Report of Independent Auditors
and Financial Statements for

# Mountain Pacific Bank

December 31, 2015 and 2014

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

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NOTE: This annual report serves as Mountain Pacific Bank's annual disclosure statement under the requirements of the Federal Deposit Insurance Corporation (FDIC). This statement has not been reviewed or confirmed for accuracy or relevance by the FDIC.

# REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Stockholders
Mountain Pacific Bank

## Report on Financial Statements

We have audited the accompanying financial statements of Mountain Pacific Bank (the Bank), which comprise the balance sheets as of December 31, 2015 and 2014, and the related statements of income, comprehensive income, changes in stockholders' 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.

### *Auditors' Responsibility*

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

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

We believe that the audit evidence 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 Mountain Pacific Bank as of December 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Everett, Washington
February 23, 2016

**ASSETS**

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| CASH AND DUE FROM BANKS | $ 4,220,884 | $ 4,704,057 |
| FEDERAL FUNDS SOLD AND EXCESS BALANCE ACCOUNT - FEDERAL RESERVE BANK | 16,012,000 | 4,660,000 |
| Total cash and cash equivalents | 20,232,884 | 9,364,057 |
| INTEREST-BEARING DEPOSITS IN BANKS | 3,000,000 | 3,725,000 |
| INVESTMENT SECURITIES available-for-sale | 8,886,060 | 6,375,956 |
| INVESTMENT SECURITIES held-to-maturity | 999,745 | 997,836 |
| LOANS HELD-FOR-SALE | - | 1,289,942 |
| LOANS | 152,599,701 | 124,332,032 |
| Less allowance for loan losses | 2,555,069 | 2,413,936 |
| Total loans, net | 150,044,632 | 121,918,096 |
| LEASEHOLDS AND EQUIPMENT, net | 658,446 | 651,128 |
| ACCRUED INTEREST RECEIVABLE | 587,824 | 654,756 |
| FEDERAL HOME LOAN BANK (FHLB) STOCK AND PACIFIC COAST BANKERS' BANK (PCBB) STOCK, at cost | 576,600 | 639,000 |
| OTHER REAL ESTATE OWNED (OREO), net | 5,340,420 | 5,609,998 |
| DEFERRED TAX ASSET, net | 3,525,000 | 3,950,000 |
| OTHER ASSETS | 427,412 | 310,273 |
| Total assets | $ 194,279,023 | $ 155,486,042 |

**LIABILITIES AND STOCKHOLDERS' EQUITY**

| | 2015 | 2014 |
|---|---|---|
| DEPOSITS | | |
| Noninterest-bearing | $ 31,088,351 | $ 24,186,581 |
| Interest-bearing | 132,760,509 | 99,417,684 |
| Total deposits | 163,848,860 | 123,604,265 |
| FEDERAL HOME LOAN BANK ADVANCES | 5,000,000 | 7,425,000 |
| ACCRUED INTEREST PAYABLE | 71,315 | 54,778 |
| OTHER LIABILITIES | 599,609 | 577,024 |
| Total liabilities | 169,519,784 | 131,661,067 |
| STOCKHOLDERS' EQUITY | | |
| Common stock, $1 par value, 10,000,000 shares authorized; 6,212,541and 6,184,206 issued and outstanding at December 31, 2015 and 2014, respectively | 6,212,541 | 6,184,206 |
| Additional paid-in capital | 26,794,351 | 26,690,434 |
| Accumulated deficit | (8,244,393) | (9,069,393) |
| Accumulated other comprehensive (loss)income | (3,260) | 19,728 |
| Total stockholders' equity | 24,759,239 | 23,824,975 |
| Total liabilities and stockholders' equity | $ 194,279,023 | $ 155,486,042 |

# MOUNTAIN PACIFIC BANK
## STATEMENTS OF INCOME

| | Years Ended December 31, 2015 | 2014 |
|---|---|---|
| INTEREST AND FEE INCOME | | |
| Loans, including fees | $ 7,113,657 | $ 6,248,009 |
| Federal funds sold and excess balance account - Federal Reserve Bank and interest-bearing deposits in banks | 26,067 | 22,667 |
| Investment securities | 175,764 | 157,286 |
| Dividends from FHLB and Pacific Coast Bankers' Bank | 12,620 | 10,656 |
| Total interest and dividend income | 7,328,108 | 6,438,618 |
| INTEREST EXPENSE | | |
| Deposits | 647,025 | 603,052 |
| FHLB advances and other borrowings | 39,634 | 41,909 |
| Total interest expense | 686,659 | 644,961 |
| Net interest income | 6,641,449 | 5,793,657 |
| PROVISION FOR LOAN LOSSES | 100,000 | 60,000 |
| Net interest income after provision for loan losses | 6,541,449 | 5,733,657 |
| NONINTEREST INCOME | | |
| Service fees | 393,712 | 324,263 |
| Gain on sale of loans | 303,982 | - |
| Gain on sale of investment securities available-for-sale | - | 8,694 |
| Gains realized on sales of real estate from joint venture activities | - | 55,616 |
| Total noninterest income | 697,694 | 388,573 |
| NONINTEREST EXPENSES | | |
| Salaries and employee benefits | 3,113,802 | 2,800,640 |
| Occupancy and equipment | 892,445 | 797,157 |
| Data processing | 424,472 | 407,566 |
| Advertising and business development | 205,926 | 189,541 |
| Professional fees and state taxes | 498,745 | 300,822 |
| Regulatory assessments | 206,400 | 285,252 |
| Other real estate owned, net | 183,422 | 136,574 |
| Other | 463,931 | 424,678 |
| Total noninterest expenses | 5,989,143 | 5,342,230 |
| NET INCOME BEFORE PROVISION (BENEFIT) FOR INCOME TAXES | 1,250,000 | 780,000 |
| PROVISION (BENEFIT) FOR INCOME TAXES | 425,000 | (3,950,000) |
| NET INCOME | $ 825,000 | $ 4,730,000 |



See accompanying notes.

| | Years Ended December 31, 2015 | 2014 |
|---|---|---|
| NET INCOME | $ 825,000 | $ 4,730,000 |
| Other comprehensive (loss) income | | |
| Unrealized (loss) gain on securities | | |
| Unrealized holding (loss) gain | (22,988) | 133,129 |
| Reclassification adjustments for realized gains on sales of securities | - | (8,694) |
| Other comprehensive (loss) income | (22,988) | 124,435 |
| COMPREHENSIVE INCOME | $ 802,012 | $ 4,854,435 |

# MOUNTAIN PACIFIC BANK
## STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

| | Common Stock | | Additional | | Accumulated Other | Noncontrolling | Total |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Paid-In Capital | Accumulated Deficit | Comprehensive Income (Loss) | Interests in Related Entity | Stockholders' Equity |
| BALANCE, December 31, 2013 | 5,589,214 | $ 5,589,214 | $ 25,396,196 | $ (13,799,393) | $ (104,707) | $ 520,020 | $ 17,601,330 |
| Net income | - | - | - | 4,730,000 | - | - | 4,730,000 |
| Accumulated other comprehensive income, net | - | - | - | - | 124,435 | - | 124,435 |
| Equity of consolidated Related Entity | - | - | - | - | - | (520,020) | (520,020) |
| Stock awards vested | 2,885 | 2,885 | (2,885) | - | - | - | - |
| Stock options exercised | 8,730 | 8,730 | 17,460 | - | - | - | 26,190 |
| Common stock warrants exercised | 575,317 | 575,317 | 1,150,634 | - | - | - | 1,725,951 |
| Stock-based compensation expense | - | - | 112,909 | - | - | - | 112,909 |
| Stock issued in lieu of compensation | 8,060 | 8,060 | 16,120 | - | - | - | 24,180 |
| BALANCE, December 31, 2014 | 6,184,206 | 6,184,206 | 26,690,434 | (9,069,393) | 19,728 | - | 23,824,975 |
| Net income | - | - | - | 825,000 | - | - | 825,000 |
| Accumulated other comprehensive loss, net | - | - | - | - | (22,988) | - | (22,988) |
| Stock awards vested | 6,885 | 6,885 | (6,885) | - | - | - | - |
| Stock options exercised | 15,200 | 15,200 | 30,400 | - | - | - | 45,600 |
| Common stock issued | 6,250 | 6,250 | 12,500 | - | - | - | 18,750 |
| Stock-based compensation expense | - | - | 67,902 | - | - | - | 67,902 |
| BALANCE, December 31, 2015 | 6,212,541 | $ 6,212,541 | $ 26,794,351 | $ (8,244,393) | $ (3,260) | $ - | $ 24,759,239 |



See accompanying notes.

| | Years Ended December 31, 2015 | 2014 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | $ 825,000 | $ 4,730,000 |
| Adjustments to reconcile net income to net cash flows from operating activities | | |
| Provision for loan losses | 100,000 | 60,000 |
| Stock-based compensation expense including stock in lieu of compensation | 67,902 | 137,089 |
| Depreciation and amortization | 276,786 | 234,943 |
| Amortization on investment securities | 64,454 | 97,331 |
| Gain on sale of loans | (303,982) | - |
| Proceeds from sale of loans | 3,179,367 | - |
| Gain on sale of investment securities available-for-sale | - | (8,694) |
| Gains realized on sales of real estate from joint venture activities | - | (55,616) |
| Gain on sale of other real estate owned | - | (22,950) |
| Deferred federal income taxes | 425,000 | 262,237 |
| Changes in operating assets and liabilities | | |
| Accrued interest receivable | 66,932 | (284,267) |
| Other assets | (117,139) | (4,149,734) |
| Accrued interest payable | 16,537 | (3,103) |
| Other liabilities | 22,585 | 100,397 |
| Net cash from operating activities | 4,623,442 | 1,097,633 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Net change in interest-bearing deposits in banks | 725,000 | 500,000 |
| Net change in loans made to customers | (29,811,979) | (13,074,916) |
| Origination of loans held-for-sale | - | (1,289,942) |
| Proceeds from investment securities available-for-sale | - | 618,070 |
| Purchases of investment securities available-for-sale | (3,858,104) | - |
| Proceeds from principal paydowns of mortgage-backed securities | 1,258,649 | 1,624,895 |
| Capitalized improvements to other real estate owned | - | (360,951) |
| Proceeds from sales of other real estate owned | 269,578 | 2,655,861 |
| Redemption of FHLB stock | 62,400 | 3,300 |
| Additions to premises and equipment, net | (284,104) | (149,564) |
| Net cash used in investing activities | (31,638,560) | (9,473,247) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Net increase in noninterest-bearing deposits | 6,901,770 | 1,235,047 |
| Net increase in interest-bearing deposits | 33,342,825 | 2,423,651 |
| Proceeds from exercise of stock options | 45,600 | 26,190 |
| Proceeds from exercise of stock warrants | - | 1,725,951 |
| Proceeds from issuance of stock | 18,750 | - |
| Proceeds from FHLB borrowings | - | 3,425,000 |
| Repayment of FHLB borrowings | (2,425,000) | (1,000,000) |
| Net cash from financing activities | 37,883,945 | 7,835,839 |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 10,868,827 | (539,775) |
| CASH AND CASH EQUIVALENTS, beginning of year | 9,364,057 | 9,903,832 |
| CASH AND CASH EQUIVALENTS, end of year | $ 20,232,884 | $ 9,364,057 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | |
| Cash paid during the period for interest | $ 670,122 | $ 648,064 |
| SUPPLEMENTAL DISCLOSURE OF NONCASH ITEMS | | |
| Unrealized (loss) gain on securities available-for-sale | $ (22,988) | $ 124,435 |

**Note 1 - Organization and Summary of Significant Accounting Policies**

**Nature of operations** - Mountain Pacific Bank (the Bank) provides a full range of banking services to individual and corporate customers through its headquarters in Everett, Washington, and full-service branches in Lynnwood, Washington, and the Ballard neighborhood of Seattle, Washington. The Bank's primary deposit products are checking and term certificate accounts, and its primary lending products are commercial loans and commercial real estate loans. The Bank is subject to significant competition from other financial institutions.

MPB Directors Buildout LLC (the Related Entity) was formed during 2010, and is a related party entity that, at December 31, 2015 and 2014, has common controlling ownership with the Bank through one of its directors. The Related Entity was formed to enter into project-specific buildouts of certain Bank-owned lots without providing further risk to the Bank. The Bank has no direct ownership in the Related Entity. The Bank and the Related Entity will form a contractual joint venture (JV) for each project, the Bank will contribute foreclosed lots, and the Related Entity will provide funds to complete the buildout. Each project under the Related Entity will be done through a separate JV entered into by both the Bank and the Related Entity. Each JV can be structured differently. There were no JVs outstanding at December 31, 2015 or 2014.

At periodic intervals, the state of Washington and the Federal Deposit Insurance Corporation (FDIC) routinely examine the Bank's financial statements as part of their legally prescribed oversight of the banking system. Based on these examinations, the regulators can direct the Bank's financial statements to be adjusted in accordance with their findings.

**Financial statement presentation and use of estimates** - The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and reporting practices applicable to the banking industry. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheets, and revenues and expenses for the period. Actual results could differ from estimated amounts. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, the valuation of impaired loans and other real estate owned, and deferred tax assets.

**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 the financial statements are available to be issued. The Bank has evaluated subsequent events through February 23, 2016, which is the date the financial statements are issued.

**Cash and cash equivalents** - For purposes of reporting cash flows, cash and cash equivalents include cash on hand, noninterest-bearing amounts due from banks, federal funds sold, and the excess balance account at the Federal Reserve Bank (FRB), all with maturities of three months or less. Generally, federal funds are purchased and sold for one-day periods. The amounts on deposit fluctuate and, at times, may exceed the insured limit by the FDIC, which potentially subjects the Bank to credit risk. Investments in federal funds sold are made with major banks as approved by the board of directors.

**Interest-bearing deposits in banks** - Interest-bearing deposits in banks include interest-bearing deposits and certificates of deposit in federally insured financial institutions located throughout the United States and territories. The amounts on deposit fluctuate and, at times, may exceed the insured limit by the FDIC, which potentially subjects the Bank to credit risk.

**Investment securities** - Investment securities are classified into one of three categories: (1) held-to-maturity, (2) available-for-sale, or (3) trading. The Bank had no trading securities at December 31, 2015 or 2014. Investment securities are categorized as held-to-maturity when the Bank has the positive intent and ability to hold those securities to maturity. Securities that are held-to-maturity are stated at cost and adjusted for amortization of premiums and accretion of discounts, which are recognized as adjustments to interest income. Interest income includes amortization of premiums and discounts. Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

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

Investment securities categorized as available-for-sale are generally held for investment purposes (to maturity), although unanticipated future events may result in the sale of some securities. Available-for-sale securities are recorded at estimated fair value, with the net unrealized gain or loss reported as “accumulated other comprehensive income loss” within the statements of changes in stockholders’ equity. Realized gains or losses on dispositions are based on the net proceeds and the adjusted carrying amount of securities sold, using the specific identification method, and are included in earnings.

Investment securities are reviewed 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 (loss). Impairment losses related to all other factors are presented as separate categories within other comprehensive income (loss).

**Federal Home Loan Bank stock** – 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 loans, total assets, or FHLB advances. This security is classified at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income. Management determined there was no impairment at December 31, 2015 and 2014. The Bank had $386,600 and $449,000 of FHLB stock at December 31, 2015 and 2014, respectively.

**Pacific Coast Bankers’ Bank stock** - Pacific Coast Bankers’ Bank (PCBB) stock represents an investment by the Bank in the capital stock of PCBB of $190,000 at both December 31, 2015 and 2014, and is carried at cost, classified as a restricted security, and periodically evaluated for impairment. As a member, the Bank is entitled to certain benefits, including overnight borrowings. At December 31, 2015 and 2014, there were no such borrowings outstanding.

**Loans held-for-sale** - Loans originated and intended for sale in secondary markets are carried at the lower of cost or estimated market value in the aggregate. Net unrealized losses are recognized through a valuation allowance by charges to income. Gains or losses on the sale of such loans are based on the specific identification method.

**Loans** - Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding principal adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash basis or cost-recovery method until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably ensured.

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

**Significant concentrations of credit risk -** Most of the Bank's business activity is with customers located within Snohomish and King Counties, Washington. The Bank originates commercial, real estate, construction, and consumer loans. Generally, loans are secured by accounts receivable, inventory, deposit accounts, personal property, or real estate. Rights to collateral vary and are legally documented to the extent practicable. Local economic conditions may affect borrowers' ability to meet the stated repayment terms. Approximately 67% of the Bank's loan portfolio is secured by real estate (Note 3). The Bank does not have any significant concentrations to one customer.

**Allowance for loan losses** - The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for credit losses is maintained at a level sufficient to provide for probable loan losses based on evaluating known and inherent risks in the loan portfolio and is evaluated on a regular basis by management. The allowance is provided based upon management's continuing analysis of the pertinent factors underlying the quality of the loan portfolio. These factors include changes in the size and composition of the loan portfolio, delinquency levels, actual loan loss experience, current economic conditions, and detailed analysis of individual loans for which full collectability may not be ensured. The detailed analysis includes techniques to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. For such loans or leases classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan or lease is lower than the carrying value of that loan. The general component covers nonimpaired loans and leases and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. The appropriateness of the allowance for loan losses is estimated based upon these factors and trends identified by management at the time the financial statements are prepared. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral, if the loan is collateral-dependent. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan are lower than the carrying value of that loan.

A troubled debt restructuring is a loan for which the Bank, for reasons related to the borrower's financial difficulties, grants a concession to the borrower that the Bank would not otherwise consider. The loan terms that have been modified or restructured due to the borrower's financial difficulty include, but are not limited to, a reduction in the stated interest rate; an extension of the maturity; an interest rate below market; a reduction in the face amount of the debt; a reduction in the accrued interest; or extension, deferral, renewal, or rewrite of the original loan terms.

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

Additionally, state and federal regulations, upon examination, may require the Bank to make additional provisions or adjustments to its allowance. Large groups of smaller-balance loans are excluded from this analysis and collectively evaluated for impairment.

**Transfers of financial assets** - Transfers of an entire financial asset, a group of entire financial assets, or participating interest in an entire financial asset are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**Loan sales recognition** - The Bank originates loans through the Small Business Administration (SBA) and sometimes sells the guaranteed portion. The Bank retains the servicing on the sold guaranteed portion of SBA loans. The Bank receives a fee for servicing the loan. The Bank recognizes a sale on loans if the transferred portion (or portions) and any portion that continues to be held by the transferor are participating interests.

To determine the gain or loss on sale of loans, the Bank's investment in the loan is allocated among the retained portion of the loan, the servicing retained, and the sold portion of the loan, based on the relative fair market value of each portion. The gain or loss on the sold portion of the loan is based on the difference between the sale proceeds and the allocated investment in the sold portion of the loan. A discount is recorded against the carrying value of the retained portion of the loan to offset the fair value allocation of said retained portion.

**SBA servicing assets** - The Bank accounts for SBA servicing rights as separately recognized servicing rights and initially measures them at fair value. For each class of separately recognized servicing assets and liabilities, an entity is permitted to choose either of the following subsequent measurement methods: (1) the amortization of servicing assets or liabilities in proportion to and over the period of estimated net servicing income or net servicing loss or (2) the reporting of servicing assets or liabilities at fair value at each reporting date and reporting changes in fair value in earnings in the period in which the changes occur.

The Bank subsequently measures each SBA servicing asset using the amortization method. Under the amortization method, servicing assets are amortized into noninterest income in proportion to, and over the period of, estimated net servicing income. The amortized assets are assessed for impairment or increased obligation based on the fair value at each reporting date.

Each class of separately recognized servicing assets subsequently measured using the amortization method is evaluated and measured for impairment. Impairment is determined by stratifying rights into tranches based on predominant characteristics, such as interest rate, loan type, and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the carrying amount of the servicing assets for that tranche. The valuation allowance is adjusted to reflect changes in the measurement of impairment after the initial measurement of fair value. Changes in valuation allowances are reported in net gains on loans sold within noninterest income on the statements of income. Fair value is based on market prices for comparable servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income.

As of December 31, 2015, SBA servicing assets totaled $71,358, included in other assets on the balance sheet, from servicing $2,807,740 in loans. There were no servicing assets as of December 31, 2014.

**Leaseholds and equipment** - Bank leaseholds and equipment are stated at cost and depreciated or amortized using the straight-line method over the estimated useful lives of the related assets, which range from 3 to 10 years. Assets are reviewed for impairment when events indicate their carrying value may not be recoverable. If management determines impairment exists, the asset is reduced with an offsetting charge to expense.

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

**Other real estate owned** - Assets acquired through, or in lieu of, loan foreclosure are held-for-sale and are initially recorded at the lower of cost or estimated fair value at the date of foreclosure. Losses arising from the acquisition of property, in full or partial satisfaction of loans, are charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from other real estate owned on the statements of income.

**Income taxes** - The Bank records its provision for income tax under the liability method. 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 are expected to 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. Deferred taxes result from temporary differences in the recognition of certain income and expense amounts between the Bank's financial statements and its tax return. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

**Financial instruments** - In the ordinary course of business, the Bank enters into off-balance-sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, standby letters of credit, and financial guarantees. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

**Advertising costs** - The Bank expenses advertising costs as they are incurred. Total advertising expense was $127,853 and $132,985 for the years ended December 31, 2015 and 2014, respectively.

**Restricted assets** - Federal Reserve Board regulations generally require maintenance of certain minimum reserve balances on deposit with the FRB or another institution in a pass-through relationship. The amounts of such balances are generally based on asset size and other factors. Such requirements were $180,000 and $139,000 at December 31, 2015 and 2014, respectively.

**Comprehensive income** - Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale investments, are reported as a separate component of the stockholders' equity section of the balance sheets. Accumulated other comprehensive income consists of only one component: unrealized gains or losses on investment securities available-for-sale.

**Stock-based compensation plan** - Stock-based compensation cost is recognized at the grant-date fair value and is based on awards that are ultimately expected to vest. The cost is recognized over the period during which an employee is required to provide services in exchange for the award. The tax benefit resulting from tax deductions in excess of the compensation cost recognized is classified as a financing activity in the statements of cash flows. There were no tax benefits realized as of December 31, 2015 and 2014.

**Fair value measurements** - Fair values of financial instruments are estimated using relevant market information and other assumptions as disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

**Reclassifications** - Certain reclassifications have been made to the prior-year financial statements in order to conform to the current-year presentation with no effect on net income or total stockholder's equity.

**Note 2 - Investment Securities**

Amortized cost and estimated fair values of investment securities are summarized as follows:

| December 31, 2015 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Available-for-sale securities | | | | |
| Obligations of U.S. agencies | $ 2,307,012 | $ 49,799 | $ (4,359) | $ 2,352,452 |
| Agency mortgage-backed securities | 4,224,280 | 33,780 | (43,738) | 4,214,322 |
| Agency collateralized mortgage obligations | 1,358,837 | - | (24,231) | 1,334,606 |
| Corporate bonds | 999,191 | - | (14,511) | 984,680 |
| | $ 8,889,320 | $ 83,579 | $ (86,839) | $ 8,886,060 |
| Held-to-maturity | | | | |
| Corporate bonds | $ 999,745 | $ 2,945 | $ - | $ 1,002,690 |
| **December 31, 2014** | | | | |
| Available-for-sale securities | | | | |
| Obligations of U.S. agencies | $ 431,452 | $ - | $ (2,061) | $ 429,391 |
| Agency mortgage-backed securities | 4,226,516 | 55,748 | (16,460) | 4,265,804 |
| Agency collateralized mortgage obligations | 699,297 | - | (32,626) | 666,671 |
| Corporate bonds | 998,962 | 15,128 | - | 1,014,090 |
| | $ 6,356,227 | $ 70,876 | $ (51,147) | $ 6,375,956 |
| Held-to-maturity | | | | |
| Corporate bonds | $ 997,836 | $ 27,714 | $ - | $ 1,025,550 |

The amortized cost and estimated fair value of investment securities at December 31, 2015, by contractual or expected maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Available-for-Sale | | Held-to-Maturity | |
|---|---|---|---|---|
| | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| 1 to 5 years | $ 1,658,965 | $ 1,659,330 | $ 999,745 | $ 1,002,690 |
| More than 5 years | 7,230,355 | 7,226,730 | - | - |
| | $ 8,889,320 | $ 8,886,060 | $ 999,745 | $ 1,002,690 |

There were no investment securities pledged at December 31, 2015 or 2014.

**Note 2 - Investment Securities (continued)**

Information pertaining to investment securities with gross unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous loss position is as follows at December 31:

| | Less Than 12 Months | | Greater Than 12 Months | |
|---|---|---|---|---|
| **December 31, 2015** | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value |
| Available-for-sale securities | | | | |
| Obligations of U.S. agencies | $ (4,359) | $ 494,135 | $ - | $ - |
| Agency mortgage-backed securities | (21,634) | 1,630,434 | (22,104) | 1,608,818 |
| Agency collateralized mortgage obligations | (4,368) | 767,315 | (19,863) | 567,291 |
| Corporate bonds | (14,511) | 984,680 | - | - |
| | $ (44,872) | $ 3,876,564 | $ (41,967) | $ 2,176,109 |
| **December 31, 2014** | | | | |
| Available-for-sale securities | | | | |
| Obligations of U.S. agencies | $ - | $ - | $ (2,061) | $ 429,391 |
| Agency mortgage-backed securities | - | - | (16,460) | 2,059,032 |
| Agency collateralized mortgage obligations | - | - | (32,626) | 666,671 |
| | $ - | $ - | $ (51,147) | $ 3,155,094 |

There are nine and five securities in an unrealized loss position at December 31, 2015 and 2014, respectively. Unrealized losses have not been recognized into income because management does not intend to sell and does not expect it will be required to sell the investments. The decline is largely due to changes in market conditions and interest rates, rather than credit quality. The fair value is expected to recover as the underlying securities in the portfolio approach maturity date and market conditions improve. The Bank does not consider these securities to be other than temporarily impaired at December 31, 2015 or 2014.

There were no securities sold in 2015. There were two securities sold for gross realized gains of $9,330 in 2014 and one security sold for a gross realized loss of $636.

**Note 3 - Loans**

The major classifications of loans at December 31 are summarized as follows:

| | 2015 | 2014 |
|---|---|---|
| Residential 1-4 family | $ 9,807,801 | $ 7,841,407 |
| Residential multi-family | 5,354,882 | 5,890,407 |
| Residential construction, 1-4 family & multifamily | 7,907,342 | 3,959,685 |
| Home equity loans and lines of credit | 1,516,890 | 1,319,436 |
| C & I loans | 24,594,304 | 15,636,524 |
| Agriculture* | 25,463,642 | 26,411,693 |
| CRE land/development and construction | 1,427,140 | 746,511 |
| CRE income property - owner-occupied (OOC) | 39,181,708 | 30,865,079 |
| CRE income property - nonowner-occupied (NOC) | 36,880,582 | 30,395,655 |
| Consumer | 945,697 | 1,659,830 |
| | 153,079,988 | 124,726,227 |
| Deferred loan fees | (480,287) | (394,195) |
| Total loans | 152,599,701 | 124,332,032 |
| Allowance for loan losses | (2,555,069) | (2,413,936) |
| Total loans, net | $ 150,044,632 | $ 121,918,096 |

*Balances included in Agriculture primarily consist of maritime loans.

The Bank pledged certain commercial, multi-family, 1-4 family residential, and land loans as collateral for purposes of borrowings with the FHLB and FRB. Loans totaling $64,307,423 and $46,391,791 were pledged to the FHLB at December 31, 2015 and 2014, respectively. There were $1,864,211 and $2,303,812 in loans pledged to the FRB at December 31, 2015 and 2014, respectively (Note 7).

**Past due loans** - Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due.

The following table presents past due loans, net of partial loan charge-offs, by type as of December 31, 2015 and 2014:

| **2015** | 30 - 59 Days Past Due | 60 - 89 Days Past Due | 90 Days or More Past Due | Total Past Due | Current | Total Loans |
|---|---|---|---|---|---|---|
| Residential 1-4 family | $ - | $ - | $ 410,221 | $ 410,221 | $ 9,397,580 | $ 9,807,801 |
| Residential multi-family | - | - | - | - | 5,354,882 | 5,354,882 |
| Residential construction, 1-4 family and multifamily | - | - | - | - | 7,907,342 | 7,907,342 |
| Home equity loans and lines of credit | - | - | - | - | 1,516,890 | 1,516,890 |
| C & I loans | - | - | - | - | 24,594,304 | 24,594,304 |
| Agriculture | - | - | - | - | 25,463,642 | 25,463,642 |
| CRE land/development and construction | - | - | - | - | 1,427,140 | 1,427,140 |
| CRE income property - OOC | - | - | - | - | 39,181,708 | 39,181,708 |
| CRE income property - NOC | - | - | - | - | 36,880,582 | 36,880,582 |
| Consumer | - | - | - | - | 945,697 | 945,697 |
| | $ - | $ - | $ 410,221 | $ 410,221 | $ 152,669,767 | $ 153,079,988 |

**Note 3 - Loans (continued)**

| 2014 | 30 - 59 Days Past Due | 60 - 89 Days Past Due | 90 Days or More Past Due | Total Past Due | Current | Total Loans |
|---|---|---|---|---|---|---|
| Residential 1-4 family | $ - | $ 416,315 | $ - | $ 416,315 | $ 7,425,092 | $ 7,841,407 |
| Residential multi-family | - | - | - | - | 5,890,407 | 5,890,407 |
| Residential construction, 1-4 family and multifamily | - | - | - | - | 3,959,685 | 3,959,685 |
| Home equity loans and lines of credit | - | - | - | - | 1,319,436 | 1,319,436 |
| C & I loans | - | - | - | - | 15,636,524 | 15,636,524 |
| Agriculture | - | - | - | - | 26,411,693 | 26,411,693 |
| CRE land/development and construction | - | - | 161,771 | 161,771 | 584,740 | 746,511 |
| CRE income property - OOC | - | - | - | - | 30,865,079 | 30,865,079 |
| CRE income property - NOC | - | - | - | - | 30,395,655 | 30,395,655 |
| Consumer | - | - | - | - | 1,659,830 | 1,659,830 |
| | $ - | $ 416,315 | $ 161,771 | $ 578,086 | $ 124,148,141 | $ 124,726,227 |

The following table presents the recorded investment in nonaccrual loans at December 31:

| | 2015 | 2014 |
|---|---|---|
| Residential 1-4 family | $ 410,221 | $ - |
| CRE land/development and construction | - | 161,771 |
| | $ 410,221 | $ 161,771 |

There were no loans 90 days past due and still accruing at December 31, 2015 or 2014.

When the Bank identifies a loan as impaired, it measures the loan for potential impairment using discount cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In these cases, the Bank uses the current fair value of the collateral, less selling costs. The starting point for determining the fair value of collateral is through obtaining external appraisals. Generally, external appraisals are updated annually. The Bank obtains appraisals from a pre-approved list of independent, third-party, local appraisal firms. Approval and addition to the list are based on experience, reputation, character, consistency, and knowledge of the respective real estate market. Upon receipt and review, an external appraisal is used to measure a loan for potential impairment. The impairment analysis documents the date of the appraisal used in the analysis, whether the officer preparing the report deems it current, and, if not, allows for internal valuation adjustments with justification. Typical justified adjustments might include discounts for continued market deterioration subsequent to appraisal date, adjustments for the release of collateral contemplated in the appraisal, or the value of other collateral or consideration not contemplated in the appraisal. Impairment analyses are updated, reviewed, and approved on a monthly basis at or near the end of each reporting period.

**Note 3 - Loans (continued)**

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2015 and 2014:

| | Recorded Investments (Loan Balance Less Charge-off) | Unpaid Principal Balance | Related Allowance | Average Investment in Impaired Loans | Interest Income Recognized |
|---|---|---|---|---|---|
| **2015** | | | | | |
| With allowance recorded | | | | | |
| C & I loans | $ 136,334 | $ 136,334 | $ 29,995 | $ 147,030 | $ 7,582 |
| With no allowance recorded | | | | | |
| Agriculture | 3,926,313 | 3,926,313 | - | 4,020,180 | 205,413 |
| Residential 1-4 family | 410,221 | 410,221 | - | 412,558 | 12,506 |
| | 4,336,534 | 4,336,534 | - | 4,432,738 | 217,919 |
| Total | $ 4,472,868 | $ 4,472,868 | $ 29,995 | $ 4,579,768 | $ 225,501 |
| **2014** | | | | | |
| With allowance recorded | | | | | |
| C & I loans | $ 159,545 | $ 159,545 | $ 17,232 | $ 170,289 | $ 10,905 |
| Agriculture | 1,691,312 | 1,691,312 | 25,605 | 1,745,664 | 78,296 |
| | 1,850,857 | 1,850,857 | 42,837 | 1,915,953 | 89,201 |
| With no allowance recorded | | | | | |
| CRE land/development and construction | 161,771 | 161,771 | - | 161,771 | - |
| Total | $ 2,012,628 | $ 2,012,628 | $ 42,837 | $ 2,077,724 | $ 89,201 |

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by class and based on impairment method as of December 31, 2015 and 2014:

| | Allowance for Loan Losses | | | Loans Receivable | | |
|---|---|---|---|---|---|---|
| **2015** | Ending Balance | Ending Balance Individually Evaluated for Impairment | Ending Balance Collectively Evaluated for Impairment | Ending Balance | Ending Balance Individually Evaluated for Impairment | Ending Balance Collectively Evaluated for Impairment |
| Residential 1-4 family | $ 168,752 | $ - | $ 168,752 | $ 9,807,801 | $ 410,221 | $ 9,397,580 |
| Residential multi-family | 73,759 | - | 73,759 | 5,354,882 | - | 5,354,882 |
| Residential construction, 1-4 family and multifamily | 242,283 | - | 242,283 | 7,907,342 | - | 7,907,342 |
| Home equity loans and lines of credit | 31,067 | - | 31,067 | 1,516,890 | - | 1,516,890 |
| C & I loans | 334,772 | 29,995 | 304,777 | 24,594,304 | 136,334 | 24,457,970 |
| Agriculture | 477,591 | - | 477,591 | 25,463,642 | 3,926,313 | 21,537,329 |
| CRE land/development and construction | 28,717 | - | 28,717 | 1,427,140 | - | 1,427,140 |
| CRE income property - OOC | 611,551 | - | 611,551 | 39,181,708 | - | 39,181,708 |
| CRE income property - NOC | 575,635 | - | 575,635 | 36,880,582 | - | 36,880,582 |
| Consumer | 10,942 | - | 10,942 | 945,697 | - | 945,697 |
| | $ 2,555,069 | $ 29,995 | $ 2,525,074 | $ 153,079,988 | $4,472,868 | $ 148,607,120 |

**Note 3 - Loans (continued)**

| | Allowance for Loan Losses | | | Loans Receivable | | |
|---|---|---|---|---|---|---|
| **2014** | Ending Balance | Ending Balance Individually Evaluated for Impairment | Ending Balance Collectively Evaluated for Impairment | Ending Balance | Ending Balance Individually Evaluated for Impairment | Ending Balance Collectively Evaluated for Impairment |
| Residential 1-4 family | $ 204,119 | $ - | $ 204,119 | $ 7,841,407 | $ - | $ 7,841,407 |
| Residential multi-family | 62,362 | - | 62,362 | 5,890,407 | - | 5,890,407 |
| Residential construction, 1-4 family and multifamily | 231,275 | - | 231,275 | 3,959,685 | - | 3,959,685 |
| Home equity loans and lines of credit | 57,323 | - | 57,323 | 1,319,436 | - | 1,319,436 |
| C & I loans | 424,567 | 17,232 | 407,335 | 15,636,524 | 159,545 | 15,476,979 |
| Agriculture | 464,426 | 25,605 | 438,821 | 26,411,693 | 1,691,312 | 24,720,381 |
| CRE land/development and constsruction | 40,541 | - | 40,541 | 746,511 | 161,771 | 584,740 |
| CRE income property - OOC | 323,871 | - | 323,871 | 30,865,079 | - | 30,865,079 |
| CRE income property - NOC | 583,821 | - | 583,821 | 30,395,655 | - | 30,395,655 |
| Consumer | 21,631 | - | 21,631 | 1,659,830 | - | 1,659,830 |
| | $ 2,413,936 | $ 42,837 | $ 2,371,099 | $ 124,726,227 | $2,012,628 | $ 122,713,599 |

Mountain Pacific Bank maintains an allowance for loan and lease losses (ALLL) to absorb losses inherent in the loan portfolio. The size of the ALLL is determined through quarterly assessments of the probable estimated losses in the loan portfolio. The Bank's methodology for making such assessments and determining the adequacy of the ALLL includes the following key elements:

A general valuation allowance is systematically calculated quarterly using quantitative and qualitative information about specific loan classes. The quantitative information uses historical losses from specific loan classes and incorporates the loan's risk rating migration from origination to the point of loss. A loan's risk rating is primarily determined based upon the borrower's ability to fulfill its debt obligation from a cash flow perspective. In the event there is financial deterioration of the borrower, the borrower's other sources of income or repayment are also considered. The qualitative information takes into account general economic and business conditions affecting the Bank's marketplace, seasoning of the loan portfolio, and duration of the business cycle to ensure the Bank's methodologies reflect the current economic environment.

The specific valuation allowance is a reserve for each loan determined to be impaired and the value of the impaired loan is less than its recorded investment. The Bank measures the impairment based on the discounted expected future cash flows, observable market price, or the fair value of the collateral if the loan is collateral-dependent or if foreclosure is probable. The specific reserve for each loan is equal to the difference between the recorded investment in the loan and its determined impaired value.

The ALLL is increased by provisions for loan losses charged to expense and is reduced by loans charged off, net of recoveries. Although the Bank's management believes the best information available is used to determine the ALLL, changes in market conditions could result in adjustments to the ALLL, affecting earnings, if circumstances differ from the assumptions used in determining the ALLL.

Adjustments to the percentages of the ALLL allocated loan categories are made based on trends with respect to delinquencies and problem loans within each pool of loans. The Bank strives to maintain a conservative approach to credit quality and will continue to prudently add to its ALLL as necessary in order to maintain adequate reserves. The Bank carefully monitors the loan portfolio and continues to emphasize the importance of credit quality while continuously strengthening loan monitoring systems and controls.

**Note 3 - Loans (continued)**

The following table presents the activity in the allowance for loan losses and impairment method by segment for the years ended December 31, 2015 and 2014:

| **2015** | Beginning Balance | Provision for Loan Losses | Charge-offs | Recoveries | Ending Balance |
|---|---|---|---|---|---|
| Residential 1-4 family | $ 204,119 | $ (35,367) | $ - | $ - | $ 168,752 |
| Residential multi-family | 62,362 | 11,397 | - | - | 73,759 |
| Residential construction, 1-4 family and multifamily | 231,275 | (21,211) | - | 32,219 | 242,283 |
| Home equity loans and lines of credit | 57,323 | (26,256) | - | - | 31,067 |
| C & I loans | 424,567 | (87,174) | (22,181) | 19,560 | 334,772 |
| Agriculture | 464,426 | 13,165 | - | - | 477,591 |
| CRE land/development and construction | 40,541 | (23,359) | - | 11,535 | 28,717 |
| CRE income property - OOC | 323,871 | 287,680 | - | - | 611,551 |
| CRE income property - NOC | 583,821 | (8,186) | - | - | 575,635 |
| Consumer | 21,631 | (10,689) | - | - | 10,942 |
| | $ 2,413,936 | $ 100,000 | $ (22,181) | $ 63,314 | $ 2,555,069 |
| **2014** | | | | | |
| Residential 1-4 family | $ 236,287 | $ (32,168) | $ - | $ - | $ 204,119 |
| Residential multi-family | 88,848 | (26,486) | - | - | 62,362 |
| Residential construction, 1-4 family and multifamily | 188,401 | 42,874 | - | - | 231,275 |
| Home equity loans and lines of credit | 50,138 | (50,332) | - | 57,517 | 57,323 |
| C & I loans | 436,507 | (14,020) | - | 2,080 | 424,567 |
| Agriculture | 290,431 | 173,995 | - | - | 464,426 |
| CRE land/development and construction | 100,913 | (68,833) | - | 8,461 | 40,541 |
| CRE income property - OOC | 500,284 | (176,413) | - | - | 323,871 |
| CRE income property - NOC | 365,003 | 218,818 | - | - | 583,821 |
| Consumer | 29,066 | (7,435) | - | - | 21,631 |
| | $ 2,285,878 | $ 60,000 | $ - | $ 68,058 | $ 2,413,936 |

**Credit quality indicator** - Federal regulations provide for the classification of lower quality loans and other assets, such as debt and equity securities, as substandard, doubtful, or loss. An asset is considered substandard if it is inadequately protected by the current net worth and pay capacity of the borrower or of any collateral pledged. Substandard assets include those characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable on the basis of currently existing facts, conditions, and values. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

The extension of credit in the form of loans to individuals and businesses is one of the Bank's principal commerce activities. The Bank's policies and applicable laws and regulations require risk analysis, as well as ongoing portfolio and credit management. The Bank manages its credit risk through lending limit constraints, credit review, approval policies, and ongoing internal monitoring. The Bank also manages credit risk through diversification of the loan portfolio by type of loan, type of industry, type of borrower, and by limiting the aggregation of debt to a single borrower.

**Note 3 - Loans (continued)**

In analyzing the Bank's existing portfolio, risk ratings are assigned to each loan. These numeric ratings range in value from 1 to 10 and are based on the following criteria:

1. Ratings of 1-5 indicate low to minimal credit risk (pass).

2. Rating of 6 indicates an average to above average credit risk with adequate repayment capacity when prolonged periods of adversity do not exist (watch).

3. Rating of 7 indicates potential weaknesses and higher credit risk requiring greater attention by Bank personnel and management to help prevent further deterioration (special mention).

4. Rating of 8 indicates a loss is possible if loan weaknesses are not corrected (substandard).

5. Rating of 9 indicates loss is highly probable; however, the amount of the loss has not yet been determined (doubtful).

6. Rating of 10 indicates the loan is uncollectible and, when identified, is charged off (loss).

Periodically, the Bank reviews all loans to assess the ability of the borrowers to service all interest and principal obligations and, as a result, the risk rating may be adjusted accordingly. Risk ratings should be reviewed and updated whenever appropriate, with more periodic reviews as the risk and dollar value of loss on the loan increases. In the event that full collection of principal and interest is not reasonably ensured, the loan is appropriately downgraded and, if warranted, placed on nonaccrual status even though the loan may be current as to principal and interest payments. Additionally, the Bank assesses whether an impairment of a loan warrants specific reserves or a write-down of the loan.

The following table represents the internally assigned grade as of December 31 by type of loans:

| **2015** | Pass/Watch | Special Mention | Substandard | Doubtful | Loss | Total |
|---|---|---|---|---|---|---|
| Residential 1-4 family | $ 8,860,336 | $ 537,244 | $ 410,221 | $ - | $ - | $ 9,807,801 |
| Residential multi-family | 5,354,882 | - | - | - | - | 5,354,882 |
| Residential construction, 1-4 family and multifamily | 7,907,342 | - | - | - | - | 7,907,342 |
| Home equity loans and lines of credit | 1,315,291 | 201,599 | - | - | - | 1,516,890 |
| C & I loans | 24,091,357 | 468,864 | 34,083 | - | - | 24,594,304 |
| Agriculture | 20,089,135 | 431,093 | 4,943,414 | - | - | 25,463,642 |
| CRE land/development and construction | 1,427,140 | - | - | - | - | 1,427,140 |
| CRE income property - OOC | 39,181,708 | - | - | - | - | 39,181,708 |
| CRE income property - NOC | 33,928,507 | 2,952,075 | - | - | - | 36,880,582 |
| Consumer | 945,697 | - | - | - | - | 945,697 |
| | $ 143,101,395 | $ 4,590,875 | $ 5,387,718 | $ - | $ - | $ 153,079,988 |

**Note 3 - Loans (continued)**

| 2014 | Pass/Watch | Special Mention | Substandard | Doubtful | Loss | Total |
|---|---|---|---|---|---|---|
| Residential 1-4 family | $ 6,706,163 | $ 1,135,244 | $ - | $ - | $ - | $ 7,841,407 |
| Residential multi-family | 5,890,407 | - | - | - | - | 5,890,407 |
| Residential construction, 1-4 family and multifamily | 3,959,685 | - | - | - | - | 3,959,685 |
| Home equity loans and lines of credit | 1,112,469 | 206,967 | - | - | - | 1,319,436 |
| C & I loans | 14,236,728 | 1,359,910 | 39,886 | - | - | 15,636,524 |
| Agriculture | 22,064,030 | 2,201,111 | 2,146,552 | - | - | 26,411,693 |
| CRE land/development and construction | 584,740 | - | 161,771 | - | - | 746,511 |
| CRE income property - OOC | 30,865,079 | - | - | - | - | 30,865,079 |
| CRE income property - NOC | 27,382,169 | 435,197 | 2,578,289 | - | - | 30,395,655 |
| Consumer | 1,659,830 | - | - | - | - | 1,659,830 |
| | $ 114,461,300 | $ 5,338,429 | $ 4,926,498 | $ - | $ - | $ 124,726,227 |

Loans classified as troubled debt restructurings (TDRs) totaled $3,960,396 and $1,731,198 at December 31, 2015 and 2014, respectively. These loans are included in the impaired loan disclosures. A troubled debt restructuring is a loan to a borrower that is experiencing financial difficulty that has been modified from its original terms and conditions in such a way that the Bank is granting the borrower a concession of some kind. The Bank has granted a variety of concessions to borrowers in the form of loan modifications. The modifications granted can generally be described in the following categories:

**Rate modification** - A modification in which the interest rate is changed.

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

**Payment modification** - A modification in which the dollar amount of the payment is changed. Interest-only modifications in which a loan is converted to interest-only payments for a period of time are included in this category.

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

Upon identifying those receivables as troubled debt restructurings, the Bank identified them as impaired for the purposes of determining the allowance for loan losses. This requires the loans to be evaluated individually for impairment, generally based on the expected cash flows under the new terms discounted at the loans' original effective interest rates. For troubled debt restructured loans that subsequently default, the method of determining impairment is generally the fair value of the collateral less estimated selling costs.

**Note 3 - Loans (continued)**

The following table presents newly restructured TDR loans by class that occurred during year ended December 31, by type of concession granted:

| 2015 | Number of Contracts | Rate Modification | Term Modification | Payment Modification | Combination Modification | Total Modifications |
|---|---|---|---|---|---|---|
| Pre-modification outstanding recorded investment | | | | | | |
| C & I loans | 1 | $ - | $ - | $ 34,083 | $ - | $ 34,083 |
| Agriculture | 3 | - | - | 2,472,933 | 1,453,380 | 3,926,313 |
| Post-modification outstanding recorded investment | | | | | | |
| C & I loans | 1 | $ - | $ - | $ 34,083 | $ - | $ 34,083 |
| Agriculture | 3 | - | - | 2,472,933 | 1,453,380 | 3,926,313 |
| **2014** | | | | | | |
| Pre-modification outstanding recorded investment | | | | | | |
| C & I loans | 1 | $ - | $ - | $ 39,886 | $ - | $ 39,886 |
| Agriculture | 1 | - | - | - | 1,691,312 | 1,691,312 |
| Post-modification outstanding recorded investment | | | | | | |
| C & I loans | 1 | $ - | $ - | $ 39,886 | $ - | $ 39,886 |
| Agriculture | 1 | - | - | - | 1,691,312 | 1,691,312 |

There were no TDR loans that were modified within the prior 12 months that subsequently defaulted during the year ended December 31, 2015 or 2014.

The Bank had no commitments to extend additional credit to borrowers owing loans whose terms have been modified in troubled debt restructurings.

**Note 4 - Leaseholds and Equipment**

Bank leaseholds and equipment at December 31 are classified as follows:

| | 2015 | 2014 |
|---|---|---|
| Leasehold improvements | $ 1,648,257 | $ 1,503,906 |
| Furniture, fixtures, and office equipment | 1,183,403 | 1,043,650 |
| | 2,831,660 | 2,547,556 |
| Accumulated depreciation and amortization | (2,173,214) | (1,896,428) |
| | $ 658,446 | $ 651,128 |

Total depreciation and amortization expense was $276,786 and $234,943 for the years ended December 31, 2015 and 2014, respectively.

**Note 5 - Other Real Estate Owned**

The following table presents other real estate owned as of December 31:

| | 2015 | 2014 |
|---|---|---|
| Beginning balance | $ 5,609,998 | $ 7,826,342 |
| Capitalized improvements | - | 360,951 |
| Sales | (269,578) | (2,655,861) |
| Gains realized on sales of real estate from joint venture activities | - | 55,616 |
| Net gain on sales | - | 22,950 |
| Ending balance | $ 5,340,420 | $ 5,609,998 |

Other real estate owned as of December 31, 2015, consists of land and a single-family residence.

**Note 6 - Deposits**

Deposits as of December 31 consisted of the following:

| | 2015 | 2014 |
|---|---|---|
| Savings accounts | $ 3,173,175 | $ 3,071,621 |
| Certificates of deposit | 49,805,038 | 43,921,624 |
| Demand accounts | | |
| Noninterest-bearing | 31,088,351 | 24,186,581 |
| Interest-bearing | 14,706,473 | 9,187,481 |
| Money market accounts | 65,075,823 | 43,236,958 |
| | $ 163,848,860 | $ 123,604,265 |

At December 31, 2015, scheduled maturities of certificates of deposit are as follows:

| | |
|---|---|
| 2016 | $ 38,189,894 |
| 2017 | 9,125,285 |
| 2018 | 1,954,078 |
| 2019 | 76,738 |
| 2020 | 459,043 |
| | $ 49,805,038 |

The Bank had $6,487,487 and $4,825,837 of certificates of deposit that met or exceeded the $250,000 federally insured limit at December 31, 2015 and 2014, respectively.

**Note 7 - Credit Arrangements**

The Bank has a committed line of credit through the Federal Reserve Bank of San Francisco for a discounted rate based on the type of loans pledged as collateral (Note 3). Loans pledged to the FRB equated to a borrowing capacity of $1,361,041 and $1,493,910 at December 31, 2015 and 2014. There were no outstanding balances under this credit arrangement at December 31, 2015 and 2014.

The Bank is a member of the FHLB of Des Moines and, as such, has a committed credit line of up to 20% of total eligible assets, subject to certain collateral requirements. Borrowings generally provide for interest at the then-current published rates.

The Bank also has a line-of-credit agreement with an unaffiliated bank totaling $2,000,000. This line provides for lending at the bank's federal fund rates. There were no borrowings outstanding at December 31, 2015 and 2014.

The Bank also entered into a line-of-credit agreement with an unaffiliated bank totaling $10,000,000 in April 2015. This line provides for lending at the bank's federal fund rates. There were no borrowings outstanding at December 31, 2015.

At December 31, 2015 and 2014, loans pledged to the FHLB equated to a borrowing capacity of $33,229,245 and $29,995,800, respectively. At December 31, 2015 and 2014, the Bank had $5,000,000 and $7,425,000 of borrowings, respectively, outstanding with the FHLB, with fixed rates ranging from 0.45% to 0.85% under these agreements. The borrowings have a weighted-average interest rate of 0.70% and 0.59% as of December 31, 2015 and 2014, respectively. Current borrowings are collateralized by pledged loans secured by commercial, multi-family, and 1-4 family real estate (Note 3). The excess balance of the loans can be used for additional borrowings.

The contractual maturities of FHLB advances at December 31, 2015, are as follows:

| | |
|---|---|
| 2016 | $ 3,000,000 |
| 2017 | 2,000,000 |
| | $ 5,000,000 |

**Note 8 - Income Taxes**

The components of the income tax expense (benefit) are as follows at December 31:

| | 2015 | 2014 |
|---|---|---|
| Current | $ - | $ - |
| Deferred | 425,000 | 262,237 |
| Change in valuation allowance | - | (4,212,237) |
| | $ 425,000 | $ (3,950,000) |

**Note 8 - Income Taxes (continued)**

The following are the significant components of the Bank's deferred tax assets and liabilities at December 31:

| | 2015 | 2014 |
|---|---|---|
| Deferred tax asset | | |
| Allowance for loan losses | $ 287,589 | $ 253,589 |
| Net operating loss carryforward | 2,454,911 | 2,861,522 |
| Organization expenditures | 46,250 | 54,495 |
| OREO valuation adjustments | 670,020 | 668,539 |
| Nonaccrual interest | 3,774 | 15,702 |
| Property and equipment depreciation | 42,669 | 29,771 |
| Unrealized losses on securities | 1,108 | - |
| Other | 127,317 | 182,036 |
| Subtotal | 3,633,638 | 4,065,654 |
| Deferred tax liabilities | | |
| Deferred loan costs | 108,638 | 108,946 |
| Unrealized gains on securities | - | 6,708 |
| Subtotal | 108,638 | 115,654 |
| Net deferred tax asset | $ 3,525,000 | $ 3,950,000 |

Pursuant to Sections 382 and 383 of the Internal Revenue Code, annual use of net operating loss and credit carryforwards may be limited in the event a cumulative change in ownership of more than 50% occurs within a three-year period. The Bank determined such an ownership change occurred as of December 12, 2011, as a result of the exercise of stock warrants. This ownership change results in annual limitations on the use of net operating loss carryforwards and may limit the Bank's ability to fully utilize its deferred tax assets. The deferred tax asset associated with the net operating loss carryforward reflects preliminary limitations based on the filed 2011 tax return.

The Bank has federal net operating loss carryforwards of approximately $7,675,000 at December 31, 2015, before the consideration of any Section 382 limits. Federal net operating loss carryforwards, to the extent not used, will begin to expire in 2028.

A valuation allowance is required for deferred tax assets if, based on available evidence, it is more-likely-than-not that all or some portion of the asset will not be realized due to the inability to generate sufficient taxable income to use the benefit of the deferred tax asset. After evaluating the positive and negative evidence associated with the deferred tax asset, including the consideration of the Bank's earnings history over the recent three-year period and improving asset quality, the Bank determined that no valuation allowance is necessary at December 31, 2015.

The variance between recording tax at the statutory rate of 34% and tax expense actually recorded primarily relates to the change in the valuation allowance.

At December 31, 2015, the Bank had unamortized preopening expenditures of approximately $136,000 (for tax reporting purposes) that can be used to offset future federal income taxes. These expenditures are amortizing at a rate of approximately $24,000 per year.

**Note 8 - Income Taxes (continued)**

At December 31, 2015 and 2014, the Bank had no unrecognized tax benefits. The Bank recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2015 and 2014, the Bank recognized no interest and penalties. The Bank files income tax returns in the U.S. federal jurisdiction. With few exceptions, the Bank is no longer subject to U.S. federal income tax examinations by tax authorities for years before 2012.

**Note 9 - Employee Benefits**

The Bank has a 401(k) defined contribution plan (the 401k Plan) for those employees who meet the eligibility requirements set forth in the 401(k) Plan. Eligible employees can contribute up to 100% of compensation subject to certain limits based on federal tax laws. The 401(k) Plan also allows for discretionary employer matching contributions equal to 100% up to the first 3%, and 50% up to the next 2% of compensation. Matching contributions vest immediately. The Bank's contribution for the years ended December 31, 2015 and 2014, was $80,152 and $71,661, respectively.

**Note 10 - Stockholders' Equity**

**Warrants** - At December 31, 2015 and 2014, there were warrants outstanding to purchase 107,500 shares of the Bank's common stock at $10 per share, which were issued in connection with the Bank's initial offering. The warrants have a term of 10 years and expire on September 15, 2016. During 2014, there were 587,467 warrants remaining from subsequent offerings, of which 575,317 warrants were exercised at $3 per share and the remaining 12,150 warrants expired at December 31, 2014.

**Regulatory capital** - 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 the Bank's assets, liabilities, and certain off-balance-sheet items, as calculated under regulatory accounting practices. The Bank's capital amounts and classifications 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 I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I (as defined) capital to average assets (as defined). As of December 31, 2015, management believes that the Bank meets all capital adequacy requirements to which it is subject.

To be categorized as adequately capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios, as set forth in the table. The institution is well capitalized under the prompt corrective action provisions.

**Note 10 - Stockholders' Equity (continued)**

As of December 31, 2015, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios, as set forth in the following table. There are no conditions or events since the notification that management believes have changed the Bank's category. The Bank's actual capital amounts and ratios as of December 31 are also presented in the table.

| | Actual | | For Capital Adequacy Purposes | | | To Be Well Capitalized Under Prompt Corrective Action Provisions | | |
|---|---|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | | Ratio | Amount | | Ratio |
| **As of December 31, 2015** | | | | | | | | |
| Total capital (to risk-weighted assets) | $ 24,642,000 | 13.9% | $ 14,151,902 | ≥ | 8.0% | $ 17,689,878 | ≥ | 10.0% |
| Tier I capital (to risk-weighted assets) | 22,408,000 | 12.7% | 10,611,523 | ≥ | 6.0% | 14,148,698 | ≥ | 8.0% |
| Common equity Tier 1 capital (to risk-weighted assets) | 22,408,000 | 12.7% | 7,958,642 | ≥ | 4.5% | 11,495,817 | ≥ | 6.5% |
| Tier I capital (to average assets) | 22,408,000 | 12.2% | 7,334,861 | ≥ | 4.0% | 9,168,576 | ≥ | 5.0% |
| **As of December 31, 2014** | | | | | | | | |
| Total capital (to risk-weighted assets) | $ 21,626,343 | 15.3% | $ 11,285,763 | ≥ | 8.0% | $ 14,107,204 | ≥ | 10.0% |
| Tier I capital (to risk-weighted assets) | 19,855,247 | 14.1% | 5,640,695 | ≥ | 4.0% | 8,461,043 | ≥ | 6.0% |
| Tier I capital (to average assets) | 19,855,247 | 13.1% | 6,048,819 | ≥ | 4.0% | 7,561,023 | ≥ | 5.0% |

Banking regulations limit the transfer of assets in the form of dividends from the Bank to its stockholders. Dividends may also be subject to approval by regulators depending upon the financial condition of the Bank.

The Federal Reserve and the FDIC approved final capital rules in July 2013 that substantially amend the existing capital rules for banks. These rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as "Basel III"), as well as requirements contemplated by the Dodd-Frank Act.

During 2015, the capital rules were amended to include the capital ratio of common equity Tier 1 capital to risk-weighted assets. Common equity Tier 1 capital generally consists of retained earnings and common stock (subject to certain adjustments). In March 2015, the Bank exercised a one-time irrevocable option to exclude investment components of accumulated other comprehensive income (AOCI). The Bank is also required to establish a "conservation buffer" consisting of a common equity Tier 1 capital amount equal to 2.5% of risk-weighted assets to be phased in by 2019. An institution that does not meet the conservation buffer will be subject to restrictions on certain activities including payment of dividends, stock repurchases, and discretionary bonuses to executive officers.

## Note 11 - Lease Commitments

**Operating lease commitments** - The Bank leases its office, administrative, and loan operations space at standard market rates from a related party LLC of which two directors are members. The Everett branch has a 12-year term, with an option to renew for two 5-year terms, and a loan operations space that has a 10-year lease ending in May 2018, with an option to renew for two 5-year terms to be mutually determined at that time. Total amounts paid to the related entity for Everett lease space were $268,193 and $280,949 for the years ended December 31, 2015 and 2014.

The Bank entered into a new lease agreement with an unaffiliated party for the Ballard Branch location beginning in September 2015. The lease is a 3-year lease ending August 2018 and contains two renewal options for three years each. The Bank also has a lease agreement with an unaffiliated party for the old Ballard Loan Production office. The lease is a 3-year lease ending November 2016 and contains no renewal option.

The Bank also has a lease agreement with an unaffiliated party for the Lynnwood office. The lease is a 10-year lease ending January 2018, and contains an option to renew for two 5-year terms at rates to be mutually determined at that time.

All lease agreements require the Bank to pay its pro rata share of building operating expenses. The minimum annual lease payments through the initial lease term for the years ending December 31 are as follows:

| | | |
|---|---|---|
| 2016 | $ | 421,667 |
| 2017 | | 431,233 |
| 2018 | | 141,186 |
| | $ | 994,086 |

Rental expense charged to operations was $469,643 and $459,143 for the years ended December 31, 2015 and 2014, respectively.

## Note 12 - Stock-Based Compensation Plan

The Bank has one stock-based compensation plan, which is described below. The total compensation cost for restricted stock and stock options that has been charged against operations for the plan was $67,902 in 2015 and $112,909 in 2014. There was no compensation cost capitalized and no income tax benefits realized on these stock-based compensation arrangements in 2015 or 2014.

**Stock option plan** - In December 2006, stockholders approved an equity incentive plan (the Plan) to promote the best interest of the Bank by providing an incentive to those key employees who contribute to its success. The Plan permits the grant of incentive stock options for employees, nonqualified stock options for directors, and restricted stock grants. The maximum amount of common stock that may be issued under the Plan is 330,000 shares, of which there are 66,000 shares available for restricted stock grants. During 2012, stockholders approved an amendment to the Plan, increasing the number of authorized shares to 800,000 available for options, of which there are 400,000 shares available for restricted stock grants. There were 69,440 and 385,835 shares remaining in the Plan at December 31, 2015, available to grant for options and restricted stock, respectively.

Incentive stock and nonqualified stock option awards are generally granted with an exercise price equal to the market price of the Bank's stock at the date of grant; those option awards generally vest and become exercisable in incremental percentages from one to five years of continuous service from the grant date, and expire after 10 years. Certain option and share awards provide for accelerated vesting upon death of the optionee or if there is a change in control (as defined in the Plan).

Restricted stock grants vest ratably over three to five years from the date of grant. The restricted stock grants' fair value equals their intrinsic value on the date of grant.

**Note 12 - Stock-Based Compensation Plan (continued)**

The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton valuation model that uses the assumptions noted in the following table. Expected volatilities are based on historical volatility of the Bank's stock and other factors. The expected term of options granted was evaluated by a calculation that factored in the contractual term and vesting period, and considered different employee segments. The risk-free interest 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 grant.

| | 2015 | 2014 |
|---|---|---|
| Risk-free interest rate | 2.04% | 2.11% to 2.35% |
| Dividend yield rate | 0.00% | 0.00% |
| Expected volatility | 30% | 32% |
| Expected term (in years) | 6.5 years | 6.5 years |

A summary of incentive and nonqualified stock option activity is presented below:

| | Granted Options for Common Stock | Weighted-Average Exercise Price of Shares Under Plan | Weighted-Average Remaining Contractual Term (Years) |
|---|---|---|---|
| Outstanding at December 31, 2014 | 299,440 | $ 3.00 | |
| Granted | 95,000 | 3.18 | |
| Exercised | (15,200) | 3.00 | |
| Forfeited | (48,680) | 3.01 | |
| Outstanding at December 31, 2015 | 330,560 | $ 3.05 | 6.33 |
| Options exercisable at December 31, 2015 | 187,950 | $ 3.00 | 4.61 |

The weighted-average grant-date fair value of options granted was $1.09 and $1.10 for each of the years ended December 31, 2015 and 2014. As of December 31, 2015, there was $112,268 of total unrecognized compensation cost related to incentive and nonqualified stock options granted under the Plan. That cost is expected to be recognized over a weighted-average period of two years. There were no tax benefits realized from the exercise of options in 2015 or 2014.

**Note 12 - Stock-Based Compensation Plan (continued)**

**Restricted stock grants** - The fair value of restricted stock grants is determined based on the last trade price or most recent stock valuation on the grant date. A summary of nonvested restricted stock grants activity is presented below:

| | Shares | Weighted-Average Grant-Date Fair Value |
|---|---|---|
| Nonvested at December 31, 2014 | 17,770 | $ 3.36 |
| Granted | 7,000 | 3.18 |
| Vested | (6,885) | 3.00 |
| Forfeited | (3,720) | 3.05 |
| Nonvested at December 31, 2015 | 14,165 | $ 3.08 |

As of December 31, 2015, there was $28,713 of total unrecognized compensation cost related to restricted stocks granted under the Plan. That cost is expected to be recognized over a weighted-average period of approximately three years.

**Note 13 - Related Party Transactions**

Certain directors, executive officers, and principal stockholders are Bank customers and have had banking transactions with the Bank. All loans and commitments included in such transactions were 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 do not involve more than the normal risk of collectibility or present any other unfavorable features. The following summarizes these transactions with directors, executive officers, principal stockholders, and companies with which they are associated at December 31:

| | 2015 | 2014 |
|---|---|---|
| Beginning balance | $ 3,082,781 | $ 5,251,127 |
| New loans | 1,228,149 | 32,896 |
| Repayments | (339,392) | (2,201,242) |
| Transfers out | (36,398) | - |
| Ending balance | $ 3,935,140 | $ 3,082,781 |
| Deposits | $ 8,831,286 | $ 8,175,548 |

The Bank leases office space from a related party LLC, of which two directors are members (Note 11).

MPB Directors Buildout LLC, as described in Note 1, did not have any activity or agreements outstanding at December 31, 2015 or 2014.

**Note 14 - Commitments and Contingencies**

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby letters of credit, and financial guarantees. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of those instruments reflect the extent of the Bank's involvement 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 instrument for commitments to extend credit, standby letters of credit, and financial guarantees written is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

**Commitments to extend credit and financial guarantees** - Commitments to extend credit are agreements to lend to a customer 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. Because many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank's experience has been that approximately 81% of loan commitments are drawn upon by customers. The Bank evaluates customers' creditworthiness on a case-by-case basis and follows the Bank's normal credit policies. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, income-producing commercial properties, and other real estate.

The distribution of commitments to extend credit approximates the distribution of loans outstanding. Commercial and standby letters of credit were granted primarily to commercial borrowers. The Bank, as a matter of policy, does not extend credit in excess of 20% of Tier I capital, or $5.0 million, to any single borrower or group of related borrowers.

Standby letters of credit and financial guarantees 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 public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank maintains various levels of collateral supporting those commitments for which collateral is deemed necessary.

The Bank has not been required to perform on any financial guarantees. The Bank has not incurred any losses on its commitments in 2015 or 2014.

A summary of the notional amounts of the Bank's financial instruments with off-balance-sheet risk at December 31 follows:

| | 2015 | 2014 |
|---|---|---|
| Commitments to extend credit | $ 41,821,174 | $ 30,676,011 |
| Standby letters of credit | $ 198,327 | $ 143,058 |

**Legal contingencies** - Various legal claims also arise from time to time in the normal course of business that, in the opinion of management, will have no material effect on the Bank's financial statements.

**Note 15 - Fair Value of Financial Instruments**

Fair value is the price to sell an asset or transfer a liability in an orderly transaction between market participants in the Bank's principal market. The Bank has established and documented its process for determining the fair values of its assets and liabilities, where applicable. Fair value is based on quoted market prices, when available, for identical or similar assets or liabilities. In the absence of quoted market prices, management determines the fair value of the Bank's assets and liabilities using valuation models or third-party pricing services, both of which rely on market-based parameters when available, such as interest rate yield curves, option volatilities and credit spreads, or unobservable inputs. Unobservable inputs may be based on management's judgment, assumptions, and estimates related to credit quality, liquidity, interest rates, and other relevant inputs.

Valuation adjustments, such as those pertaining to counterparty and the Bank's own credit quality and liquidity, may be necessary to ensure that assets and liabilities are recorded at fair value. Credit valuation adjustments are made when market pricing is not indicative of the counterparty's credit quality.

Any changes to valuation methodologies are reviewed by management to ensure that they are relevant and justified. Valuation methodologies are refined as more market-based data becomes available.

There are three levels of inputs that may be used to measure fair values:

**Level 1** - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

**Level 2** - Either (i) quoted prices for similar assets or liabilities; (ii) observable inputs, such as interest rates or yield curves; or (iii) inputs derived principally from or corroborated by observable market data.

**Level 3** - Unobservable inputs.

The hierarchy gives the highest ranking to Level 1 inputs and the lowest ranking to Level 3 inputs. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the overall fair value measurement.

**Qualitative disclosures of valuation techniques**

**Investment securities** - Where quoted prices are available in an active market, securities are classified as Level 1. Level 1 instruments include highly liquid government bonds, securities issued by the U.S. Treasury, and exchange-traded equity securities. If quoted prices are not available, management determines fair value using pricing models, quoted prices of similar securities, or discounted cash flows. Such instruments are classified as Level 2. In certain cases where there is limited activity in the market for a particular instrument, assumptions must be made to determine its fair value. Such instruments are classified as Level 3.

**Assets measured at fair value on a recurring basis** - Assets are considered to be fair valued on a recurring basis if fair value is measured regularly (i.e., daily, weekly, monthly, or quarterly). The following table shows the Bank's assets and liabilities measured at fair value on a recurring basis:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **2015** | | | | |
| Obligations of U.S. agencies | $ - | $ 2,352,452 | $ - | $ 2,352,452 |
| Agency mortgage-backed securities | - | 4,214,322 | - | 4,214,322 |
| Agency collateralized mortgage obligations | - | 1,334,606 | - | 1,334,606 |
| Corporate bonds | - | 984,680 | - | 984,680 |
| **2014** | | | | |
| Obligations of U.S. agencies | $ - | $ 429,391 | $ - | $ 429,391 |
| Agency mortgage-backed securities | - | 4,265,804 | - | 4,265,804 |
| Agency collateralized mortgage obligations | - | 666,671 | - | 666,671 |
| Corporate bonds | - | 1,014,090 | - | 1,014,090 |

**Note 15 - Fair Value of Financial Instruments (continued)**

**Assets measured at fair value on a nonrecurring basis** - Assets are considered to be fair valued on a nonrecurring basis if the fair value measurement of the instrument does not necessarily result in a change in the amount recorded on the balance sheets. Generally, nonrecurring valuation is the result of the application of other accounting pronouncements that require assets or liabilities to be assessed for impairment or recorded at the lower of cost or fair value. The following table presents the Bank's assets measured at fair value on a nonrecurring basis:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **December 31, 2015** | | | | |
| Impaired loans | $ - | $ - | $ 4,088 | $ 4,088 |
| Other real estate owned | - | - | 5,340,420 | 5,340,420 |
| **December 31, 2014** | | | | |
| Impaired loans | $ - | $ - | $ 1,688,361 | $ 1,688,361 |
| Other real estate owned | - | - | 5,609,998 | 5,609,998 |

Valuations of impaired loans are periodically performed by management, and the fair value of the loans is carried at the fair value of the underlying collateral less cost to foreclose, sell, and carry the collateral. Fair value of the underlying collateral is determined by an appraisal performed by a qualified independent appraiser. Other real estate owned is valued in a similar manner as impaired loans.

**Quantitative information about Level 3 fair value measurements** - The range and weighted average of the significant unobservable inputs used to fair value Level 3 nonrecurring assets during the years ending December 31, 2015 and 2014, along with the valuation techniques used, are shown in the following table:

| | Fair Value at December 31, 2015 | Valuation Technique | Unobservable Input | Range[1] |
|---|---|---|---|---|
| Impaired loans | $ 4,088 | Market comparable | Adjustment to appraisal value | 0% - 10% |
| OREO | $ 5,340,420 | Market comparable | Adjustment to appraisal value | 0% - 10% |

[1] Discount for selling costs.

| | Fair Value at December 31, 2014 | Valuation Technique | Unobservable Input | Range[1] |
|---|---|---|---|---|
| Impaired loans | $ 1,688,361 | Market comparable | Adjustment to appraisal value | 0% - 10% |
| OREO | $ 5,609,998 | Market comparable | Adjustment to appraisal value | 0% - 10% |

[1] Discount for selling costs.

The fair value estimates on the following page are subjective in nature and involve uncertainties and matters of significant judgment; therefore, they are not necessarily indicative of the amounts the Bank could realize in a current market exchange. The Bank has not included certain material items in its disclosure, such as the value of the long-term relationships with the Bank's lending and deposit clients, since this is an intangible and not a financial instrument. Additionally, the estimates do not include any tax ramifications. There may be inherent weaknesses in any calculation technique and changes in the underlying assumptions used, including discount rates and estimates of future cash flows that could materially affect the results. For all of these reasons, the aggregation of the fair value calculations presented herein do not represent, and should not be construed to represent, the underlying value of the Bank.

**Note 15 - Fair Value of Financial Instruments (continued)**

Estimated fair values of the Bank's financial instruments at December 31 were as follows:

| | 2015 | | 2014 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial assets | | | | |
| Cash and cash equivalents | $ 20,232,884 | $ 20,232,884 | $ 9,364,057 | $ 9,364,057 |
| Interest-bearing deposits in banks | 3,000,000 | 3,000,000 | 3,725,000 | 3,725,000 |
| Investment securities available-for-sale | 8,886,060 | 8,886,060 | 6,375,956 | 6,375,956 |
| Investment securities held-to-maturity | 999,745 | 1,002,690 | 997,836 | 1,025,550 |
| FHLB and PCBB stock | 576,600 | 576,600 | 639,000 | 639,000 |
| Loans held-for-sale | - | - | 1,289,942 | 1,289,942 |
| Loans | 152,599,701 | 152,449,654 | 124,332,032 | 125,738,994 |
| Accrued interest receivable | 587,824 | 587,824 | 654,756 | 654,756 |
| Financial liabilities | | | | |
| Deposits | 163,848,860 | 161,273,860 | 123,604,265 | 119,678,678 |
| FHLB advances | 5,000,000 | 4,981,000 | 7,425,000 | 7,407,000 |
| Accrued interest payable | 71,315 | 71,315 | 54,778 | 54,778 |

**Cash and cash equivalents, interest-bearing deposits in banks, and accrued interest** - The carrying amount represents fair value.

**Investment securities** - Fair values are based on quoted market prices or dealer quotations of similar securities.

**FHLB stock and PCBB stock** - The fair value is based upon the redemption value of the stock, which equated to its carrying value.

**Loans held-for-sale** - The carrying amount approximates fair value.

**Loans** - Fair values are estimated using current market interest rates to discount future cash flows. Interest rates used to discount the cash flows are based on the U.S. Treasury yields or other market interest rates with appropriate spreads. Prepayment rates are based on expected future prepayment rates or, where appropriate and available, market prepayment rates. Liquidity and credit quality discounts are not considered.

**Deposits** - The fair value of deposits with no stated maturity, such as demand, checking, money market, and savings accounts, equals the amount payable on demand. The fair value of certificates of deposit is calculated based on the discounted value of contractual cash flows. The discount rate is equal to the rate currently offered on similar products.

**Federal Home Loan Bank advances** - The fair value of Federal Home Loan Bank advances is calculated based on the discounted cash flow method, adjusted for market interest rates and terms to maturity.

**Off-balance-sheet instruments** - The fair value of commitments to extend credit and letters of credit was estimated using the fees currently charged to enter into similar arrangements, taking into account the remaining terms of the agreements and the present creditworthiness of the customers. Because the majority of the Bank's off-balance-sheet instruments consist of non-fee-producing, variable-rate commitments, the Bank has determined they do not have a distinguishable fair value.