Report of Independent Auditors
and Financial Statements for

People's Bank of Commerce
(an Oregon Banking Corporation)

December 31, 2011 and 2010

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

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Note: These financial statements have not been reviewed, or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Stockholders
People's Bank of Commerce

We have audited the accompanying balance sheets of People's Bank of Commerce (an Oregon Banking Corporation) (the Bank) as of December 31, 2011 and 2010, and the related statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. 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 includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of People's Bank of Commerce as of December 31, 2011 and 2010, 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.

Moss Adams LLP

Portland, Oregon
March 15, 2012

	December 31, 2011	December 31, 2010
ASSETS		
Cash and cash equivalents	$ 5,933,073	$ 6,054,016
Investment securities available-for-sale, at fair value	11,606,055	9,166,297
Restricted equity securities	163,200	163,200
Loans held-for-sale	3,526,890	607,600
Loans, net of allowance for loan losses, and unearned income	92,201,577	79,471,348
Premises, equipment, and leasehold improvements, net of accumulated depreciation and amortization	3,080,760	3,248,226
Other real estate owned	2,606,413	2,426,735
Bank-owned life insurance	3,787,428	3,004,317
Investment in real estate joint venture	1,073,889	-
Accrued interest receivable and other assets	2,092,924	1,949,121
Total assets	$ 126,072,209	$ 106,090,860
LIABILITIES		
Noninterest-bearing demand deposits	$ 32,320,600	$ 20,576,464
Interest-bearing demand and money market accounts	40,785,196	36,111,516
Savings deposits	4,645,268	3,580,449
Time deposits	32,796,135	31,578,194
Total deposits	110,547,199	91,846,623
Borrowings	775,000	775,000
Accrued interest payable and other liabilities	1,136,004	1,041,918
Total liabilities	112,458,203	93,663,541
COMMITMENTS AND CONTINGENCIES (Notes 9 and 11)		
STOCKHOLDERS' EQUITY		
Common stock, $5 par value, 2,000,000 shares authorized; 1,137,546 and 1,062,352 shares issued and outstanding at December 31, 2011 and 2010, respectively	5,687,730	5,311,760
Surplus	7,094,652	6,887,880
Retained earnings	706,429	177,926
Accumulated other comprehensive income	125,195	49,753
Total stockholders' equity	13,614,006	12,427,319
Total liabilities and stockholders' equity	$ 126,072,209	$ 106,090,860

See accompanying notes.

PEOPLE'S BANK OF COMMERCE
STATEMENTS OF INCOME

	Years Ended December 31, 2011	2010
INTEREST INCOME		
Interest and fees on loans	$ 5,298,670	$ 5,057,118
Interest on investment securities	239,288	276,647
Interest on federal funds sold	2,346	1,729
Total interest income	5,540,304	5,335,494
INTEREST EXPENSE		
Time deposit accounts	529,060	925,304
Interest-bearing deposit and savings accounts	143,690	228,240
Other borrowings	26,203	22,888
Total interest expense	698,953	1,176,432
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	4,841,351	4,159,062
PROVISION FOR LOAN LOSSES	410,600	250,900
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	4,430,751	3,908,162
NONINTEREST INCOME		
Service charges and other fees	674,511	610,952
Gain on sale of loans	419,358	389,262
Mortgage brokerage fees	181,716	280,094
Other noninterest income	281,184	145,711
Total noninterest income	1,556,769	1,426,019
NONINTEREST EXPENSE		
Salaries and employee benefits	2,985,367	2,643,733
Occupancy and equipment	735,400	701,232
Data processing	203,274	179,546
Advertising and promotional	152,659	162,639
Supplies	67,701	66,885
Impairment loss on other real estate owned	39,359	141,620
Loss (gain) on sale of other real estate owned	31,953	(62,078)
Other noninterest expense	1,050,934	1,044,782
Total noninterest expense	5,266,647	4,878,359
INCOME BEFORE PROVISION FOR INCOME TAXES	720,873	455,822
PROVISION FOR INCOME TAXES	192,370	90,390
NET INCOME	$ 528,503	$ 365,432
Basic and Diluted Earnings Per Share of Common Stock	$ 0.47	$ 0.39

See accompanying notes.

STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31, 2011	Years Ended December 31, 2010
Net income	$ 528,503	$ 365,432
Change in net unrealized gain on investment securities available-for-sale, net of taxes	150,373	(3,846)
Reclassification adjustment for gains included in net income, net of taxes	(74,931)	(13,547)
Total comprehensive income	$ 603,945	$ 348,039

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock Shares	Common Stock Amount	Surplus	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income	Total Stockholders' Equity
BALANCE, December 31, 2009	917,302	$ 4,586,510	$ 6,404,931	$ (187,506)	$ 67,146	$ 10,871,081
Net income	-	-	-	365,432	-	365,432
Change in net unrealized gain on investment securities available-for-sale, net of taxes	-	-	-	-	(3,846)	(3,846)
Reclassification adjustment for gains included in net income, net of taxes	-	-	-	-	(13,547)	(13,547)
Restricted stock grants issued	13,500	67,500	(67,500)	-	-	-
Stock-based compensation expense	-	-	1,446	-	-	1,446
Exercise of stock options and related tax benefit	7,113	35,565	24,838	-	-	60,403
Common stock issued, net of expenses	124,437	622,185	524,165	-	-	1,146,350
Total comprehensive income						
BALANCE, December 31, 2010	1,062,352	5,311,760	6,887,880	177,926	49,753	12,427,319
Net income	-	-	-	528,503	-	528,503
Change in net unrealized gain on investment securities available-for-sale, net of taxes	-	-	-	-	150,373	150,373
Reclassification adjustment for gains included in net income, net of taxes	-	-	-	-	(74,931)	(74,931)
Restricted stock grants issued	13,500	67,500	(67,500)	-	-	-
Stock-based compensation expense	-	-	43,948	-	-	43,948
Exercise of stock options and related tax benefit	22,898	114,490	55,742	-	-	170,232
Common stock issued, net of expenses	38,796	193,980	174,582	-	-	368,562
Total comprehensive income						
BALANCE, December 31, 2011	1,137,546	$ 5,687,730	$ 7,094,652	$ 706,429	$ 125,195	$ 13,614,006

PEOPLE'S BANK OF COMMERCE
STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 528,503	$ 365,432
Adjustments to reconcile net income to net cash from operating activities:		
Deferred income taxes	(81,407)	(156,367)
Provision for loan losses	410,600	250,900
Depreciation and amortization	220,235	214,262
Stock-based compensation expense	43,948	1,446
Amortization of premiums on investment securities	114,958	84,564
Realized gain on sale of investment securities	(121,642)	(21,350)
Excess tax benefit on stock options exercised	(15,213)	(5,406)
Impairment loss on other real estate owned	39,359	141,620
Loss/(gain) on sale of other real estate owned	31,953	(62,078)
Net appreciation of bank-owned life insurance	(118,111)	(108,594)
Gain on sale of loans	(419,358)	(389,262)
Proceeds from the sale of loans held-for-sale	27,697,428	32,720,626
Production of loans held-for-sale	(30,197,360)	(31,188,355)
Changes in cash due to changes in certain assets and liabilities		
Accrued interest receivable and other assets	(94,213)	264,317
Accrued interest payable and other liabilities	94,086	474,111
Net cash from operating activities	(1,866,234)	2,585,866
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities available-for-sale	(9,040,525)	(3,413,966)
Proceeds from payments, calls, and sales of investment securities available-for-sale	6,729,923	5,714,344
Purchase of Federal Home Loan Bank stock	-	(26,600)
Net increase in loans	(14,046,697)	(6,409,798)
Proceeds from sale of other real estate owned	654,878	367,996
Improvements on other real estate owned	-	(11,339)
Purchase of bank-owned life insurance	(665,000)	-
Investment in real estate joint venture	(1,073,889)	-
Payments made for purchase of premises, equipment, and leasehold improvements	(52,769)	(21,285)
Net cash from investing activities	(17,494,079)	(3,800,648)

See accompanying notes.

	Years Ended December 31, 2011	2010
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposit accounts	$ 18,700,576	$ 2,373,115
Proceeds from stock options exercised	155,019	54,997
Proceeds from sales of common stock, net of expenses	368,562	1,146,350
Excess tax benefit on stock options exercised	15,213	5,406
Net cash from financing activities	19,239,370	3,579,868
NET CHANGE IN CASH AND CASH EQUIVALENTS	(120,943)	2,365,086
CASH AND CASH EQUIVALENTS, beginning of year	6,054,016	3,688,930
CASH AND CASH EQUIVALENTS, end of year	$ 5,933,073	$ 6,054,016
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	$ 754,053	$ 1,218,609
Cash paid for taxes	$ (208,000)	$ (41,962)
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Change in fair value of investment securities available-for-sale, net of taxes	$ 75,442	$ (17,393)
Transfers of loans to other real estate owned	$ 905,868	$ 1,874,999

Note 1 – Organization and Summary of Significant Accounting Policies

Organization – In March 1998, People's Bank of Commerce (the Bank) was incorporated and received regulatory approval to become a state-chartered institution authorized to provide banking services in the state of Oregon. The Bank is subject to the regulations of certain federal and state agencies and will undergo periodic examinations by those regulatory authorities.

The Bank, which is headquartered in Medford, Oregon, operates three full-service branches in Ashland, Central Point, and Medford, Oregon, and provides banking services to businesses and individuals located primarily in Southern Oregon.

Management's estimates and assumptions – 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 sheets, and revenues and expenses for the reporting periods. Actual results could differ significantly from management's estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses, the valuation of investment securities available-for-sale, other real estate owned, and deferred tax assets.

Cash and cash equivalents – Cash equivalents are generally short-term investments with a maturity of three months or less. Cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

The Bank maintains balances in correspondent bank accounts which, at times, may exceed federally insured limits. Management believes that its risk of loss associated with such balances is minimal due to the financial strength of correspondent banks. The Bank has not experienced any losses in such accounts.

Investment securities – The Bank is required to specifically identify its investment securities as "available-for-sale," "held-to-maturity," or "trading accounts." Management has designated investment securities held at December 31, 2011 and 2010 as "available-for-sale."

Available-for-sale securities consist of bonds, notes, and debentures. Securities are generally 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. Unrealized holding gains and losses, net of taxes, on available-for-sale securities are reported as a net amount in a separate component of equity until realized. Fair values for these investment securities are based on quoted market prices. Gains and losses on the sale of available-for-sale securities are determined using the specific-identification method. Premiums and discounts are recognized in interest income using the effective interest method over the period to maturity.

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

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 amortized cost basis 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, i.e., 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. Impairment losses related to all other factors are presented as separate categories within other comprehensive income.

Loans held-for-sale – Mortgage loans held-for-sale are carried at the lower of cost or estimated market value. Market value is determined on an aggregate loan basis.

Loans, net of allowance for loan losses, and deferred loan costs – In the normal course of business, the Bank originates and services loans receivable from borrowers. Loans are stated at the amount of unpaid principal, net of an allowance for loan losses, and net of deferred loan fees or costs. Interest on loans is calculated using 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 the yield of the related loan.

Loans are classified as impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal and interest when due, in accordance with the terms of the original loan agreement. The carrying value of impaired loans is based on the present value of expected future cash flows (discounted at each loan's effective interest rate) or, for collateral dependent loans, at fair value of the collateral. If the measurement of each impaired loan's value is less than the recorded investment in the loan, an impairment allowance is created by either charging the provision for loan losses or allocating an existing component of the allowance for loan losses.

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

Loans, including impaired loans, are classified as non-accrual if the collection of principal and interest is doubtful. Generally, this occurs when a loan is past due as to maturity or payment of principal or interest by 90 days or more, unless such loans are well-secured and in the process of collection. If a loan or portion thereof is partially charged-off, the loan is considered impaired and classified as non-accrual. Loans that are less than 90 days past due may also be classified as non-accrual if repayment in full of principal and/or interest is in doubt.

When a loan is classified as non-accrual, all uncollected accrued interest is reversed against interest income and the accrual of interest income is terminated. Generally, any cash payments are applied as a reduction of principal outstanding. In cases where the future collectibility of the principal balance in full is expected, interest income may be recognized on a cash basis. A loan may be restored to accrual status when the borrower's financial condition improves so that full collection of principal is considered likely.

A troubled debt restructuring is a formal restructure of a loan where the Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower. The concessions may be granted in various forms, 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.

The allowance for loan losses is established through a provision for loan losses charged to expenses. Loans are charged against the allowance for loan losses when management believes that the collectibility of principal is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible, based on evaluations of the collectibility of loans and prior loan loss experience. These 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. Management carefully monitors changing economic conditions, the concentrations of loan categories and collateral, the financial condition of borrowers, the history of the loan portfolio, and historical peer group loan loss data to determine the adequacy of the allowance for loan losses. The allowance is based on estimates, and actual losses may vary from the estimates. No assurance can be given that adverse future economic conditions will not lead to delinquent loans, increases in the provision for loan losses, and/or charge-offs. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Bank to recognize additional losses based on their judgment about information available to them at the time of their examination.

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

Premises, equipment, and leasehold improvements – Premises, equipment, and leasehold improvements are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization are computed principally by the straight-line method over the estimated useful lives of the assets, or lease term in the case of leasehold improvements, which range from two to forty years.

Other real estate owned – Property and assets acquired through foreclosure or deed in lieu of foreclosure are stated at the lower of the carrying value of the loan or the fair value of the assets received, less estimated costs to sell, at the date the asset is acquired. Subsequent impairment wrote-down to net realizable value, if any, or any disposal gains or losses are included in noninterest income or expense. Costs relating to the development and improvement of property are capitalized and holding costs are charged to expense as incurred.

Federal Home Loan Bank (FHLB) stock – At December 31, 2011 and 2010, the Bank held FHLB stock with a par value of $159,700. As a member of the FHLB system, the Bank is required to maintain a minimum investment level in FHLB stock based on specific percentages of the Bank's outstanding mortgages, total assets, or FHLB advances. This security is reported at par value, which represents the Bank's cost. The Seattle FHLB has reported a risk-based capital deficiency under the regulations of the Federal Housing Finance Agency (the FHFA), its primary regulator. As a result, the Seattle FHLB has stopped paying a dividend and cannot repurchase or redeem outstanding common stock until it meets a minimum retained earnings requirement.

The stock in the Seattle FHLB is classified as restricted stock and is evaluated for impairment based on ultimate recoverability. 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 determination of whether a decline affects the ultimate recoverability is influenced by criteria such as (1) the significance of the decline in the net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of the legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB, and (4) the liquidity position of the FHLB. Management's review for impairment is based on ultimate recoverability of the Bank's cost basis in FHLB stock and concluded that the FHLB stock investment is not impaired as of December 31, 2011.

Investment in real estate joint venture – During 2011, the Bank entered into a joint venture with another investor in a limited liability company formed to manage the construction and eventual ownership of a new building that the Bank is expected to occupy near the end of 2012. The Bank accounts for this investment using the equity method of accounting, and carries the investment at 50% of total costs incurred to construct the new building. To date, no revenues and limited expenses have been generated by the limited liability company.

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

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. 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 its valuation allowance and by adjusting the amount of such allowance, if necessary.

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 tax authorities, based on the technical merits of the position. The 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 accrued for the years ended December 31, 2011 and 2010.

Off-balance sheet financial instruments – The Bank holds no derivative financial instruments. However, in the ordinary course of business, the Bank enters into off-balance sheet financial instruments consisting of commitments to extend 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 allowance for off-balance sheet credit losses related to unfunded loan commitments is increased through charges to noninterest expense and is decreased by charge-offs or transfers to the allowance for loan losses at the time that the related loan is funded. Management periodically evaluates the adequacy of this allowance based on the Bank's off-balance sheet credit loss experience, known and inherent risks in the portfolio, adverse situations which may increase the likelihood of loss, and current economic conditions. This reserve for unfunded loan commitments is included in the balance sheets under the caption "accrued interest payable and other liabilities."

Advertising and promotional expenses – Advertising and promotional costs are charged to expense during the year in which they are incurred.

Earnings per share – Basic earnings per share is computed by dividing net income available to stockholders by the weighted average number of common shares outstanding during the period, after giving retroactive effect to stock dividends and splits. Diluted earnings per share is computed similar to basic earnings per share except that the denominator is increased to include dilutive common equivalent shares for stock options assumed to be outstanding during the period utilizing the treasury stock method.

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

Stock compensation plans – The Bank has adopted stock-based compensation plans, and utilizes the Black-Scholes valuation model for determining the fair value of options on the date of grant as well as compensation expense for stock options issued. Share-based awards that do not require future service (i.e., fully vested awards at grant date) are expensed immediately. Share-based employee awards that require future service are amortized over the relevant service period. The Bank recognizes share-based compensation expense on a straight-line basis.

Fair value measurements – 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. 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 shall be adjusted for market consideration when reasonably available.

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

Investment securities available-for-sale – Investment securities available-for-sale are measured and carried at fair value on a recurring basis. 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 (Level 1). When market quotes are not readily accessible or available, alternative approaches are utilized, such as matrix or model pricing (Level 2).

Impaired loans – Impaired loans are measured and adjusted to fair value on a non-recurring basis. Impaired loans are measured for impairment at the present value of expected future cash flows discounted at the loan's effective interest rate (Level 3), the loan's market price (Level 2), or the fair value of the collateral based on independent appraisals, less costs to sell, if the loan is collateral dependent (Level 3).

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

Other real estate owned – Other real estate owned is measured and adjusted to fair value on a non-recurring basis. On the date that other real estate owned is received in satisfaction of a loan receivable, it is measured at fair value, less cost to sell, based on recent independent appraisals (Level 3). Subsequent to the acquisition date, it is measured for impairment and written down to its fair value, less costs to sell, based on updated independent appraisals (Level 3).

The following methods and assumptions were used by the Bank in estimating fair values of assets and liabilities not carried at fair value on a recurring or nonrecurring basis:

Cash and cash equivalents – The carrying amounts reported in the balance sheets for cash and cash equivalents approximate their fair value at the balance sheet date.

Restricted equity securities – The Bank's investment in restricted equity securities are carried at par value which is expected to approximate fair value.

Loans held-for-sale – The carrying value of loans held-for-sale approximates fair value.

Loans receivable, net – For variable rate loans that re-price frequently and have no significant change in credit risk, fair value is equivalent to carrying value. Fair values for all other 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.

Bank-owned life insurance – Fair values of insurance policies owned are based on the insurance contract's cash surrender value.

Borrowings – The fair value of borrowings is estimated by discounting future cash flows using rates currently offered for notes payable of similar remaining maturities.

Deposit liabilities – Fair value disclosed for demand deposits equals their carrying amount, which represents the amount payable on demand. The carrying amounts for variable-rate interest bearing deposit accounts and certificates of deposit approximate their fair value at the balance sheet date. Fair value for fixed-rate certificates of deposit is estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregate expected monthly maturities on time deposits.

Accrued interest receivable and payable – The fair value of accrued interest receivable and payable equals the carrying value at the balance sheet date.

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.

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

The Bank assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. Consequently, the fair value of the Bank's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Bank. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed-rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities, and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Bank's overall interest rate risk.

Reclassifications – Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation. These reclassifications have no effect on previously reported net income.

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 the 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 March 15, 2012 which is the date the financial statements became available to be issued.

Note 2 – Investment Securities

The amortized cost and estimated fair value of the Bank's investment securities available-for-sale, with gross unrealized gains and losses, are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses Less than 12 Months	Gross Unrealized Losses Greater than 12 Months	Estimated Fair Value
December 31, 2011					
U.S. government agency obligations	$ 3,600,291	$ 47,298	$ -	$ -	$ 3,647,589
SBA backed securities	4,808,777	20,180	(18,959)	-	4,809,998
Municipal securities	2,993,748	154,720	-	-	3,148,468
	$ 11,402,816	$ 222,198	$ (18,959)	$ -	$ 11,606,055

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses Less than 12 Months	Gross Unrealized Losses Greater than 12 Months	Estimated Fair Value
December 31, 2010					
U.S. government agency obligations	$ 3,500,702	$ 92,695	$ -	$ -	$ 3,593,397
SBA backed securities	2,362,852	1,718	(1,317)	-	2,363,253
Municipal securities	3,221,974	7,084	(13,802)	(5,609)	3,209,647
	$ 9,085,528	$ 101,497	$ (15,119)	$ (5,609)	$ 9,166,297

At December 31, 2011, the Bank had five investment securities with amortized cost of $2,341,783 in a loss position for less than 12 months, as shown in the above table. The Bank evaluated the unrealized losses and determined that the declines in value at December 31, 2011 were temporary and related to the change in market interest rates since the date of purchase. At December 31, 2010, the Bank had two SBA backed securities with amortized cost of $1,308,747 and five municipal investment securities with amortized cost of $1,762,757 in a loss position for less than 12 months, and one municipal security with amortized cost of $330,371 in an unrealized loss position for more than 12 months, as shown in the above table.

At December 31, 2011 and 2010, securities in the amount of $400,000 were pledged to secure public deposits.

Note 2 – Investment Securities (continued)

The amortized cost and estimated fair value of available-for-sale investment securities by contractual maturity at December 31, 2011 are as follows:

	Amortized Cost	Estimated Fair Value
Due from one year through five years	$ 3,600,291	$ 3,647,589
Due from five years through ten years	2,947,710	2,959,509
Due after ten years	4,854,815	4,998,957
	$ 11,402,816	$ 11,606,055

Note 3 – Loans, Net of Allowance for Loan Losses, and Unearned Income

The composition of loan balances is summarized as follows as of December 31:

	2011	2010
Real estate loans	$ 60,600,150	$ 50,202,582
Commercial loans	25,927,935	21,750,673
Construction loans	5,988,604	7,557,041
Consumer loans	1,427,357	1,538,368
Total loans	93,944,046	81,048,664
Allowance for loan losses	(1,583,116)	(1,429,814)
Unearned income	(159,353)	(147,502)
Loans, net of allowance for loan losses, and unearned income	$ 92,201,577	$ 79,471,348

Note 4 – Allowance for Loan Losses

The following table displays the activity and allocation of the allowance for loan losses to significant segments of the loan portfolio at December 31:

	2011					
	Real Estate	Commercial	Construction	Consumer	Unallocated	Total
Allowance for loan losses						
Beginning balance	$ 842,736	$ 315,574	$ 261,492	$ 10,012	$ -	$ 1,429,814
Charge-offs	(287,144)	(7,299)	-	(5,320)	-	(299,763)
Recoveries	33,253	7,620	500	1,092	-	42,465
Provision for loan losses	458,934	20,570	(85,052)	16,148	-	410,600
Ending balance	$ 1,047,779	$ 336,465	$ 176,940	$ 21,932	$ -	$ 1,583,116
Ending balance Loans individually evaluated for impairment	$ 98,139	$ 27,340	$ 45,452	$ -	$ -	$ 170,931
Ending balance Loans collectively evaluated for impairment	$ 949,640	$ 309,125	$ 131,488	$ 21,932	$ -	$ 1,412,185

	2010					
	Real Estate	Commercial	Construction	Consumer	Unallocated	Total
Allowance for loan losses						
Beginning balance	$ 634,877	$ 350,359	$ 122,145	$ 6,396	$ 107,916	$ 1,221,693
Charge-offs	(70,829)	(1,749)	(24,000)	(689)	-	(97,267)
Recoveries	7,360	47,003	-	125	-	54,488
Provision for loan losses	271,328	(80,039)	163,347	4,180	(107,916)	250,900
Ending balance	$ 842,736	$ 315,574	$ 261,492	$ 10,012	$ -	$ 1,429,814
Ending balance Loans individually evaluated for impairment	$ 133,113	$ 28,296	$ 125,774	$ -	$ -	$ 287,183
Ending balance Loans collectively evaluated for impairment	$ 709,623	$ 287,278	$ 135,718	$ 10,012	$ -	$ 1,142,631

Note 4 – Allowance for Loan Losses (continued)

The following table displays the activity and allocation of loans evaluated individually for impairment to significant segments of the loan portfolio at December 31:

	2011				
	Real Estate	Commercial	Construction	Consumer	Total
Loans					
Ending balance	$ 60,600,150	$ 25,927,935	$ 5,988,604	$ 1,427,357	$ 93,944,046
Ending balance Loans individually evaluated for impairment	$ 450,703	$ 980,759	$ 2,078,085	$ -	$ 3,509,547
Ending balance Loans collectively evaluated for impairment	$ 60,149,447	$ 24,947,176	$ 3,910,519	$ 1,427,357	$ 90,434,499

	2010				
	Real Estate	Commercial	Construction	Consumer	Total
Loans					
Ending balance	$ 50,202,582	$ 21,750,673	$ 7,557,041	$ 1,538,368	$ 81,048,664
Ending balance Loans individually evaluated for impairment	$ 1,185,928	$ 930,803	$ 2,248,085	$ -	$ 4,364,816
Ending balance Loans collectively evaluated for impairment	$ 49,016,654	$ 20,819,870	$ 5,308,956	$ 1,538,368	$ 76,683,848

Note 4 – Allowance for Loan Losses (continued)

The following table represents loan portfolio information by loan type and credit grade as of December 31:

	2011				
	Real Estate	Commercial	Construction	Consumer	Total
Grade					
Pass	$ 57,141,378	$ 23,253,813	$ 2,878,258	$ 1,409,955	$ 84,683,404
Special mention	3,026,709	1,606,923	870,078	2,464	5,506,174
Substandard	432,063	1,067,199	2,240,268	14,938	3,754,468
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
Total	$ 60,600,150	$ 25,927,935	$ 5,988,604	$ 1,427,357	$ 93,944,046

	2010				
	Real Estate	Commercial	Construction	Consumer	Total
Grade					
Pass	$ 45,679,159	$ 17,859,111	$ 4,745,898	$ 1,532,033	$ 69,816,201
Special mention	3,073,779	2,525,239	2,641,143	6,335	8,246,496
Substandard	1,449,644	1,366,323	170,000	-	2,985,967
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
Total	$ 50,202,582	$ 21,750,673	$ 7,557,041	$ 1,538,368	$ 81,048,664

Credit quality indicators – The Bank's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. Assignment of a risk rating is done on the individual loan rather than at the borrower level. Loans are graded from inception and on a continuing basis until the debt is repaid.

The risk rating categories can be generally described by the following groupings:

Pass – An acceptable asset carrying a normal degree of credit risk exhibiting the capacity to perform according to the repayment terms.

Special Mention – A special mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in a deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

Note 4 – Allowance for Loan Losses (continued)

Substandard – A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt.

Doubtful – Any asset classified doubtful has all the weaknesses inherent in one classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and value, highly questionable and improbable.

Loss – Assets classified loss are considered uncollectible and of such minimal value that the continuance as bankable assets are not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value but that it is not practical or desirable to defer writing off this basically worthless asset even though a partial recovery may occur in the future.

Past due loans are loans for which principal and interest were not paid timely according to the contractual payment date. The following table represents loans past due by loan category as of December 31:

	2011					
	30 – 59 Days Past Due	60 – 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans
Real estate	$ -	$ -	$ -	$ -	$ 60,600,150	$ 60,600,150
Commercial	-	-	21,279	21,279	25,906,656	25,927,935
Construction	-	-	-	-	5,988,604	5,988,604
Consumer	-	-	-	-	1,427,357	1,427,357
	$ -	$ -	$ 21,279	$ 21,279	$ 93,922,767	$ 93,944,046

	2010					
	30 – 59 Days Past Due	60 – 89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loans
Real estate	$ 255,750	$ 588,205	$ 234,829	$ 1,078,784	$ 49,123,798	$ 50,202,582
Commercial	-	25,155	-	25,155	21,725,518	21,750,673
Construction	-	170,000	-	170,000	7,387,041	7,557,041
Consumer	-	-	-	-	1,538,368	1,538,368
	$ 255,750	$ 783,360	$ 234,829	$ 1,273,939	$ 79,774,725	$ 81,048,664

Note 4 – Allowance for Loan Losses (continued)

The following shows loans on nonaccrual status as of December 31:

	2011		2010	
	Loans on Nonaccrual Status	Recorded Investment > 90 Days and Accruing	Loans on Nonaccrual Status	Recorded Investment > 90 Days and Accruing
Real estate	$ 108,973	$ -	$ 1,078,784	$ -
Commercial	21,279	-	-	-
Construction	-	-	170,000	-
Consumer	14,938	-	-	-
	$ 145,190	$ -	$ 1,248,784	$ -

The following table represents a comparison of impaired loans with and without specific allowance recorded for the period ended December 31:

	2011				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Real estate	$ 108,973	$ 185,586	$ -	$ 331,424	$ -
Commercial	-	-	-	-	-
Construction	-	-	-	-	-
Consumer	-	-	-	-	-
	$ 108,973	$ 185,586	$ -	$ 331,424	$ -
With allowance recorded					
Real estate	$ 341,730	$ 348,834	$ 98,139	$ 219,674	$ 25,020
Commercial	980,759	980,759	27,340	921,378	59,405
Construction	2,078,085	2,078,085	45,452	2,093,972	68,476
Consumer	-	-	-	-	-
	$ 3,400,574	$ 3,407,678	$ 170,931	$ 3,235,024	$ 152,901
Total					
Real estate	$ 450,703	$ 534,420	$ 98,139	$ 551,098	$ 25,020
Commercial	980,759	980,759	27,340	921,378	59,405
Construction	2,078,085	2,078,085	45,452	2,093,972	68,476
Consumer	-	-	-	-	-
	$ 3,509,547	$ 3,593,264	$ 170,931	$ 3,566,448	$ 152,901

Note 4 – Allowance for Loan Losses (continued)

	2010				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Real estate	$ 651,886	$ 772,486	$ -	$ 655,260	$ 45,386
Commercial	-	-	-	-	-
Construction	-	-	-	-	-
Consumer	-	-	-	-	-
	$ 651,886	$ 772,486	$ -	$ 655,260	$ 45,386
With allowance recorded					
Real estate	$ 534,042	$ 544,396	$ 133,113	$ 537,330	$ 28,317
Commercial	930,803	930,803	28,296	885,297	58,472
Construction	2,248,085	2,248,085	125,774	2,263,230	98,397
Consumer	-	-	-	-	-
	$ 3,712,930	$ 3,723,284	$ 287,183	$ 3,685,857	$ 185,186
Total					
Real estate	$ 1,185,928	$ 1,316,882	$ 133,113	$ 1,192,590	$ 73,703
Commercial	930,803	930,803	28,296	885,297	58,472
Construction	2,248,085	2,248,085	125,774	2,263,230	98,397
Consumer	-	-	-	-	-
	$ 4,364,816	$ 4,495,770	$ 287,183	$ 4,341,117	$ 230,572

Troubled Debt Restructurings – At December 31, 2011 and 2010, impaired loans of $3,338,616 and $2,118,814, respectively, were classified as restructured loans. The restructurings were granted in response to borrower financial difficulty, and generally provide for a temporary modification of loan repayment terms.

The types of modifications offered can generally be described in the following categories:

Rate Modification – A modification in which the interest rate is modified.

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

Payment Modification – A modification in which the payment amount is changed.

Combination Modification – Any other type of modification, including the use of multiple types of modifications.

Note 4 – Allowance for Loan Losses (continued)

The following table presents newly restructured loans that occurred during the year ended December 31, 2011:

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Real estate	3	$ 362,117	$ 352,564
Commercial	1	$ 818,575	$ 793,596
Construction	-	$ -	$ -
Consumer	-	$ -	$ -

All modifications offered during the years ended December 31, 2011 and 2010 were rate modifications and have an insignificant impact to the financial statements.

There were no loans restructured for which there was a payment default within a period of 12 months following the restructure during the years ended December 31, 2011 and 2010.

Note 5 – Premises, Equipment, and Leasehold Improvements

The composition of premises, equipment, and leasehold improvements is summarized as follows as of December 31:

	2011	2010
Land	$ 583,248	$ 583,248
Bank premises	2,783,839	2,783,839
Furniture and equipment	1,075,682	1,101,669
Leasehold improvements	118,247	117,199
	4,561,016	4,585,955
Less accumulated depreciation and amortization	(1,480,256)	(1,337,729)
Premises, equipment, and leasehold improvements, net of accumulated depreciation and amortization	$ 3,080,760	$ 3,248,226

Depreciation expense for the years ended December 31, 2011 and 2010 was $220,235 and $214,262, respectively.

Note 6 – Time Deposits

Time certificates of deposit of $100,000 and over totaled $13,901,167 and $12,420,973 at December 31, 2011 and 2010, respectively.

As of December 31, 2011, the scheduled maturities for all time deposits are as follows:

Years ending December 31,	
2012	$ 14,110,081
2013	5,174,256
2014	3,057,773
2015	1,979,465
2016	7,621,370
Thereafter	853,190
	$ 32,796,135

Note 7 – Borrowings

Federal Home Loan Bank advances – As a member of the Federal Home Loan Bank of Seattle (FHLB), the Bank has entered into an "Advances, Security, and Deposit Agreement" with the FHLB. Borrowings under the credit arrangement are collateralized by the Bank's FHLB stock as well as deposits or other instruments, which may be pledged. As of December 31, 2011 and 2010, the Bank had $775,000 in outstanding borrowings with the FHLB carrying an interest rate of 2.91% and maturing in 2014. As of December 31, 2011, the Bank had approximately $18,815,000 available for additional borrowing with the FHLB.

Federal funds line of credit – The Bank has obtained federal funds lines totaling $7,000,000 with two correspondent banks. One federal fund line for $3,000,000 will expire at the discretion of the correspondent bank. The second line for $4,000,000 was established with a term extending from June 1, 2011 through June 30, 2012. There were no balances outstanding on these federal funds lines as of December 31, 2011 and 2010.

Note 8 – Income Taxes

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

	2011	2010
Current income taxes		
Federal	$ 220,569	$ 222,284
State	53,208	24,473
Total current income taxes	273,777	246,757
Deferred income taxes		
Federal	(65,551)	(124,863)
State	(15,856)	(31,504)
Total deferred income taxes	(81,407)	(156,367)
Provision for income taxes	$ 192,370	$ 90,390

Note 8 – Income Taxes (continued)

Deferred income taxes, recorded as other assets, represent the tax effect of differences in timing between financial income and taxable income. Net deferred tax assets, in the accompanying balance sheets, include the following components as of December 31:

	2011	2010
Allowance for loan losses	$ 512,396	$ 452,152
Unrealized gains on investment securities available-for-sale	(78,044)	(31,015)
Prepaids	(75,832)	(39,463)
Supplemental executive retirement plan	265,530	212,640
Split-dollar liability	58,132	51,214
Intangible assets - permits and licenses	(24,710)	(20,914)
Reserve for off-balance sheet instruments	9,191	6,224
Depreciation and organization costs	(7,962)	(20,474)
Non-accrual interest	403	86,746
Stock-based compensation	18,133	-
Accrued bonuses	42,459	-
Other	86,298	74,505
Net deferred tax assets	$ 805,994	$ 771,615

A valuation allowance has not been recognized as an offset to the net deferred tax assets since management believes it is more likely than not that all deferred tax assets will be utilized in future periods.

Note 9 – Financial Instruments with Off-Balance Sheet Risk

In the normal course of business 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 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 contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and letters of credit written is represented by the contractual 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.

Commitments to extend credit are 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 counter party. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing properties.

Letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support bonding requirements for real estate developers and contractors. 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, marketable securities, or real estate as collateral supporting those commitments for which collateral is deemed necessary.

Note 9 – 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 as of December 31 is as follows:

	2011	2010
Commitments to extend credit	$ 16,138,486	$ 8,632,610
Commercial and standby letters of credit	$ 126,400	$ 237,802

Note 10 – Concentrations of Credit Risk

All of the Bank's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area. The majority of such customers are also depositors of the Bank. Concentrations of credit by type of loan are set forth in Note 3. During 2011, the Bank's loan policy did not allow the extension of credit to any single borrower or group of related borrowers in excess of $750,000 on an unsecured basis and $1,500,000 on a secured basis, without approval from the Board of Directors' Loan Committee.

Note 11 – Commitments and Contingencies

Lease commitments – As of December 31, 2011, the Bank leased branch and administrative office space under two operating lease agreements. The branch and administrative office space lease will expire in 2013 while the other branch lease expires in 2036.

Future minimum lease payments associated with the office space lease and other agreements are as follows:

Years ending December 31,	
2012	$ 294,263
2013	61,522
2014	63,207
2015	65,419
2016	67,709
Thereafter	1,925,665
	$ 2,477,785

For the years ended December 31, 2011 and 2010, rent expense was $286,187 and $281,367, respectively.

During the year ended December 31, 2011, the Bank entered into an agreement to lease its administrative office space from its 50%-owned limited liability company (LLC) as described under Note 12. This lease will begin on January 1, 2013 and will terminate on December 31, 2022. Monthly base rent is estimated at $21,069 (prior to allocated common area maintenance, taxes, and insurance) and will be adjusted based on the actual construction costs of the building.

The Bank also has a commitment to contribute $1,662,744 to the LLC a part of the construction costs of the Bank's future administrative office.

Legal contingencies – The Bank may become a defendant in certain claims and legal actions arising in the ordinary course of business. As of December 31, 2011, the Bank was not involved in any current matters expected to have a material adverse effect on its financial condition or results of operations.

Note 12 – Transactions with Related Parties

Certain directors, executive officers, and principal stockholders 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. All loans and commitments to lend included in such transactions are made in compliance with applicable laws on substantially the same 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.

The amount of loans and loan commitments outstanding to directors, executive officers, principal stockholders, and companies that they are associated with was as follows as of December 31:

	2011	2010
Balance, beginning of year	$ 1,972,353	$ 1,338,589
Loans made	3,288,878	2,533,547
Loans repaid	(2,892,216)	(1,899,783)
Balance, end of year	$ 2,369,015	$ 1,972,353
Outstanding loan commitments	$ 972,717	$ 713,642

The Bank has a loan to its 50% partner in the LLC. The loan, which was originated for the purpose of funding the partner's portion of construction costs of the new administrative office, had a balance of $397,962 as of December 31, 2011. The outstanding loan commitment under this loan as of December 31, 2011 was $1,662,744.

Note 13 – Stock-Based Compensation Plans

Under its stock-based compensation plans, the Bank may grant nonqualified stock options and restricted stock awards to its directors, officers, and employees for up to 282,966 shares of common stock. The exercise price of each option must be at least equal to 100% of the market price of the Bank's stock on the date of grant. An option's maximum term is 10 years.

The following summarizes stock option activity under the plans:

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Contractual Term
Options under grant as of December 31, 2010	115,051			
Options granted	26,500	$ 7.00		
Options exercised	(22,898)	$ 6.77	$ 39,734	
Options under grant as of December 31, 2011	118,653	$ 9.87	$ -	5.44
Options exercisable as of December 31, 2011	69,750	$ 11.11	$ -	2.61

The Bank determines fair value of stock options at grant date using the Black-Scholes pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option, the volatility of the underlying stock, the expected dividend yield, and the risk-free interest rate over the expected life of the option. The assumptions used in the pricing model are noted in the table below. The expected term of options granted is derived from historical data on employee exercise and post-vesting employment termination behavior. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. Expected volatility is based on the historical volatility of an index of comparable bank stocks.

Note 13 – Stock-Based Compensation Plans (continued)

The fair values of options granted during 2011 and 2010 were computed utilizing the following weighted-average assumptions.

	2011	2010
Dividend yield	0.00%	0.00%
Weighted average expected life	7.5 years	7.5 years
Expected volatility	49.74%	24.56%
Risk-free rate	1.30%	2.70%

The Black-Scholes option valuation model requires the input of highly subjective assumptions, including the expected life of the stock-based award and stock price volatility. These assumptions represent management's best estimates, but involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, the Bank's recorded stock-based compensation expense could have been materially different. Additionally, the effects of applying this accounting model are not indicative of future amounts that may be realized by the option holders upon exercise. The weighted average grant-date fair value of options granted during the years 2011 and 2010 was $3.70 and $3.24, respectively. The total intrinsic value of options exercised during the years ended December 31, 2011 and 2010 was $39,734 and $12,558, respectively.

The Bank expenses stock options on a straight-line basis over the options' related vesting term. As of December 31, 2011, there was $169,987 of unrecognized compensation expense related to the granting of stock options. That cost is expected to be recognized over a period of five years.

The following table summarizes restricted stock award activity under the Plan as of December 31, 2011:

	Number of Shares	Weighted Average Fair Value
Restricted stock awards unvested at beginning of period	13,500	
Awards granted	13,500	$ 7.00
Awards vested	(2,700)	$ 9.50
Restricted stock awards unvested at end of period	24,300	$ 8.11

As of December 31, 2011, there was $197,100 of unrecognized stock-based compensation expense related to nonvested restricted stock awards. The cost is expected to be recognized over the vesting period upon certain performance conditions being reached.

Total compensation expense recognized for stock-based compensation plans was $43,948 and $1,446 for the years ended December 31, 2011 and 2010, respectively.

Note 14 – Employee Benefit Plans and Agreements

During 1999, the Bank adopted a 401(k) plan in which substantially all employees participate. Employees may contribute the maximum permissible under federal tax laws. The Bank matches employee contributions on the first 3% of their compensation. Matching contributions vest to the employee equally over a five-year period. For the years ended December 31, 2011 and 2010, the Bank's expense attributable to the plan was $66,436 and $54,673, respectively.

Note 14 – Employee Benefit Plans and Agreements (continued)

In December 2005, the Bank entered into supplemental retirement plans with key executive officers. In 2006, to support its 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 $829,562 and $672,860 as of December 31, 2011 and 2010, respectively. These amounts are included on the balance sheet among "accrued interest payable and other liabilities." For 2011 and 2010, compensation expense related to these plans was $187,755 and $149,310, respectively.

Note 15 – Earnings Per Share

The following table illustrates the computations of basic and diluted earnings per share for the years ended December 31:

	Net Income	Weighted Average Shares	Per Share Amount
For the year ended December 31, 2011			
Basic income per share	$ 528,503	1,118,372	$ 0.47
Stock options		176	
Diluted income per share	$ 528,503	1,118,548	$ 0.47
For the year ended December 31, 2010			
Basic income per share	$ 365,432	930,584	$ 0.39
Stock options		15,756	
Diluted income per share	$ 365,432	946,340	$ 0.39

Options for 118,652 and 24,249 shares of common stock were excluded from the diluted earnings per share calculation in 2011 and 2010, respectively, due to their anti-dilutive effect.

Note 16 – Fair Value of Financial Instruments

Assets are displayed at fair value in the table below based upon recurring or nonrecurring measurement status. Recurring assets are initially measured at fair value and are required to be re-measured at fair value in the financial statements at each reporting date. Assets measured on a nonrecurring basis are assets that, due to an event or circumstance, were required to be re-measured at fair value after initial recognition in the financial statements at some time during the reporting period. Total losses included in earnings represent impairments on loans recognized as a charge to the allowance for loan losses, or impairments of other real estate owned for fair value adjustments based on the fair value of the real estate.

		Fair Value Measurements Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses Included in Earnings
Recurring items as of December 31, 2011					
Investment securities available-for-sale					
U.S. government agency obligations	$ 3,647,589	$ -	$ 3,647,589	$ -	
SBA backed securities	4,809,998	-	4,809,998	-	
Municipal securities	3,148,468	-	3,148,468	-	
Total investment securities available-for-sale	$ 11,606,055	$ -	$ 11,606,055	$ -	
Nonrecurring items as of December 31, 2011					
Loans measured for impairment	$ 3,229,643	$ -	$ -	$ 3,229,643	$ 170,931
Other real estate owned	$ 2,606,413	$ -	$ -	$ 2,606,413	$ 39,359

		Fair Value Measurements Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses Included in Earnings
Recurring items as of December 31, 2010					
Investment securities available-for-sale:					
U.S. government agency obligations	$ 3,593,397	$ -	$ 3,593,397	$ -	
SBA backed securities	2,363,253	-	2,363,253	-	
Municipal securities	3,209,647	-	3,209,647	-	
Total investment securities available-for-sale	$ 9,166,297	$ -	$ 9,166,297	$ -	
Nonrecurring items as of December 31, 2010					
Loans measured for impairment	$ 3,425,747	$ -	$ -	$ 3,425,747	$ 287,183
Other real estate owned	$ 2,426,735	$ -	$ -	$ 2,426,735	$ 132,635

Note 16 – Fair Value of Financial Instruments (continued)

The following table discloses fair value information about all financial instruments, whether carried or not carried at fair value on the balance sheet, where it is practicable to estimate that value.

	Fair Value Measurements Using			
	2011		2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Cash and cash equivalents	$ 5,933,073	$ 5,933,073	$ 6,054,016	$ 6,054,016
Investment securities available-for-sale	11,606,055	11,606,055	9,166,297	9,166,297
Restricted equity securities	163,200	163,200	163,200	163,200
Loans held-for-sale	3,526,890	3,526,890	607,600	607,600
Loans receivable, gross	93,944,046	93,657,002	81,048,664	81,072,238
Other real estate owned	2,606,413	2,606,413	2,426,735	2,426,735
Bank-owned life insurance	3,787,428	3,787,428	3,004,317	3,004,317
Financial liabilities				
Noninterest-bearing demand deposits	32,320,600	32,320,600	20,576,464	20,576,464
Interest-bearing demand, money market accounts, and savings deposits	45,430,464	45,430,464	39,691,965	39,691,965
Time certificates of deposit	32,796,135	33,332,326	31,578,194	31,897,104
Borrowings	775,000	804,380	775,000	780,783

The Bank normally intends to hold the majority of its financial instruments until maturity; it does not expect to realize many of the estimated amounts disclosed. The disclosures also do not include estimated fair value amounts for items which are not defined as financial instruments but which have significant value. These include such off-balance sheet items as core deposit intangibles on non-acquired deposits. The Bank does not believe that it would be practicable to estimate a representational fair value for these types of items as of December 31, 2011 and 2010.

Note 17 – Common Stock Issuance

The Bank completed a Private Placement Offering (Offering), selling 38,796 and 124,437 shares of common stock to directors, executives, and other investors at a price of $9.50 per share during the years ended December 31, 2011 and 2010, respectively. Total proceeds to the Bank, net of direct offering costs, were $368,562 and $1,146,350 for the years ended December 31, 2011 and 2010, respectively, and will be used to fund continuing operations and anticipated growth.

Note 18 – Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by 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 the Bank's 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 following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to average assets (as defined). Management believes, as of December 31, 2011 and 2010, that the Bank met all capital adequacy requirements to which it is subject.

As of the most recent notifications from its regulatory agencies, the Bank was categorized as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as adequately capitalized, the Bank must maintain minimum total risk-based capital, Tier 1 risk-based capital, and Tier 1 leverage capital ratios as set forth in the following table. There are no conditions or events since that notification that management believes may have changed the Bank's category.

Note 18 – Regulatory Matters (continued)

(in thousands)	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2011						
Total capital to risk-weighted assets	$ 14,631	14.3%	$ 8,181	≥8.0%	$ 10,226	≥10.0%
Tier 1 capital to risk-weighted assets	13,339	13.0%	4,091	≥4.0%	6,136	≥6.0%
Tier 1 capital to average assets	13,339	10.7%	4,967	≥4.0%	6,209	≥5.0%
December 31, 2010						
Total capital to risk-weighted assets	$ 13,295	15.6%	$ 6,808	≥8.0%	$ 8,510	≥10.0%
Tier 1 capital to risk-weighted assets	12,227	14.4%	3,404	≥4.0%	5,106	≥6.0%
Tier 1 capital to average assets	12,227	11.7%	4,189	≥4.0%	5,236	≥5.0%