Willamette
COMMUNITY BANK

Albany, Oregon
FINANCIAL STATEMENTS
December 31, 2013 and 2012

WILLAMETTE COMMUNITY BANK
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For the Years Ended December 31, 2013 and 2012

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This report has not been reviewed, or confirmed for accuracy or relevance, by the Federal Deposit Insurance Corporation.

Boldt Carlisle + Smith
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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders
of Willamette Community Bank

We have audited the accompanying financial statements of Willamette Community Bank, which comprise the statements of financial condition as of December 31, 2013 and 2012, 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, 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 audit to obtain reasonable assurance about whether the financial statements are free of 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, 2013 and 2012, 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

Boldt Carlisle + Smith
Certified Public Accountants
Salem, Oregon
March 11, 2014

FINANCIAL STATEMENTS

WILLAMETTE COMMUNITY BANK
STATEMENTS OF FINANCIAL CONDITION
December 31, 2013 and 2012

	2013	2012
ASSETS		
Cash and due from banks	$ 5,477,164	$ 7,745,731
Investment securities available for sale	15,592,706	13,719,711
Mortgage loans held for sale	-	593,303
Loans, net	62,499,100	60,792,353
Pacific Coast Bankers' Bank (PCBB) stock	100,000	100,000
Federal Home Loan Bank (FHLB) stock	56,100	53,200
Premises and equipment, net	1,683,317	1,782,860
Prepaid FDIC assessment	-	121,735
Accrued interest and other assets	824,884	656,583
Total assets	$ 86,233,271	$ 85,565,476
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Demand	$ 14,217,555	$ 15,522,762
Interest-bearing demand	18,255,304	19,160,940
Money market	19,691,929	16,887,252
Savings	7,298,415	7,083,800
Time	17,640,446	18,343,104
Total deposits	77,103,649	76,997,858
Accrued interest and other liabilities	106,800	145,983
Total liabilities	77,210,449	77,143,841
SHAREHOLDERS' EQUITY		
Common stock, 882,467 and 816,108 shares issued and outstanding at December 31, 2013 and December 31, 2012, respectively	7,870,413	7,526,977
Accumulated surplus	1,258,730	857,999
Accumulated other comprehensive income (loss)	(106,321)	36,659
Total shareholders' equity	9,022,822	8,421,635
Total liabilities and shareholders' equity	$ 86,233,271	$ 85,565,476

See accompanying notes

WILLAMETTE COMMUNITY BANK
STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
Years ended December 31, 2013 and 2012

	2013	2012
INTEREST INCOME		
Interest and fees on loans	$ 3,547,203	$ 3,774,475
Taxable interest on investment securities	154,099	159,805
Other interest income	29,795	13,589
Total interest income	3,731,097	3,947,869
INTEREST EXPENSE		
Deposits:		
Interest-bearing demand, money market and savings	198,905	301,404
Time	162,852	200,028
Borrowing	-	464
Total interest expense	361,757	501,896
Net interest income	3,369,340	3,445,973
Loan loss provision	87,000	298,000
Net interest income after loan loss provision	3,282,340	3,147,973
NON-INTEREST INCOME		
Service charges on deposit accounts	60,451	65,530
Mortgage-loan income	113,836	207,168
Interchange fee income	137,644	135,644
(Loss) on other real estate owned	-	(40,500)
Gains on sales and early redemptions of securities	11,263	9,250
Other	35,003	32,447
Total non-interest income	358,197	409,539
NON-INTEREST EXPENSE	2,994,006	3,146,079
Income before income taxes	646,531	411,433
Provision for income taxes	245,800	162,200
NET INCOME	400,731	249,233
OTHER COMPREHENSIVE INCOME		
Unrealized holding gains (losses) during period	(220,043)	77,200
Reclassification adjustment for amounts included in net income	(11,263)	(9,250)
Other comprehensive income (loss) before income taxes	(231,306)	67,950
Income tax expense related to items of other comprehensive income (loss)	(88,326)	26,344
Other comprehensive income (loss), net of tax	(142,980)	41,606
Comprehensive income	$ 257,751	$ 290,839
Basic earnings per common share	$ 0.49	$ 0.33
Diluted earnings per common share	N/A	N/A
Weighted average common shares outstanding:		
Basic	818,449	745,487
Diluted	N/A	N/A

See accompanying notes

WILLAMETTE COMMUNITY BANK
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31, 2013 and 2012

	Number of shares	Common stock	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
2012					
Balances at December 31, 2011	668,147	$ 6,736,481	$ 608,766	$ (4,947)	$ 7,340,300
Comprehensive income:					
Net income			249,233		249,233
Other comprehensive income				41,606	41,606
Total comprehensive income					290,839
Issuance of common stock	147,961	790,496			790,496
Balances at December 31, 2012	816,108	7,526,977	857,999	36,659	8,421,635
2013					
Comprehensive income:					
Net income			400,731		400,731
Other comprehensive income (loss)				(142,980)	(142,980)
Total comprehensive income					257,751
Issuance of common stock	66,359	343,436			343,436
Balances at December 31, 2013	882,467	$ 7,870,413	$ 1,258,730	$ (106,321)	$ 9,022,822

See accompanying notes

WILLAMETTE COMMUNITY BANK
STATEMENTS OF CASH FLOWS
Years ended December 31, 2013 and 2012

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 400,731	$ 249,233
Adjustments to reconcile net income to net cash provided by operating activities:		
Loan loss provision	87,000	298,000
Deferred income taxes	(12,342)	14,121
Depreciation and amortization	170,329	183,364
Net amortization of premiums/discounts on investment securities	278,274	323,412
Gains on sales and early redemptions of securities	(11,263)	(9,250)
Loss on disposition of equipment	863	5,847
Mortgage loan originations, net	593,303	(477,208)
Changes in certain assets and liabilities:		
Accrued interest and other assets	49,114	(11,804)
Accrued interest and other liabilities	(32,183)	6,872
Net cash provided by operating activities	1,523,826	582,587
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment securities available for sale:		
Purchases	(14,322,692)	(12,116,312)
Maturities, sales, early redemptions and principal reductions	11,951,381	12,861,802
Net (increase) in loans	(1,800,748)	(2,286,321)
Net decrease in other real estate owned	-	40,500
Purchases of premises and equipment	(57,661)	(130,544)
Purchases of computer software	(9,000)	(2,664)
Purchase of FHLB stock	(2,900)	(2,700)
Net cash (used in) investing activities	(4,241,620)	(1,636,239)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	105,791	5,133,869
Issuance of common stock	343,436	790,496
Net cash provided by financing activities	449,227	5,924,365
Net increase (decrease) in cash and cash equivalents	(2,268,567)	4,870,713
Cash and cash equivalents at beginning of year	7,745,731	2,875,018
Cash and cash equivalents at end of year	$ 5,477,164	$ 7,745,731
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 365,401	$ 559,008
Cash paid for income taxes	$ 184,179	$ 201,200

See accompanying notes

WILLAMETTE COMMUNITY BANK

NOTES TO FINANCIAL STATEMENTS
Years Ended December 31, 2013 and 2012

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*. Commitments are pooled by assigned credit risk ratings with adversely-rated pools 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. The commitment loss provision is recognized into the reserve through non-interest expense rather than the loan loss provision. The commitment loss provisions for 2013 and 2012 were ($13,000) and ($1,000), respectively. The Bank's historical charge-off experience is the primary basis supporting the loss allocation factors used to estimate collective impairment.

In determining allowance adequacy, management also 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.

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

Loans (continued)

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. 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. If appropriate, interest income 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

Until mid-2013, the Bank's activities included the origination and sale of residential mortgage loans. Mortgage-loan originations and sales occurred on a pre-sold basis pursuant to contractual arrangements with various wholesale lenders. Mortgage-loan sales included 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 2013 and 2012 all such loans were carried at cost because of the contractual arrangements involved.

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.

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

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 five 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.

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.

2. INVESTMENT SECURITIES AVAILABLE FOR SALE

Investment securities available for sale consisted of the following at December 31, 2013:

Description	Book value	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U.S. government agency notes	$ 1,500,000	$ -	$ (27,775)	$ 1,472,225
U.S. government agency mortgaged-backed securities	1,634,634	657	(13,789)	1,621,502
U.S. government/government agency collateralized mortgage obligations	12,629,280	42,298	(172,599)	12,498,980
	$ 15,763,914	$ 42,955	$ (214,163)	$ 15,592,706

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. government agency mortgage-backed securities	803,330	19,000	-	822,330
U.S. government/government agency collateralized mortgage obligations	10,691,734	44,294	(20,762)	10,715,266
Corporate debt obligations	1,164,550	17,930	-	1,182,480
	$ 13,659,614	$ 81,224	$ (21,127)	$ 13,719,711

NOTES TO FINANCIAL STATEMENTS (Continued)

2. INVESTMENT SECURITIES AVAILABLE FOR SALE (Continued)

Investment securities with unrealized losses at December 31, 2013 were as follows:

	Continuous unrealized loss for less than 12 months		Continuous unrealized loss for more than 12 months		Total	
Description	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
Agency	$ 1,472,226	$ (27,775)	$ --	$ --	$1,472,226	$ (27,775)
Mortgage-backed	1,609,386	(13,789)	--	--	1,609,386	(13,789)
Collateralized mortgage obligations	7,610,764	(150,683)	808,741	(21,917)	8,419,505	(172,600)
	$ 10,692,376	$ (192,247)	$ 808,741	$ (21,917)	$11,501,117	$ (214,164)

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, 2013, 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	$ --	$ --
Due after one through five years	500,000	493,952
Due after five through ten years	--	--
Due after ten years	1,000,000	978,273
Collateralized mortgage obligations and mortgaged-backed	14,263,914	14,120,481
Total	$ 15,763,914	$ 15,592,706

At December 31, 2013 and 2012, no available-for-sale securities were pledged for any purpose.

NOTES TO FINANCIAL STATEMENTS (Continued)

3. LOANS

Loans consisted of the following at December 31, 2013 and 2012:

	2013	2012
Real estate	$ 47,319,580	$ 43,697,716
Commercial and agricultural	13,462,370	15,949,617
Consumer	1,682,854	1,663,889
Other	1,073,158	427,617
	63,537,962	61,738,839
Less unearned loan fees	(250,213)	(183,207)
Less allowance for loan losses	(788,649)	(763,279)
Loans, net	$ 62,499,100	$ 60,792,353

Transactions in the allowance for loan losses for the years ended December 31, 2013 and 2012 were as follows:

	2013	2012
Balance at beginning of year	$ 763,279	$ 738,182
Loan loss provision	87,000	298,000
Adjustments	7,000	--
Loans charged-off	(69,810)	(273,278)
Loan recoveries	1,180	375
Balance at end of year	$ 788,649	$ 763,279

The allowance for loan losses has been determined based on loans that are individually evaluated for impairment and the collective balance of all other loans collectively as follows:

Loans individually evaluated for impairment	$ 13,100	$ 1,000
Collectively evaluated	775,549	762,279
Total	$ 788,649	$ 763,279

Loans on non-accrual status as of December 31, 2013 and 2012 were as follows:

	2013	2012
Real estate	$ --	$ 76,421

Interest income not received on non-accrual loans totaled $2,894 during 2013.

NOTES TO FINANCIAL STATEMENTS (Continued)

3. LOANS (Continued)

An aged analysis of past due loans as of December 31, 2013 and 2012 is as follows:

2013	30-89 Days Past Due	Over 90 Days Past Due	Total Past Due	Current	Total Loans	Over 90 Days and Accruing
Real estate	$ 565,197	$ -	$ 565,197	$ 46,754,383	$ 47,319,580	$ -
Commercial and agricultural	42,755	-	42,755	13,419,615	13,462,370	-
Consumer	27,328	-	27,328	1,655,526	1,682,854	-
Other	-	-	-	1,073,158	1,073,158	-
Total	$ 635,280	$ -	$ 635,280	$ 62,902,682	$ 63,537,962	$ -
2012						
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	$ -	$ 521,159	$ 521,159	$ 61,217,680	$ 61,738,839	$ 444,101

Impaired loans as of December 31, 2013 and 2012 were as follows:

2013	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Real estate	$ 138,778	$ 138,778	$ -	$ 138,834	$ 692
Commercial and agricultural	434,692	434,692	-	472,157	26,259
With a related allowance recorded:					
Real estate	116,837	116,837	12,600	116,837	345
Commercial and agricultural	14,881	14,881	500	15,784	960
	$ 705,188	$ 705,188	$ 13,100	$ 743,611	$ 28,256
2012					
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
	$ 1,277,099	$ 1,494,099	$ 1,000	$ 1,473,724	$ 111,057

NOTES TO FINANCIAL STATEMENTS (Continued)

3. LOANS

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 risk to those with minor deficiencies and requiring increased monitoring but not subject to adverse risk rating.

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.

Loans by credit quality indicators as of December 31, 2013 and 2012 were as follows:

2013	Real Estate	Commercial and Agricultural	Consumer	Other
Grade:				
Pass	$ 44,081,553	$ 12,440,072	$ 1,682,854	$ 1,073,158
Special mention	2,023,238	194,000	-	-
Substandard	1,214,789	828,298	-	-
Doubtful	-	-	-	-
Loss	-	-	-	-
Total	$ 47,319,580	$ 13,462,370	$ 1,682,854	$ 1,073,158
2012				
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	$ 43,697,716	$ 15,949,617	$ 1,663,889	$ 427,617

3. LOANS (Continued)

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, 2013 and 2012, $705,067 and $832,361 in loans were classified as troubled debt restructurings. Newly restructured loans during the years ended December 31, 2013 and 2012 were as follows:

2013	Number of Contracts	Outstanding Recorded Investment Before Modification	Outstanding Recorded Investment After Modification	Concession(s) Granted	Impairment Amount at December 31st
Real estate	2	$ 255,635	$ 255,855	Note term(s)	12,600
Commercial and agricultural	3	135,205	135,205	Note term(s)	-
Total	5	$ 390,840	$ 391,060		12,600
2012					
Commercial and agricultural	5	$ 721,890	$ 721,890	Note term(s)	-

4. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following at December 31, 2013 and 2012:

	2013	2012
Land and improvements	$ 336,939	$ 336,939
Leasehold improvements	435,411	435,411
Building	1,093,374	1,093,374
Furniture and equipment	844,582	797,620
	2,710,306	2,663,344
Less accumulated depreciation	(1,026,989)	(880,484)
Premises and equipment, net	$ 1,683,317	$ 1,782,860

Depreciation expense was $156,341 and $162,559 for the years ended December 31, 2013 and 2012, respectively. Software amortization expense was $13,988 and $20,805 for the years ended December 31, 2013 and 2012, respectively.

5. TIME DEPOSITS

Time deposits of $100,000 or more aggregated $11,576,042 and $11,561,216 at December 31, 2013 and 2012, respectively. At December 31, 2013, the scheduled annual maturities of all time deposits were as follows:

2014	$ 13,225,418
2015	3,394,764
2016	426,633
2017	572,077
2018	21,554
Total	$ 17,640,446

6. BORROWINGS

The Bank had no borrowings outstanding at December 31, 2013 and 2012.

At December 31, 2013, the Bank had borrowing availability of approximately $950,000 under its Cash Management Advance ("CMA") facility with the Federal Home Loan Bank of Seattle. The CMA facility is secured by mulitfamily, residential-mortgage loans. In addition, the Bank maintains an unsecured $2,500,000 federal funds facility with its primary correspondent bank, Pacific Coast Bankers' Bank. Both facilities were fully available at December 31, 2013. 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 $1,245,000 at December 31, 2013. 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, 2013 and 2012:

	2013	2012
Salaries and employee benefits	$ 1,435,540	$ 1,532,476
Premises and equipment	436,409	411,964
Data processing	430,753	466,430
Business development	75,170	108,917
Legal and professional	190,136	169,131
Other	425,998	457,161
Total non-interest expense	$ 2,994,006	$ 3,146,079

8. PROVISION FOR INCOME TAXES

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

	2013	2012
Current		
Federal	$ 223,029	$ 120,899
State	46,863	27,180
Less state tax credits	(11,750)	--
	258,142	148,079
Deferred		
Federal	(10,104)	11,132
State	(2,238)	2,989
	(12,342)	14,121
	$ 245,800	$ 162,200

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

	2013	2012
Expected tax at statutory rates	$ 219,821	$ 139,887
State taxes, net of federal benefit	28,163	20,638
Other	(2,184)	1,675
	$ 245,800	$ 162,200

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

	2013	2012
Loan loss provision	$ 266,267	$ 267,095
Market adjustment on investment securities available for sale	64,888	(23,210)
Accrued interest receivable	(124,549)	(123,795)
Prepaid expenses	(39,335)	(37,735)
Difference in depreciation	(56,189)	(80,390)
Accrued interest payable	7,184	8,600
Accrued expenses	14,900	20,835
Valuation adjustment on other real estate owned	16,800	16,800
Total deferred tax benefits	$ 149,966	$ 48,200

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, 2011, 2012 and 2013 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, 2013 and 2012 were as follows:

	2013	2012
Commitments to extend credit by type:		
Real estate	$ 4,194,734	$ 2,447,260
Commercial and agricultural	9,139,487	5,877,966
Consumer	257,442	269,692
Other	627,218	394,670
Standby letter 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.

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 $5,000 and $25,000 at December 31, 2013 and 2012 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 2013 and 2012 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 Chief Financial Officer 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.

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.

10. ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

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, 2013 and 2012 were as follows:

		Fair value measurements at reporting 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)
December 31, 2013				
Financial assets:				
Cash and cash equivalents	$ 5,477,164	$5,477,164		
Available-for-sale securities	15,592,706		$15,592,706	
Loans	62,499,100			$62,329,100
Interest receivable	322,047			322,047
PCBB stock	100,000			100,000
FHLB stock	56,100			56,100
Financial liabilities:				
Deposits	77,103,649			77,195,649
Interest payable	18,602			18,602
December 31, 2012				
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

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, 2013 and 2012 were as follows:

Balance at December 31, 2011	$ 502,857
Additions or renewals	2,259,000
Amounts collected	(56,848)
Balance at December 31, 2012	2,705,009
Additions or renewals	102,000
Amounts collected	(388,257)
Balance at December 31, 2013	$ 2,418,752

At December 31, 2013 and 2012, the commitments in note 9 included $248,000 and $71,000, respectively, in unused commitments to extend credit to Directors and their affiliates.

At December 31, 2013 and 2012, time deposits of $100,000 or more, as discussed in note 5 above, included $575,593 and $465,318, 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, 2013 and 2012.

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, 2013 and 2012 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, 2013 and 2012 were as follows:

2013	Net Income (numerator)	Shares (denominator)	Per-share amount
Basic earnings per common share	$ 400,731	818,449	$ .49

2012	Net Income (numerator)	Shares (denominator)	Per-share amount
Basic earnings per common share	$ 249,233	745,487	$ 0.33

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, 2013, that the Bank met all regulatory capital adequacy requirements.

As of December 31, 2013, 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:

	Actual		Regulatory minimum to be "adequately capitalized"		Regulatory minimum to be "well capitalized"	
	Amounts (In thousands)	Ratios	Amounts (In thousands)	Ratios	Amounts (In thousands)	Ratios
December 31, 2013						
Total capital to risk-weighted assets	9,762	14.0%	5,568	8.0%	6,961	10.0%
Tier 1 capital to risk-weighted assets	8,969	12.9%	2,784	4.0%	4,176	6.0%
Tier 1 capital to average assets	8,969	10.5%	3,424	4.0%	4,280	5.0%
December 31, 2012						
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%

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, 2013, the minimum rental payments due under the lease were as follows:

2014	40,998
2015	41,520
2016	43,284
2017	43,872
2018	9,749
Thereafter	--

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 $55,908 and $54,899 in 2013 and 2012, respectively. The 2013 total included contingent rentals of $13,257.

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, 2013 and 2012 totaled $33,478 and $39,236, 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.