$ 6,849,499
Held-to-maturity investment securities				
Municipal bonds - general obligations	$ 3,642,282	$ 88,053	$ (38,430)	$ 3,691,905
Municipal bonds - revenue	1,670,650	38,060	(515)	1,708,195
	$ 5,312,932	$ 126,113	$ (38,945)	$ 5,400,100

Note 2 – Investment Securities (continued)

The Bank had twelve collateralized mortgage obligation securities, two treasury note securities, fourteen agency note securities, and ten mortgage-backed securities in the following table with gross unrealized losses at December 31, 2017.

	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
December 31, 2017						
Available-for-sale investment securities						
U.S. Government treasury notes	$ 990,625	$ (8,402)	$ -	$ -	$ 990,625	$ (8,402)
U.S. Government agency notes	4,486,414	(45,912)	2,958,982	(50,689)	7,445,396	(96,601)
U.S. Government agency mortgage-backed securities	3,604,532	(37,240)	98,963	(1,011)	3,703,495	(38,251)
U.S. Government/agency collateralized mortgage obligations	899,339	(6,175)	414,318	(6,772)	1,313,657	(12,947)
	$ 9,980,910	$ (97,729)	$ 3,472,263	$ (58,472)	$ 13,453,173	$ (156,201)

Included in the totals above were five collateralized mortgage obligation securities, six agency note securities, and one mortgage-backed security that had been in a gross unrealized loss position for greater than one year.

At December 31, 2016, the Bank had one general obligations municipal bond, one revenue municipal bond, eight collateralized mortgage obligation securities, one treasury note security, four agency note securities, and two mortgage-backed securities in the following table with gross unrealized losses.

	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
December 31, 2016						
Available-for-sale investment securities						
U.S. Government treasury notes	$ 499,844	$ (156)	$ -	$ -	$ 499,844	$ (156)
U.S. Government agency notes	1,965,289	(40,126)	-	-	1,965,289	(40,126)
U.S. Government agency mortgage-backed securities	359,693	(1,137)	-	-	359,693	(1,137)
U.S. Government/agency collateralized mortgage obligations	1,162,237	(4,661)	165,878	(4,498)	1,328,115	(9,159)
	$ 3,987,063	$ (46,080)	$ 165,878	$ (4,498)	$ 4,152,941	$ (50,578)
Held-to-maturity investment securities						
Municipal bonds - general obligations	$ 788,873	$ (38,430)	$ -	$ -	$ 788,873	$ (38,430)
Municipal bonds - revenue	771,145	(515)	-	-	771,145	(515)
	$ 1,560,018	$ (38,945)	$ -	$ -	$ 1,560,018	$ (38,945)

Included in the totals above was one collateralized mortgage obligation security that had been in a gross unrealized loss position for greater than one year.

Note 2 – Investment Securities (continued)

The Bank evaluated these unrealized losses and determined that the declines in value at December 31, 2017 and 2016 were temporary and related to the change in market interest rates since the date of their purchases. 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 available-for-sale and held-to-maturity investment securities at December 31, 2017, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers could have the right to call or prepay obligations with or without call or prepayment penalties.

	Securities Available-for-Sale		Securities Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 499,535	$ 497,063	$ 800,000	$ 800,000
Due after one through five years	8,041,488	7,938,957	-	-
Due after five through ten years	-	-	3,007,286	3,155,950
Due after ten years	-	-	1,481,831	1,591,070
Collateralized mortgage obligations and mortgage-backed securities	5,829,068	5,780,378	-	-
Total	$ 14,370,091	$ 14,216,398	$ 5,289,117	$ 5,547,020

There were no sales of securities during 2017. In 2016 there were gross gains from the sales of securities of $11,277.

At December 31, 2017, available-for-sale investments securities of $1,134,795 and held-to-maturity securities of $5,289,117 were pledged to secure public funds, as permitted or required by law.
At December 31, 2016, available-for-sale investment securities of $1,950,250 and held-to-maturity securities of $4,541,272, were pledged to secure public funds, as permitted or required by law.

Note 3 – Loans

As of December 31, the loan portfolio consisted of the following:

	2017	2016
Real estate loans	$ 62,185,012	$ 53,398,338
Commercial	24,516,987	16,947,956
Agricultural	4,835,654	3,786,980
Consumer	316,468	307,961
Other and overdrafts	582,741	286,074
	92,436,862	74,727,309
Less unearned loan fees, net	(294,827)	(283,504)
Less allowance for loan losses	(1,141,878)	(956,775)
Loans, net	$ 91,000,157	$ 73,487,030

Note 4 – Allowance for Loan Losses

The following table displays the allocation of, and activity within, the allowance for loan losses to significant segments of the loan portfolio as of and for the year ended December 31, 2017:

	2017					
	Real Estate	Commercial	Agricultural	Consumer	Other	Totals
Allowance	$ 752,818	$ 143,286	$ 36,541	$ 21,105	$ 3,025	$ 956,775
Balance, beginning of the period						
Charge-offs	-	-	-	-	-	-
Recoveries	-	-	-	149,103	-	149,103
Provision for loan losses	20,000	10,000	3,000	3,000	-	36,000
Balance, end of the period	$ 772,818	$ 153,286	$ 39,541	$ 173,208	$ 3,025	$ 1,141,878
Ending balance individually evaluated for impairment	$ 700	$ 15,000	$ -	$ 6,100	$ -	$ 21,800
Ending balance collectively evaluated for impairment	$ 772,118	$ 138,286	$ 39,541	$ 167,108	$ 3,025	$ 1,120,078
Loans						
Ending balance	$ 62,185,012	$ 24,516,987	$ 4,835,654	$ 316,468	$ 582,741	$ 92,436,862
Ending balance individually evaluated for impairment	$ 1,225,788	$ 41,604	$ -	$ 17,863	$ -	$ 1,285,255
Ending balance collectively evaluated for impairment	$ 60,959,224	$ 24,475,383	$ 4,835,654	$ 298,605	$ 582,741	$ 91,151,607

Note 4 – Allowance for Loan Losses (continued)

Transactions in the allowance for loan losses for the year ended December 31, 2016 were as follows:

	2016					
	Real Estate	Commercial	Agricultural	Consumer	Other	Totals
Allowance	$ 737,818	$ 138,286	$ 36,541	$ 13,500	$ 3,025	$ 929,170
Balance, beginning of the period						
Charge-offs	-	-	-	(292)	-	(292)
Recoveries	-	-	-	7,897	-	7,897
Provision for loan losses	15,000	5,000	-	-	-	20,000
Balance, end of the period	$ 752,818	$ 143,286	$ 36,541	$ 21,105	$ 3,025	$ 956,775
Ending balance individually evaluated for impairment	$ -	$ 35,700	$ -	$ 6,100	$ -	$ 41,800
Ending balance collectively evaluated for impairment	$ 752,818	$ 107,586	$ 36,541	$ 15,005	$ 3,025	$ 914,975
Loans						
Ending balance	$ 53,398,338	$ 16,947,956	$ 3,786,980	$ 307,961	$ 286,074	$ 74,727,309
Ending balance individually evaluated for impairment	$ 3,048,429	$ 237,885	$ -	$ 23,213	$ -	$ 3,309,527
Ending balance collectively evaluated for impairment	$ 50,349,909	$ 16,710,071	$ 3,786,980	$ 284,748	$ 286,074	$ 71,417,782

Credit quality indicators – The Bank's risk rating methodology assigns risk ratings ranging from 1 to 8, where a higher rating represents higher risk. The 8 risk rating categories can be generally described by the following groupings:

Pass (rated 1 through 3) – These loans range from minimal credit risk to higher than average, but still acceptable, credit risk. Primary repayment sources generate satisfactory debt service coverage under normal conditions. Cash flow from recurring sources is expected to continue to produce adequate debt service capacity. There are many categories within the pass definition, but none of the loans rise to the level of Watch.

Watch (rated 4) – Loans are graded as Watch when, for various reasons, close monitoring is required. This includes loans that have performed satisfactorily, but because of recent events, deteriorating trends, or signs of developing problems require close monitoring. While continued satisfactory performance is expected, the situation, if not monitored, could develop into weaknesses that result in the loan being adversely risk rated.

Special Mention (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 asset or the Bank's credit position at some future date. They contain unfavorable characteristics and are generally undesirable. Loans in this category are currently protected but are potentially weak and constitute an undue and unwarranted credit risk, but not to the point of a Substandard classification. Unlike a Substandard credit, there is a reasonable expectation that these temporary issues will be corrected within the normal course of business, rather than liquidation of assets, and in a reasonable period of time.

Note 4 – Allowance for Loan Losses (continued)

Substandard (rated 6) – A Substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified have a well-defined weakness or weaknesses that jeopardize the orderly repayment of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not necessarily exist in each individual asset classified as Substandard. The likely need to liquidate assets to correct the problem, rather than repayment from successful operations, is the key distinction between Special Mention and Substandard loans.

Doubtful (rated 7) – Loans classified as Doubtful have all the weaknesses inherent in one classified as Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work towards strengthening of the asset, classification as a Loss (and immediate charge-off) is deferred until more exact status may be determined.

Loss (rated 8) – These loans are considered uncollectible and of such little value that their continuance as active assets of the Bank is not warranted. This classification does not mean that the loan has no recovery or salvage value, but rather that it is not practical or desirable to defer writing it off as an asset. While Loss is an active grade in the risk rating system, any loan considered to be in this category is to be charged-off as soon as possible.

The following tables show credit quality indicators as of December 31, 2017 and 2016:

	Real Estate		Commercial		Agriculture	
	2017	2016	2017	2016	2017	2016
Grade						
Pass	$ 60,874,186	$ 51,848,151	$ 21,905,799	$ 16,742,491	$ 4,835,654	$ 3,786,980
Special Mention	-	-	-	-	-	-
Substandard	1,310,826	1,550,187	2,611,188	205,465	-	-
Doubtful	-	-	-	-	-	-
Loss	-	-	-	-	-	-
	$ 62,185,012	$ 53,398,338	$ 24,516,987	$ 16,947,956	$ 4,835,654	$ 3,786,980

	Consumer		Other		Totals	
	2017	2016	2017	2016	2017	2016
Grade						
Pass	$ 300,918	$ 289,546	$ 582,741	$ 286,074	$ 88,499,298	$ 72,953,242
Special Mention	-	-	-	-	-	-
Substandard	15,550	184,151	-	-	3,937,564	1,774,067
Doubtful	-	-	-	-	-	-
Loss	-	-	-	-	-	-
	$ 316,468	$ 473,697	$ 582,741	$ 286,074	$ 92,436,862	$ 74,727,309

Note 4 – Allowance for Loan Losses (continued)

The following table shows the age analysis of past due loans as of December 31, 2017 and 2016:

	30-59 Days Past Due	60-89 Days Past Due	Over 90 Days Past Due	Total Past Due	Current	Total Loans	Over 90 Days and Accruing
December 31, 2017							
Real estate	$ -	$ -	$ -	$ -	$ 62,185,012	$ 62,185,012	$ -
Commercial	-	-	53,263	53,263	24,463,724	24,516,987	-
Agriculture	-	-	-	-	4,835,654	4,835,654	-
Consumer	-	-	-	-	316,468	316,468	-
Other and overdrafts	-	-	-	-	582,741	582,741	-
Total	$ -	$ -	$ 53,263	$ 53,263	$ 92,383,599	$ 92,436,862	$ -
December 31, 2016							
Real estate	$ 221,753	$ -	$ 166,723	$ 388,476	$ 53,009,862	$ 53,398,338	$ -
Commercial	-	149,950	55,515	205,465	16,742,491	16,947,956	-
Agriculture	-	-	-	-	3,786,980	3,786,980	-
Consumer	-	-	-	-	307,961	307,961	
Other and overdrafts	-	-	-	-	286,074	286,074	-
Total	$ 221,753	$ 149,950	$ 222,238	$ 593,941	$ 74,133,368	$ 74,727,309	$ -

The following table shows impaired loans as of and for the years ended December 31, 2017 and 2016:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2017					
With no related allowance recorded:					
Real estate	$ 1,187,415	$ 1,187,415	$ -	$ 1,233,517	$ 56,102
With a related allowance recorded:					
Real estate	38,373	38,373	700	40,107	2,541
Commercial	41,604	41,604	15,000	65,650	3,602
Consumer	17,863	17,863	6,100	26,048	984
	$ 1,285,255	$ 1,285,255	$ 21,800	$ 1,365,322	$ 63,229
December 31, 2016					
With no related allowance recorded:					
Real estate	$ 3,048,429	$ 3,048,429	$ -	$ 3,085,541	$ 153,474
Commercial	54,959	54,959	-	57,947	4,648
With a related allowance recorded:					
Commercial	182,926	182,926	35,700	199,623	11,128
Consumer	23,213	23,213	6,100	30,370	1,853
	$ 3,309,527	$ 3,309,527	$ 41,800	$ 3,373,481	$ 171,103

Note 4 – Allowance for Loan Losses (continued)

A commercial loan with a balance of $41,604, four real estate loans totaling $1,098,593, and a consumer loan with a balance of $9,869 were in non-accrual status as of December 31, 2017. The Bank had four commercial loans totaling $195,783, one real estate loan with a balance of $166,723, and one consumer loan with a balance of $13,286 on non-accrual status as of December 31, 2016.

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 Bank offers a variety of modifications to borrowers that are considered to be troubled debt restructurings (TDR's). The modification categories offered can generally be described as follows:

Rate modification – A modification in which the interest rate is changed.

Term modification – A modification in which the maturity date, timing of payments, or frequency of payments is changed.

Interest only modification – A modification in which the loan is converted to interest only payments for a period of time.

Payment modification – A modification in which the dollar amount of the payment is changed, other than an interest only modification described above.

Combination modification – Any other type of modification, including the use of multiple categories above.

At December 31, 2017 and 2016, the Bank had $176,794 and $1,726,036, respectively, in loans classified as troubled debt restructurings. There were no loans modified as troubled debt restructurings during the year ended December 31, 2017. Newly restructured loans during the year ended December 31, 2016 were as follows:

	Number of Contracts	Outstanding Recorded Investment Before Modification	Outstanding Recorded Investment After Modification	Concession Granted	Impairment Amount at December 31
December 31, 2016					
Commercial	1	$ 96,463	$ 96,463	Note term	$ -
Total	1	$ 96,463	$ 96,463		$ -

Note 4 – Allowance for Loan Losses (continued)

During 2017, there were no loans modified as troubled debt restructurings that had a payment default within 12 months of the restructure date. There were two commercial loans totaling $140,267 that were restructured during 2016, which subsequently had a payment default within 12 months of the restructure date. Troubled debt restructurings on nonaccrual status totaled $41,604 and $140,267 as of December 31, 2017 and 2016, respectively. There were no available commitments to lend additional funds on troubled debt restructurings as of December 31, 2017 and 2016.

Note 5 – Premises and Equipment

As of December 31, the composition of premises and equipment is summarized as follows:

	2017	2016
Land and improvements	$ 336,939	$ 336,939
Leasehold improvements	680,799	435,410
Building	1,097,164	1,097,164
Furniture and equipment	1,063,760	817,252
Construction in progress	5,860	52,924
	3,184,522	2,739,689
Less accumulated depreciation and amortization	(1,526,882)	(1,347,525)
Premises and equipment, net	$ 1,657,640	$ 1,392,164

Depreciation and amortization expense was $179,356 and $135,938 for the years ended December 31, 2017 and 2016, respectively.

Note 6 – Time Deposits

The aggregate amount of certificates of deposit $250,000 and over totaled $590,155 and $941,326, as of December 31, 2017 and 2016, respectively.

At December 31, 2017, the scheduled annual maturities of all time deposits were as follows:

2018	$ 3,815,146
2019	1,764,159
2020	583,734
2021	-
2022	39,263
	$ 6,202,302

Note 7 – Lines of Credit and Other Borrowings

At December 31, 2017, the Bank had borrowing availability of approximately $2,880,000 under its Cash Management Advance ("CMA") facility with the Federal Home Loan Bank of Des Moines. The CMA facility is secured by multifamily, residential-mortgage loans, which was fully available at December 31, 2017. In addition, the Bank maintains an unsecured $3,000,000 federal funds facility with its primary correspondent bank, Pacific Coast Bankers' Bank, which had $2,855,000 available at December 31, 2017. The Bank also maintains a discount window primary credit facility with the Federal Reserve Bank of San Francisco, which had a borrowing limit of approximately $2,590,000 as of December 31, 2017. The discount window facility is secured by pledged commercial real estate loans. The Bank also maintains federal fund lines with the Independent Bankers Bank and the United Bankers Bank, with an unsecured, fully available borrowing limit of $2,600,000 and $5,000,000, respectively. Federal funds of $145,000 were purchased at a rate of 1.33% as of December 31, 2017.

Note 8 – Income Taxes

The provision for income taxes consists of the following for the years ended December 31:

	2017	2016
Current		
Federal	$ 180,398	$ 189,947
State	46,825	58,314
Less state tax credit benefit	(5,880)	(5,880)
	221,343	242,381
Deferred		
Federal	5,427	(1,941)
State	1,230	(440)
	6,657	(2,381)
Provision for income taxes	$ 228,000	$ 240,000

Note 8 – Income Taxes (continued)

Deferred income taxes represent the tax effect of differences in timing between financial income and taxable income. As of December 31, 2017 and 2016, net deferred tax benefits are included in the category accrued interest receivable and other assets in the accompanying balance sheets and include the following components:

	2017	2016
Deferred tax assets:		
Allowance for loan losses	$ 231,589	$ 325,050
State tax credits	26	21,841
Market adjustment on investment securities available-for-sale	40,289	13,172
Book tax depreciation differences	9,753	-
Other reserves	-	38
	281,657	360,101
Deferred tax liabilities:		
Accrued interest receivable	(88,010)	(141,842)
Prepaid expenses	(44,803)	(61,230)
Book tax depreciation differences	-	(6,804)
	(132,813)	(209,876)
Net deferred tax asset	$ 148,844	$ 150,225

The Bank recognized an adjustment to the net deferred tax asset in December 2017 as a tax expense upon enactment of the new federal tax law. Deferred tax assets and liabilities in the table above reflect the new measurement.

Management believes, based upon the Bank's historical performance, the deferred tax assets will be realized in the normal course of operations, and has determined that no valuation allowance is deemed necessary as of December 31, 2017 or 2016.

The following summarizes the differences between the provision for income taxes for financial statement purposes and the federal statutory rate of 34.00% for the years ended December 31, 2017 and 2016:

	2017		2016	
Federal tax at statutory rates	$ 227,057	34.00%	$ 271,495	34.00%
State income taxes, net of federal effect	29,090	4.36%	34,783	4.36%
Tax exempt income	(82,787)	-12.40%	(57,662)	-7.22%
Impact of tax rate change	37,157	5.56%	-	0.00%
Other	17,483	2.62%	(8,616)	-1.08%
	$ 228,000	34.14%	$ 240,000	30.06%

Note 9 – Transactions with Related Parties

Certain directors, executive officers, and principal shareholders are customers of and have had banking transactions with the Bank in the ordinary course of business, and the Bank expects to have such transactions in the future. Management believes loans and commitments to loan funds included in such transactions are made in compliance with applicable laws on substantially equivalent terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons and, in the opinion of the management of the Bank, do not involve more than the normal risk of collection or present any other unfavorable features. At December 31, 2017 and 2016, loans outstanding to directors and their affiliates were as follows:

	2017	2016
Beginning balance	$ 360,320	$ 2,081,764
Removed from related party status	-	(1,690,473)
Repayments	(28,027)	(30,971)
Ending balance	$ 332,293	$ 360,320

At December 31, 2017, there were no unused commitments to extend credit to directors and their affiliates.

Related-party deposits held by the Bank at December 31, 2017 and 2016 were $2,495,582 and $3,760,894, respectively.

Note 10 – Financial Instruments with Off-Balance Sheet Risk

In the normal course of business, in order to meet the financing needs of its customers, the Bank is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and the issuance of standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the balance sheets. 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 written is represented by the notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Note 10 – Financial Instruments with Off-Balance Sheet Risk (continued)

A summary of the notional amounts of the Bank's financial instruments with off-balance sheet risk at December 31, 2017 and 2016, are as follows:

	2017	2016
Commitments to extend credit by type:		
Real estate	$ 7,354,538	$ 6,943,588
Commercial	12,611,584	12,652,653
Agricultural	3,159,555	3,484,642
Consumer	147,172	147,433
Other	1,010,738	1,200,839
Standby letter of credit	27,000	17,000
Total commitments to extend credit	$ 24,310,587	$ 24,446,155

The undisbursed balance of existing lines of credit represents agreements to lend to customers, as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies but may include cash, accounts receivable, inventory, property and equipment, securities and real estate.

Standby letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds cash, accounts receivable, inventories, equipment, securities, and real estate as collateral supporting those commitments for which collateral is deemed necessary.

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 $100 at December 31, 2017 and 2016 and is included with accrued interest and other liabilities in the accompanying statements of financial condition.

Note 11 – Concentrations of Credit Risk

A majority of the Bank's loans and commitments to lend have been granted to customers in the Bank's market area. The distribution of commitments to extend credit approximates the distribution of loans outstanding. The majority of such customers are also depositors of the Bank. Concentrations of credit by type of loan are set forth in Note 3. The Bank's loan policies do not allow the extension of credit to any single borrower in excess of 25% of the Bank's capital (15% for other than real estate secured loans).

Note 12 – Commitments and Contingencies

Lease commitments – On August 1, 2017, the Bank entered into a first amendment to the original lease agreement for its office space in Lebanon, Oregon, under an operating lease agreement which expires on March 31, 2020. Rental payments shall follow the original lease escalation through March 20, 2018, and beginning April 1, 2018 are fixed at $4,456 per month. In 2016, the Bank entered into a sub-lease for office space in Salem, Oregon, under an operating agreement which expires March 1, 2028. Approximate future minimum payments under these lease agreements are as follows:

Years ending December 31,	2018	$ 137,094
	2019	141,126
	2020	103,213
	2021	92,091
	2022	94,394
	Thereafter	419,206
		$ 987,124

Rent expense, including common area maintenance, was $153,286 and $71,030 for the years ended December 31, 2017 and 2016, respectively.

Legal contingencies – The Bank may become a defendant in certain claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, there are no matters presently known that are expected to have a material adverse effect on the financial condition of the Bank.

Note 13 – Employee Benefit Plans and Agreements

The Bank has adopted a 401(k) savings investment plan which allows employees to defer certain amounts of compensation for income tax purposes under section 401(k) of the Internal Revenue Code. Essentially, all employees over the age of 18 are eligible to participate in the plan. Employees may elect to defer and contribute up to the statutory limits. Their contributions and those of the Bank, which are discretionary, are invested in employee-designated funds. The Bank's matching contributions to the plan were $60,481 and $54,899 for the years ended December 31, 2017 and 2016, respectively, and were recorded as employee benefits expense.

On November 30, 2017, the Bank entered into supplemental retirement plans with key executive officers. In 2017, to support is obligations under these plans and to provide death benefits to selected employees, the Bank acquired bank-owned life insurance. The Bank's liability pursuant to these supplemental retirement plans was $7,052 as of December 31, 2017. This amount is included on the balance sheet among accrued interest and other liabilities. For 2017, compensation expense related to these plans was $7,052.

Note 14 – 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 entitled holders to purchase one additional share of common stock at a stock-dividend adjusted price of $9.33 until expiration on May 5, 2013. In September 2011, the Bank's Board of Directors approved an extension of the expiration date to May 5, 2016. In April 2016, the Board of Directors approved another extension of the expiration date to May 5, 2019. Warrants outstanding totaled 105,929 at December 31, 2017 and 2016.

Note 15 – Basic and Diluted Earnings per Common Share

The numerator and denominator used in computing basic and diluted earnings per common share for the years ended December 31, 2017 and 2016 were as follows:

	Net Income (numerator)	Shares (denominator)	Per-share amount
2017			
Basic earnings per common share	$ 439,601	1,039,663	$ 0.42
Stock warrants		5,199	
Diluted earnings per common share	$ 439,601	1,044,862	$ 0.42

	Net Income (numerator)	Shares (denominator)	Per-share amount
2016			
Basic and diluted earnings per common share	$ 558,519	1,039,663	$ 0.54

Because the impact on earnings per share from the outstanding warrants was determined to be anti-dilutive, basic and diluted earnings per share were equivalent as of December 31, 2016.

Note 16 – Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet minimum capital requirements can trigger 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, banks must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Note 16 – Regulatory Matters (continued)

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total capital, Tier 1 capital, and common equity Tier 1 to risk-weighted assets, and of Tier 1 capital to average assets (as defined in the regulations).

The Bank's and the Company's capital amounts and ratios are substantially equivalent and as of December 31, 2017 and 2016, are as follows:

	Actual		For Capital Adequacy Purposes		To Be Considered Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(dollars in thousands)						
December 31, 2017:						
Total risk-based capital ratio -						
Total capital (to risk-weighted assets)	11,522	10.2%	9,014	8.0%	11,268	10.0%
Tier 1 risk-based capital ratio -						
Tier 1 capital (to risk-weighted assets)	12,664	11.2%	6,761	6.0%	9,014	8.0%
Common equity tier 1 to risk-weighted assets	12,664	11.2%	5,071	4.5%	7,324	6.5%
Leverage ratio -						
Tier 1 capital (to average assets)	11,522	9.5%	4,861	4.0%	6,076	5.0%
December 31, 2016:						
Total risk-based capital ratio -						
Total capital (to risk-weighted assets)	12,040	13.1%	7,358	8.0%	9,198	10.0%
Tier 1 risk-based capital ratio -						
Tier 1 capital (to risk-weighted assets)	11,083	12.0%	5,519	6.0%	7,358	8.0%
Common equity tier 1 to risk-weighted assets	11,083	12.0%	4,139	4.5%	5,979	6.5%
Leverage ratio -						
Tier 1 capital (to average assets)	12,040	11.5%	3,864	4.0%	4,830	5.0%

As of the most recent notification from its regulatory agencies, the Bank was categorized as well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's regulatory capital category. Management believes, as of December 31, 2017, that the Bank meet all capital adequacy requirements to which they are subject.

The Bank is required to establish and phase-in a "conservation buffer," consisting of a common equity Tier 1 capital amount equal to 2.5% of risk-weighted assets by 2019. An institution that does not meet the conservation buffer requirement will be subject to restrictions on certain activities including payment of dividends, stock repurchases, and discretionary bonuses to executive officers. The phase-in began in 2016 and increases until fully phased-in by 2019.

Dividends – Regulations of the FDIC do not permit the Bank to pay dividends on its common stock if shareholders' equity would thereby be reduced below the Bank's regulatory capital requirements.

Note 17 – Fair Value Measurements

The following table presents information about the Bank's assets and liabilities measured at fair value on a recurring and non-recurring basis, and indicates the fair value hierarchy of the valuation techniques utilized by the Bank to determine such fair value:

		Fair Value Measurements at Report Date Using		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring items at December 31, 2017				
Available-for-sale investment securities				
U.S. Government treasury notes	$ 990,625	$ -	$ 990,625	$ -
U.S. Government agency notes	7,445,395	-	7,445,395	-
U.S. Government agency mortgage-backed securities	3,703,495	-	3,703,495	-
U.S. Government/agency collateralized mortgage obligations	2,076,883	-	2,076,883	-
Total	$ 14,216,398	$ -	$ 14,216,398	$ -
Non-recurring items at December 31, 2017				
Impaired loans, net of specific reserves and charge-offs	$ 1,263,455	$ -	$ -	$ 1,263,455
Total	$ 1,263,455	$ -	$ -	$ 1,263,455
Recurring items at December 31, 2016				
Available-for-sale investment securities				
U.S. Government treasury notes	$ 499,844	$ -	$ 499,844	$ -
U.S. Government agency notes	2,465,926	-	2,465,926	-
U.S. Government agency mortgage-backed securities	359,693	-	359,693	-
U.S. Government/agency collateralized mortgage obligations	3,524,036	-	3,524,036	-
Total	$ 6,849,499	$ -	$ 6,849,499	$ -
Non-recurring items at December 31, 2016				
Other real estate owned	$ 11,000	$ -	$ -	$ 11,000
Impaired loans, net of specific reserves and charge-offs	3,267,727	-	-	3,267,727
Total	$ 3,278,727	$ -	$ -	$ 3,278,727

Note 17 – Fair Value Measurements (continued)

Assets and liabilities are disclosed in the table above by recurring or non-recurring measurement status. Recurring assets are initially measured at fair value and are required to be remeasured at fair value in the consolidated financial statements at each reporting date. Assets measured on a non-recurring basis are assets that, due to an event or circumstance, were required to be remeasured at fair value after initial recognition in the consolidated financial statements or at some time during the reporting period.

The loans in the previous table represent impaired, collateral dependent loans that have been adjusted to fair value with a specific valuation allowance. When management determines that the value of the underlying collateral is less than the recorded investment in the loan, the Bank recognizes this impairment and adjusts the carrying value of the loan to fair value by charging-off the amount of the impairment to the allowance for loan losses, or recording a specific reserve in the allowance for loan losses.

The other real estate owned balance is real estate in which the Bank has taken ownership in partial or full satisfaction of unpaid loans. At the time of foreclosure, other real estate owned is recorded at the net realizable value, which becomes the property's new basis. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan and lease losses. After foreclosure, management periodically performs valuations such that the real estate is carried at the lower of its new cost basis or fair value, net of estimated costs to sell.

Fair value adjustments on other real estate owned are recorded as a net loss on real estate owned. This loss represents impairments on other real estate owned for adjustments based on the fair value of the real estate.

Note 17 – Fair Value Measurements (continued)

The following table discloses the estimated fair value and the related carrying value of the Bank's financial assets and liabilities, in accordance with disclosures about fair value of financial instruments, as of December 31, 2017 and 2016.

		Fair Value at December 31, 2017			
	Carrying Value	Total	Level 1	Level 2	Level 3
Financial assets					
Cash and due from banks	$ 2,790,931	$ 2,790,931	$ 2,790,931	$ -	$ -
Investment securities available-for-sale	14,216,398	14,216,398	-	14,216,398	-
Investment securities held-to-maturity	5,289,117	5,547,020	-	5,547,020	-
Restricted equity securities	218,000	218,000	-	218,000	-
Loans, net	91,000,157	90,832,862	-	-	90,832,862
Financial liabilities					
Non-interest bearing demand deposits	29,041,581	29,041,581	-	29,041,581	-
Interest-bearing demand deposits	10,876,200	10,876,200	-	10,876,200	-
Money market and savings accounts	61,095,459	61,095,459	-	61,095,459	-
Time deposits	6,202,302	6,202,302	-	6,202,302	-

		Fair Value at December 31, 2016			
	Carrying Value	Total	Level 1	Level 2	Level 3
Financial assets					
Cash and due from banks	$ 10,172,246	$ 10,172,246	$ 10,172,246	$ -	$ -
Investment securities available-for-sale	6,849,499	6,849,499	-	6,849,499	-
Investment securities held-to-maturity, at amortized cost	5,312,932	5,400,100	-	5,400,100	-
Restricted equity securities	218,700	218,700	-	218,700	-
Loans, net	73,487,030	73,396,309	-	-	73,396,309
Financial liabilities					
Non-interest bearing demand deposits	22,320,671	22,320,671	-	22,320,671	-
Interest-bearing demand deposits	9,396,876	9,396,876	-	9,396,876	-
Money market and savings accounts	49,541,267	49,541,267	-	49,541,267	-
Time deposits	5,855,472	5,855,472	-	5,855,472	-

Note 18 – Subsequent Events

On February 14, 2018 the Bank finalized a capital raising agreement, and issued 795,382 shares of voting, no-par common stock at $9.00 a share. Proceeds, net costs incurred to raise the capital, are expected to be approximately $6.7 million.