Following the vision.

2015 FINANCIAL STATEMENT

Liberty Bay Bank

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Dear Shareholders, Clients and Employees,

It is in a spirit of optimism that I reflect on and share Liberty Bay Bank's progress over the last five year period where we have experienced notable growth in both loans and deposits.

Our team of intelligent, seasoned bankers supported by hard-working leadership has continued to fulfill our mission to become a community bank like no other.

Expanded market presence and technology enhancements demonstrate our consistent commitment to offer the best in community banking. Our intentional lending and service commitment to local businesses to cultivate their expansion, more efficient operations, and their success has resulted in a sustainable, strong balance sheet and a growing, diverse client base of which we can all be proud.

The bank's financial performance is illustrated inside this report, and there are several important milestones and trends to acknowledge:

Growth – Excellent growth over the last 5 years.

- Loan growth at a 20% compound annual growth rate.
- Deposit growth at a 12% compound annual growth rate.
- A 31% compound annual growth rate in non-interest bearing deposits.

Sustainable Earnings – Annual 2015 net earnings increased by 275% from 2014.
Liberty Bay Bank earned $ 702,000 or an 8.74% return on average equity in 2015. We have 10 consecutive quarters of positive earnings.

Credit Quality – We have an excellent lending credit quality record nationally.

- We have no past due or non-performing loans at December 31, 2015.
- Ranked # 1 in Washington state for best loan credit metrics.[1]
- Ranked in the Top 1% Nationally for best loan credit metrics.[2]

Technology – LBB introduced a revitalized website, including enhanced Mobile Banking with Mobile Remote Deposit Capture (2015).

The footprint of the bank's community influence continues to expand well-beyond Kitsap County. We have a growing and diverse business and consumer client base across the Puget Sound region. Our clients choose Liberty Bay Bank because we provide what they need and want, and we have a shared determination to help them succeed.

This—our second full year of profitability—demonstrates that Liberty Bay Bank is, indeed, a valued partner in economic development in our region. We are achieving our founders' vision of a community-minded bank that is strong, with a sustainable model of profitability

Determination, diligence, informed community reinvestment and thriving client relationships combine to position us for continued success. Thank you for your confidence in our mission.

Richard Darrow
PRESIDENT &
CHIEF EXECUTIVE OFFICER

BOARD OF DIRECTORS

Eric Anderson
Director & Founder

Richard Darrow
President &
Chief Executive Officer

James Ferris
Director & Founder

Marie Gallagher
Director & Founder

Klaus Golombek
(retired Nov. 2015)
Director & Founder

Clif McKenzie
Director & Founder

Joseph Michelsen
Director & Founder

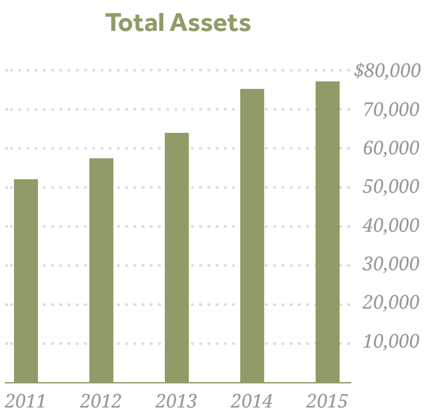
William Parnell
Chairman & Founder

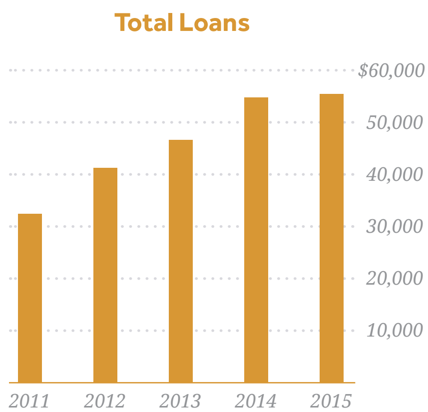
Jefferey Uberuaga
Director & Founder

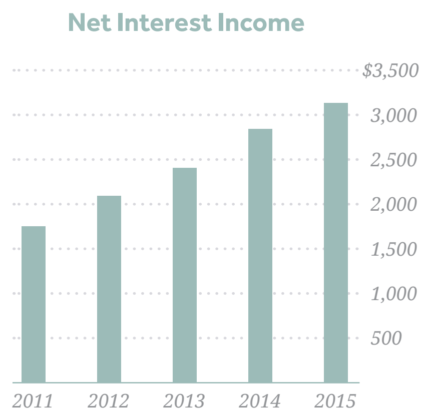
[1] Ranked by 5 year trend of non-performing loans, and 5 year trend of net loan charge-offs, which included all banks and credit unions based in the State of Washington at December 31, 2015.

[2] Ranked by 5 year trend of non-performing loans and 5 year trend of net loan charge-offs, which included all banks and credit unions with assets greater than $ 50 million based in the USA.

FINANCIAL HIGHLIGHTS (dollars in thousands except per share amounts)







At December 31	2011	2012	2013	2014	**2015**
Assets	$52,202	$58,086	$64,657	$76,045	**$78,553**
Loans	33,740	41,752	47,203	55,718	**56,026**
Deposits	45,188	50,085	55,910	64,992	**59,788**
Stockholders' equity	6,763	7,817	7,514	7,838	**8,558**

For the year ended	2011	2012	2013	2014	**2015**
Net interest income	$1,757	$2,112	$2,333	$2,830	**$3,182**
Net income (loss)	(530)	(47)	(191)	187	**702**
Noninterest income	611	221	378	137	**126**
Noninterest expenses	2,687	2,533	2,737	2,872	**3,051**

Key Operating Ratios	2011	2012	2013	2014	**2015**
Return on average equity	-7.60%	-0.70%	-2.50%	2.44%	**8.74%**
Return on average assets	-0.93%	-0.09%	-0.31%	0.27%	**0.91%**
Net interest margin	3.33%	4.16%	3.93%	4.24%	**4.30%**
Non-interest expense to average assets	4.74%	4.62%	4.40%	4.13%	**3.93%**
Ratio of non-performing loans to total assets	-	-	-	-	**-**
Net loan chargeoffs to average loans	-	-	-	-	**-**

Capital Ratios	2011	2012	2013	2014	**2015**
Leverage	11.98%	14.19%	11.98%	10.44%	**10.59%**
Total risk-based	22.05%	20.53%	17.22%	15.12%	**14.74%**

Report of Independent Auditors

To the Board of Directors and Shareholders
Liberty Bay Bank

Report on Financial Statements

We have audited the accompanying financial statements of Liberty Bay Bank, which comprise the balance sheets as of December 31, 2015 and 2014, and the related statements of income, comprehensive income (loss), changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

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 Liberty Bay 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
March 17, 2016

BALANCE SHEETS (dollars in thousands)

ASSETS	December 31, 2015	December 31, 2014
CASH AND CASH EQUIVALENTS		
Cash and due from banks	$1,817	$1,156
Overnight funds	4,410	3,675
Total cash and cash equivalents	6,227	4,831
INTEREST-BEARING DEPOSITS WITH OTHER FINANCIAL INSTITUTIONS	2,953	86
SECURITIES AVAILABLE-FOR-SALE, at fair value	7,095	9,411
SECURITIES HELD-TO-MATURITY, at amortized cost	3,831	4,277
FEDERAL HOME LOAN BANK stock	491	135
LOANS AND LEASES	56,026	55,718
Less allowance for credit losses	715	660
Total loans and leases, net	55,311	55,058
LEASEHOLDS AND EQUIPMENT, net	445	499
ACCRUED INTEREST RECEIVABLE	195	202
OTHER REAL ESTATE OWNED, net	1,248	1,248
OTHER ASSETS	757	298
Total assets	$78,553	$76,045
LIABILITIES AND SHAREHOLDERS' EQUITY		
DEPOSITS		
Noninterest-bearing	$14,907	$14,326
Interest-bearing	44,881	50,666
Total deposits	59,788	64,992
FEDERAL HOME LOAN BANK ADVANCES	10,000	3,000
ACCRUED INTEREST PAYABLE	8	13
OTHER LIABILITIES	199	202
Total liabilities	69,995	68,207
SHAREHOLDERS' EQUITY		
Common stock, $1 par value, 10,000,000 shares authorized, 1,411,261 shares issued and outstanding at December 31, 2015 and 2014	1,411	1,411
Additional paid-in capital	11,626	11,604
Accumulated deficit	(4,483)	(5,185)
Accumulated other comprehensive income	4	8
Total shareholders' equity	8,558	7,838
Total liabilities and shareholders' equity	$78,553	$76,045

See accompanying notes.

STATEMENTS OF INCOME (dollars in thousands)

	Years Ended December 31,	
	2015	2014
INTEREST AND FEE INCOME		
Loans and leases, including fees	$3,306	$2,863
Investments	214	207
Interest-bearing deposits and overnight funds	10	11
Total interest and fee income	3,530	3,081
INTEREST EXPENSE		
Deposits	294	243
Federal Home Loan Bank advances	54	8
Total interest expense	348	251
NET INTEREST INCOME	3,182	2,830
PROVISION FOR CREDIT LOSSES	55	8
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	3,127	2,822
NONINTEREST INCOME		
Gain on sale of investment securities	45	43
Service charges on deposits	34	42
Other income	47	52
Total noninterest income	126	137
NONINTEREST EXPENSE		
Salaries and employee benefits	1,790	1,631
Occupancy and equipment	386	382
Data processing	279	339
Advertising and business development	59	28
Professional and regulatory expenses	239	223
Other expenses	298	269
Total noninterest expense	3,051	2,872
NET INCOME BEFORE BENEFIT FOR INCOME TAX	202	87
BENEFIT FOR FEDERAL INCOME TAX	500	100
NET INCOME	$702	$187

See accompanying notes.

STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (dollars in thousands)

	Years Ended December 31,	
	2015	2014
NET INCOME	$702	$187
Other comprehensive income (loss)		
Unrealized gain on securities available-for-sale		
Unrealized holding gain	41	170
Reclassification adjustments for realized gains on		
securities available-for-sale	(45)	(43)
Other comprehensive income (loss)	(4)	127
COMPREHENSIVE INCOME	$698	$314

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (dollars in thousands)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive (Loss) Income	Total Shareholders' Equity
	Shares	Amount				
BALANCE, December 31, 2013	1,411,261	$1,411	$11,594	$(5,372)	$(119)	$7,514
Net Income	-	-	-	187	-	187
Unrealized holding gain	-	-	-	-	127	127
Stock-based compensation	-	-	10	-	-	10
BALANCE, December 31, 2014	1,411,261	1,411	11,604	(5,185)	8	7,838
Net income	-	-	-	702	-	702
Unrealized holding loss	-	-	-	-	(4)	(4)
Stock-based compensation	-	-	22	-	-	22
BALANCE, December 31, 2015	1,411,261	$1,411	$11,626	$(4,483)	$4	$8,558

See accompanying notes.

STATEMENTS OF CASH FLOWS (dollars in thousands)

	Years Ended December 31, 2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$702	$187
Adjustments to reconcile net income to net cash from operating activities		
Provision for credit losses	55	8
Depreciation and amortization	107	111
Deferred benefit for income taxes	(500)	(100)
Net amortization of investment security premium/discount	68	83
Stock-based compensation	22	10
Gain on sale of investment securities	(45)	(43)
Changes in operating assets and liabilities		
Accrued interest receivable	7	(27)
Other assets	41	5
Accrued interest payable	(5)	9
Other liabilities	(3)	(27)
Net cash provided by operating activities	449	216
CASH FLOWS FROM INVESTING ACTIVITIES		
Net change in interest-bearing deposits with other financial institutions	(2,867)	1,528
Activity in securities available-for-sale		
Maturities, prepayments, and calls	884	735
Purchases	(4,527)	(6,542)
Sales	5,959	4,213
Activity in securities held-to-maturity		
Maturities, prepayments, and calls	420	310
Purchases	-	(498)
Purchase of Federal Home Loan Bank stock	(356)	(107)
Sale of other real estate owned	-	116
Loan and lease originations, net of principal collections	(308)	(8,515)
Purchase of premises and equipment, net	(54)	(32)
Net cash used in investing activities	(849)	(8,792)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	(5,204)	9,082
Advances from Federal Home Loan Bank borrowings	7,000	3,000
Repayment of Federal Home Loan Bank borrowings	-	(1,000)
Net cash received from financing activities	1,796	11,082
NET CHANGE IN CASH AND CASH EQUIVALENTS	1,396	2,506
CASH AND CASH EQUIVALENTS, beginning of year	4,831	2,325
CASH AND CASH EQUIVALENTS, end of year	$6,227	$4,831
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for interest	$353	$242
NONCASH INVESTING AND FINANCING ACTIVITIES		
Unrealized (loss) gain on securities available-for-sale	$(4)	$127

See accompanying notes.

Note 1 - Organization and Summary of Significant Accounting Policies

Nature of operations - Liberty Bay Bank (the Bank) provides a full range of banking services to individual and corporate customers through its sole office in Poulsbo, Washington. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are commercial loans, commercial real estate loans, and leases. The Bank is subject to significant competition from other financial institutions. The Bank is also subject to the regulations of certain federal and state of Washington agencies and undergoes periodic examinations by those regulatory authorities.

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 sheet, and revenues and expenses for the year. Actual results could differ from estimated amounts. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for credit losses, valuation of other real estate owned, and deferred tax assets. All dollar amounts are stated in thousands.

Subsequent events - Subsequent events are events or transactions that occur after the date of the balance sheet but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through March 17, 2016, the date the financial statements were issued, and noted no subsequent events requiring accrual or disclosure.

Cash and cash equivalents - For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, overnight funds, and federal funds sold, 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, exceed the insured limit by the Federal Deposit Insurance Corporation (FDIC), which potentially subjects the Bank to credit risk. Overnight funds include federal funds sold and are made with major banks as approved by the board of directors.

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

Restricted assets - Federal Reserve Board regulations generally require maintenance of certain minimum reserve balances on deposit with the Federal Reserve Bank or another institution in a pass-through relationship. The amounts of such balances are generally based on size and other factors. There were no such requirements at December 31, 2015 or 2014.

Investment securities - Investment securities are classified into one of three categories: (1) held-to-maturity, (2) available-for-sale, or (3) trading. Investment securities are categorized as held-to-maturity when the Bank has the positive intent and ability to hold those securities to maturity. The Bank held no trading securities at December 31, 2015 and 2014, respectively. Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

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 holding gain or loss reported as other comprehensive income (loss). 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.

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 - The Bank is a member of the Federal Home Loan Bank (FHLB) of Des Moines. As a member of the FHLB system, the Bank is required to maintain a minimum level of investment in FHLB stock, based on specified percentages of its outstanding FHLB advances. The Bank's investment in FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value ($100 per share).

The Bank evaluates FHLB stock for impairment. The determination of whether this investment is impaired is based on the Bank's assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared with the capital stock amount for the FHLB and the length of time this situation has persisted; (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB; (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB; and (4) the liquidity position of the FHLB. Based on the above, the Bank has determined that there is not an other-than-temporary impairment on the FHLB stock investment as of December 31, 2015 or 2014.

Loans held-for-sale - Loans originated and intended for sale in secondary markets are carried at the lower of cost or estimated fair 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. There were no loans held-for-sale at December 31, 2015 or 2014.

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.

Leases - The Bank uses the direct finance method of accounting to record direct financing leases and related interest income. At the inception of a lease, the Bank records as an asset the minimum future lease payments receivable, plus the estimated residual value of the leased equipment, less unearned lease income. Initial direct costs and fees related to lease originations are deferred as part of the investment and amortized over the lease term. Unearned lease income is the amount by which the total lease receivable plus the estimated residual value exceeds the investment in the lease. Unearned lease income, net of initial direct costs and fees, is recognized as revenue over the lease term using the interest method.

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

The allowance for loan and lease losses is maintained at a level sufficient to provide for probable loan losses based on evaluating known and inherent risks in the loan and lease portfolio. The allowance is provided based upon management's continuing analysis of the pertinent factors underlying the quality of the loan and lease portfolio. These factors include changes in the size and composition of the loan and lease portfolio, delinquency levels, actual loan and lease loss experience, current economic conditions, and detailed analysis of individual loans and leases for which full collectibility may not be ensured. The detailed analysis includes techniques to estimate the fair value of loan and lease 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 and leases 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 or lease. 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 credit losses is estimated based upon these factors and trends identified by management at the time the financial statement is prepared.

A loan or lease 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 or lease 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 and leases 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 credit's effective interest rate, the credit's obtainable market price, or the fair value of the collateral if the credit is collateral-dependent. Additionally, state and federal regulations, upon examination, may require the Bank to make additional provisions or adjustments to its allowance.

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.

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 12 years. Total depreciation and amortization expense was $107 and $111 for the years ended December 31, 2015 and 2014, respectively.

Foreclosed assets - Foreclosed assets include real estate and personal property acquired through foreclosure and in-substance foreclosed properties. In-substance foreclosed properties are those properties for which the institution has taken physical possession, regardless of whether formal foreclosure proceedings have taken place.

At the time of foreclosure, foreclosed property is recorded at the fair value less cost to sell, which becomes the property's new basis. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for credit losses. After foreclosure, valuations are periodically performed by management and foreclosed property is carried at the lower of the new cost basis or fair value less costs to sell. Impairment losses on property to be held and used are measured as the amount by which the carrying amount of a property exceeds its fair value. Costs incurred in maintaining foreclosed property and subsequent adjustments to the carrying amount of the property are included in noninterest expense.

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

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 expenses were $18 and $6 in 2015 and 2014, respectively.

Comprehensive income (loss) - 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 equity section of the balance sheets. Reclassification adjustments during December 31, 2015 and 2014, are included within the statements of comprehensive income (loss).

Stock-based compensation - The Bank has a stock-based compensation plan for employees that includes stock options and restricted stock, which are recognized as stock-based compensation expense in the statements of income based on the grant-date fair value of the award with a corresponding increase in common stock. The fair value is amortized over the requisite service period, which is generally the vesting period. The fair value at the grant date is determined using the Black-Scholes pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option, the volatility of the underlying stock, the expected dividend yield, and the risk-free interest rate over the expected life of the option. The Black-Scholes option valuation model requires the input of subjective assumptions, including the expected life of the share-based award and stock price volatility. The assumptions used represent management's best estimates, but these estimates involve inherent uncertainties and the application of management's judgment.

Fair value measurements - Fair value measurements are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risks, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Note 2 - Investments

The amortized cost of securities and their approximate fair value are as follows:

December 31, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available-for-sale				
Mortgage-backed securities	$7,091	$12	$(8)	$7,095
Total available-for-sale	$7,091	$12	$(8)	$7,095
Held-to-maturity				
Mortgage-backed securities	$3,831	$-	$(92)	$3,739
December 31, 2014				
Securities available-for-sale				
Obligations of U.S. government agencies	$3,019	$3	$(8)	$3,014
Mortgage-backed securities	6,384	35	(22)	6,397
Total available-for-sale	$9,403	$38	$(30)	$9,411
Held-to-maturity				
Mortgage-backed securities	$4,277	$3	$(83)	$4,197

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
Due in 1 to 5 years	$-	$-	$-	$-
Due in 5 to 15 years	7,091	7,095	-	-
Due after 15 years	-	-	3,831	3,739
	$7,091	$7,095	$3,831	$3,739

As of December 31, 2015, there were two securities with a carrying value of $1,785 pledged to secure borrowings at the FHLB and two securities with a carrying value of $1,600 pledged to secure public deposits. As of December 31, 2014, there were two securities with a carrying value of $1,991 pledged to secure borrowings at the FHLB and eight securities with a carrying value of $5,818 pledged to secure public deposits.

During the year ended December 31, 2015, the Bank sold $5,959 in investment securities, realizing gross gains of $45 and no losses. During the year ended December 31, 2014, the Bank sold $4,213 in investment securities, realizing gross gains of $43 and no losses.

At December 31, 2015 and 2014, eleven and nine securities, respectively, were in an unrealized loss position. Of the 11 securities in a loss position at year end, seven have been in a loss position for less than 12 months, while four have been in a loss position for greater than 12 months. The Bank has evaluated these securities and has determined that the decline in value is temporary and is related to the change in market interest rates since purchase. The decline in value is not related to any bank- or industry-specific event. The Bank anticipates full recovery of amortized cost with respect to these securities at maturity or sooner in the event of a more favorable market interest rate environment. Because management does not intend to sell and will not be required to sell these securities in the near term, no declines are deemed to be other than temporary.

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		Over 12 Months		
December 31, 2015	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Total Unrealized Losses
Securities available-for-sale					
Mortgage-backed securities	$8	$2,874	$-	$-	$8
	$8	$2,874	$-	$-	$8
Held-to-maturity					
Mortgage-backed securities	$11	$1,241	$81	$2,498	$92
December 31, 2014					
Securities available-for-sale					
Obligations of U.S. government agencies	$-	$-	$8	$1,001	$8
Mortgage-backed securities	-	-	22	1,708	22
	$-	$-	$30	$2,709	$30
Held-to-maturity					
Mortgage-backed securities	$-	$-	$83	$3,706	$83

Note 3 - Loans, Leases, and Allowance for Credit Losses

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

	2015	2014
Commercial real estate	$31,460	$30,450
Commercial	6,728	8,144
Construction and land	6,407	6,130
Consumer	833	530
Residential real estate	10,766	10,223
Leases	158	612
Gross loans and leases	56,352	56,089
Discount on purchased loan	(139)	(145)
Deferred fees and costs	(187)	(226)
Allowance for credit losses	(715)	(660)
Total loans and leases, net	$55,311	$55,058

Net investment in leases is summarized as follows at December 31:

	2015	2014
Minimum lease payments receivable	$162	$628
Estimated unguaranteed residual values of leased property	-	8
Unearned income	(4)	(24)
	$158	$612

At December 31, future minimum lease payments to be received are as follows:

2016	$150
2017	12
	$162

The Bank pledged certain commercial loans as collateral for purposes of borrowings with the FHLB. Loans totaling $17,293 were pledged to the FHLB at December 31, 2015 (Note 6).

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

2015	Beginning Balance	Provision (Recovery) for Credit Losses	Charge-offs	Recoveries	Ending Ending Balance
Commercial real estate	$257	$49	$-	$-	$306
Commercial	60	(5)	-	-	55
Construction and land	124	54	-	-	178
Consumer	3	4	-	-	7
Residential real estate	76	(52)	-	-	24
Leases	6	(4)	-	-	2
Unallocated	134	9	-	-	143
	$660	$55	$-	$-	$715
2014					
Commercial real estate	$253	$4	$-	$-	$257
Commercial	65	(5)	-	-	60
Construction and land	57	67	-	-	124
Consumer	3	-	-	-	3
Residential real estate	76	-	-	-	76
Leases	21	(15)	-	-	6
Unallocated	177	(43)	-	-	134
	$652	$8	$-	$-	$660

A loan is considered impaired when the Bank has determined that it may be unable to collect payments of principal or interest when due under the terms of the loan. In the process of identifying loans as impaired, management takes into consideration factors that include payment history and status, collateral value, financial condition of the borrower, and the probability of collecting scheduled payments in the future. Minor payment delays and insignificant payment shortfalls typically do not result in a loan being classified as impaired. The significance of payment delays and shortfalls is considered by management on a case-by-case basis, after taking into consideration the totality of circumstances surrounding the loans and the borrowers, including payment history and amounts of any payment shortfall, length and reason for delay, and likelihood of return to stable performance. Impairment is measured on a loan-by-loan basis for all loans in the portfolio except for the smaller groups of homogeneous consumer loans in the portfolio.

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

2015	Recorded Investments (Loan Balance Less Charge-off)	Unpaid Principal Balance	Related Allowance	Average Investment in Impaired Loans	Interest Income Recognized
With no allowance recorded					
Commercial real estate	$-	$-	$-	$306	$16
2014					
With no allowance recorded					
Commercial real estate	$1,226	$1,226	$-	$1,229	$16

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

	Allowance for Credit Losses			Loans and Leases		
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
Commercial real estate	$306	$-	$306	$31,460	$-	$31,460
Commercial	55	-	55	6,728	-	6,728
Construction and land	178	-	178	6,407	-	6,407
Consumer	7	-	7	833	-	833
Residential real estate	24	-	24	10,766	-	10,766
Leases	2	-	2	158	-	158
Unallocated	143	-	143	-	-	-
	$715	$-	$715	$56,352	$-	$56,352
2014						
Commercial real estate	$257	$-	$257	$30,305	$1,226	$29,079
Commercial	60	-	60	8,144	-	8,144
Construction and land	124	-	124	6,130	-	6,130
Consumer	3	-	3	530	-	530
Residential real estate	76	-	76	10,223	-	10,223
Leases	6	-	6	612	-	612
Unallocated	134	-	134	-	-	-
	$660	$-	$660	$55,944	$1,226	$54,718

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 current and past due loans, net of partial loan charge-offs, by type and delinquency status, 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
Commercial real estate	$-	$-	$-	$-	$31,460	$31,460
Commercial	-	-	-	-	6,728	6,728
Construction and land	-	-	-	-	6,407	6,407
Consumer	-	-	-	-	833	833
Residential real estate	-	-	-	-	10,766	10,766
Leases	-	-	-	-	158	158
	$-	$-	$-	$-	$56,352	$56,352
2014						
Commercial real estate	$-	$-	$-	$-	$30,305	$30,305
Commercial	-	-	-	-	8,144	8,144
Construction and land	-	-	-	-	6,130	6,130
Consumer	-	-	-	-	530	530
Residential real estate	-	-	-	-	10,223	10,223
Leases	-	-	-	-	612	612
	$-	$-	$-	$-	$55,944	$55,944

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.

When the Bank classifies problem assets as either substandard or doubtful, it may establish a specific allowance to address the risk specifically or the Bank may allow the loss to be addressed in the general allowance. General allowances represent loss allowances that have been established to recognize the inherent risk associated with lending activities, but, unlike specific allowances, have not been specifically allocated to particular problem assets. When an insured institution classifies problem assets as a loss, it is required to charge off such assets in the period in which they are deemed uncollectible. Assets that do not currently expose the Bank to sufficient risk to warrant classification as substandard or doubtful but possess identified weaknesses are designated as either watch or special mention assets. At December 31, 2015, the Bank had no loans classified as doubtful or loss.

Additionally, the Bank categorizes loans as performing or nonperforming based on payment activity. Loans that are more than 90 days past due and nonaccrual loans are considered nonperforming.

The following tables represent the credit risk profile by internally assigned grade and performing status as of December 31, 2015 and 2014, by class of loans:

Credit Risk Profile by Internally Assigned Grade

2015	Commercial Real Estate	Commercial	Construction and Land	Consumer	Residential Real Estate	Leases	Total
Grade							
Pass	$28,977	$5,382	$4,786	$833	$10,766	$158	$50,902
Watch	1,278	1,346	511	-	-	-	3,135
Special mention	1,205	-	1,110	-	-	-	2,315
Substandard	-	-	-	-	-	-	-
	$31,460	$6,728	$6,407	$833	$10,766	$158	$56,352
2014							
Grade							
Pass	$27,972	$6,437	$4,984	$530	$9,770	$612	$50,305
Watch	1,107	1,707	1,013	-	453	-	4,280
Special mention	-	-	99	-	-	-	99
Substandard	1,226	-	34	-	-	-	1,260
	$30,305	$8,144	$6,130	$530	$10,223	$612	$55,944

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

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.

Upon identifying those receivables as troubled debt restructurings, the Bank will identify them as impaired for 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. There were no loans modified by the Bank as troubled debt restructurings at December 31, 2015 and 2014, or modified during the years then ended.

Note 4 - Leaseholds and Equipment

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

	2015	2014
Leasehold improvements	$720	$707
Furniture, fixtures, and office equipment	383	350
Vehicles	23	22
	1,126	1,079
Less accumulated depreciation and amortization	(681)	(580)
	$445	$499

Note 5 - Deposits

Deposits as of December 31 consisted of the following:

	2015	2014
Savings accounts	$5,441	$6,561
Certificates of deposit	11,193	22,638
Demand accounts		
Noninterest-bearing	14,907	14,326
Interest-bearing	6,592	3,655
Money market accounts	21,655	17,812
	$59,788	$64,992

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

2016	$10,489
2017	454
2018	151
2019	-
2020 and thereafter	99
	$11,193

The Bank had $3,915 and $8,239 of certificates of deposit that met or exceeded the $250,000 federally insured limit at December 31, 2015 and 2014, respectively.

Note 6 - Credit Arrangements

At December 31, 2015, committed line-of-credit agreements totaling approximately $8.0 million were available to the Bank from unaffiliated banks. Such lines generally provide for interest at the lending bank's prime rate or other money market rates. These arrangements require total compensating balances of at least $485 maintained in a demand deposit account. The compensating balances are included in cash and cash equivalents at December 31, 2015.

The Bank is a member of the FHLB of Des Moines, and as such, is eligible for a credit line up to 35% of total assets, subject to certain collateral requirements. At December 31, 2015, loans and investments pledged as collateral to the FHLB equated to a borrowing capacity of $27,494, when fully collateralized. Borrowings generally provide for interest at the then-current published rates and are subject to certain reserve rates. Borrowings must be secured by eligible investments held at the FHLB.

At December 31, 2015, the Bank had $10,000 of total advances outstanding with the FHLB, of which $3,000 were short-term revolving advances and $7,000 were long-term advances with a weighted-average rate of 1.02%. Current borrowings are collateralized by pledged investment securities (Note 2) and loans (Note 3). The excess balance of all collateral can be used for additional borrowings.

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

2016	$2,000
2017	4,000
2018	1,000
	$7,000

Note 7 - Income Taxes

Income taxes consist of the following for the years ended December 31:

	2015	2014
Current	$-	$-
Deferred	77	33
Change in valuation allowance	(577)	(133)
Total tax benefit	$(500)	$(100)

The following is a reconciliation between the statutory and the effective federal income tax rate for the years ended December 31:

	2015		2014	
	Amount	Percent of Pre-Tax Income	Amount	Percent of Pre-Tax Income
Income tax at statutory rates	$69	34.00	$30	34.00
Increase (decrease) resulting from				
Permanent differences	8	4.00	3	5.00
Valuation allowance reversal	(577)	(285.00)	(133)	(154.00)
Total income tax benefit	$(500)	(247.00)	$(100)	(115.00)

The nature and components of the Bank's net deferred tax asset at December 31 are as follows:

	2015	2014
Deferred tax assets		
Net operating loss carryforward	$1,117	$1,273
Organization expenditures	259	290
Property and equipment depreciation	40	28
Other, net	19	60
Allowance for credit losses	218	199
Subtotal	1,653	1,850
Deferred tax liabilities		
Unrealized loss on securities	2	3
Cash basis method of accounting	31	64
Deferred costs	39	126
Subtotal	72	193
Net deferred tax asset	1,581	1,657
Less valuation allowance on net deferred tax asset	(981)	(1,557)
Total	$600	$100

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 $600 of the deferred tax asset could be supported at December 31, 2015.

At December 31, 2015, the Bank has, for tax reporting purposes, a net operating loss carryforward totaling approximately $3,285, eligible to offset future federal income taxes. The net operating loss carryforward will begin to expire in 2029.

At December 31, 2015, the Bank had unamortized preopening expenditures of approximately $763 (for tax reporting purposes) that can be used to offset future federal income taxes. These expenditures are amortizing over 15 years on the straight-line basis at a rate of approximately $91 per year.

The Bank recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Bank had no uncertain tax positions at December 31, 2015 or 2014.

The Bank's policy is to recognize interest and penalties in tax expense. During the years ended December 31, 2015 and 2014, the Bank recognized no interest or penalties.

The Bank files income tax returns in the U.S. federal jurisdiction. In general, the Bank is subject to U.S. federal income tax examinations by tax authorities for the years ended after 2011.

Note 8 - Employee Benefits

The Bank has a 401(k) defined contribution plan for those employees who meet the eligibility requirements. Individuals who are 21 years of age and have completed three consecutive months of service are considered eligible to participate. Eligible employees can contribute up to an amount or percentage of compensation not to exceed certain limits based on federal tax laws. The Bank has elected discretionary matching contributions under the plan. Matching contributions vest at 20% per year after the first year and will be fully vested after six years of service. There were no Bank contributions for the years ended December 31, 2015 or 2014.

Note 9 - Stock-Based Compensation

The Bank has an equity incentive plan (the Plan), which is shareholder-approved and permits the grant of incentive stock options, nonqualified stock options, and restricted stock awards at the discretion of the compensation committee. The Plan provides for up to a maximum of 235,000 shares of authorized common stock; of this amount, no more than 100,000 shares may be granted as restricted stock to certain key employees and directors. There were 93,130 remaining shares in the Plan available to grant at December 31, 2015. The Bank believes that such awards better align the interests of its employees with those of its shareholders. Option awards are generally granted with an exercise price equal to or greater than the market price of the Bank's stock at the date of grant; those option awards generally vest and become exercisable in incremental percentages over 5 years of continuous service from the grant date and expire after 10 years.

The fair value of each option award is estimated on the date of grant using the Black-Scholes valuation model that uses the assumptions noted in the following table. Because the Black-Scholes valuation model incorporates ranges of assumptions of inputs, those ranges are disclosed. Expected volatilities are based on historical volatility of the Bank's stock and other factors. The Bank uses market and peer data to estimate option exercises and employee termination within the option valuation model, segregated into separate groups of employees that have similar historical exercise behavior, which are considered separately for valuation purposes. The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding. 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.

The weighted-average Black-Scholes inputs for grants during 2015 are as follows:

	2015
Weighted-average risk-free interest rate	1.83%
Dividend yield rate	0.00%
Expected volatility	16.40%
Expected term (in years)	6.5

There were no options granted in 2014.

A summary of stock option transactions is presented below:

	Granted Options for Common Stock	Weighted-Average Exercise Price of Shares Under Plan	Weighted-Average Remaining Contractual Term
Outstanding at December 31, 2014	$143,220	$6.25	7.8
Granted	24,000	6.60	
Exercised	-	-	
Forfeited	(25,350)	9.76	
Outstanding at December 31, 2015	141,870	5.69	7.9
Options exercisable at December 31, 2015	47,388	5.50	7.5

At December 31, 2015, there was approximately $72 of total unrecognized compensation cost related to share-based compensation arrangements. The cost is expected to be recognized over a period of approximately 4.5 years.

Note 10 - Shareholders' Equity

Warrants - At December 31, 2015 and 2014, there were warrants outstanding to purchase 172,000 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 June 5, 2019.

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 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2015 and 2014, that the Bank meets all capital adequacy requirements to which it is subject.

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)	$8,817	14.74%	$4,785 >	8.0%	$5,981 >	10.0%
Tier I capital						
(to risk-weighted assets)	8,094	13.53%	3,589 >	6.0%	4,785 >	8.0%
Common equity Tier 1 capital						
(to risk-weighted assets)	8,094	13.53%	2,692 >	4.5%	3,888 >	6.5%
Tier I capital						
(to average assets)	8,094	10.59%	3,058 >	4.0%	3,823 >	5.0%
As of December 31, 2014						
Total capital						
(to risk-weighted assets)	$8,499	15.12%	$4,497 >	8.0%	$5,621 >	10.0%
Tier I capital						
(to risk-weighted assets)	7,831	13.93%	2,249 >	4.0%	3,373 >	6.0%
Tier I capital						
(to average assets)	7,831	10.44%	3,001 >	4.0%	3,752 >	5.0%

Banking regulations limit the transfer of assets in the form of dividends from the Bank to its shareholders. 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.

Under the amended capital rules, there is a new 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 office premises for its operations. This lease expired in 2015. The Bank renewed the lease for an additional three-year term ending in 2018 and has the option to renew for another three-year term thereafter. The lease requires the Bank to pay its pro rata share of building operating expenses. The annual lease through the initial lease term and renewal options is as follows:

2016	$277
2017	291
2018	306
2019	321
2020	337
Thereafter	143
	$1,675

Rental expense, including operating expenses charged to operations, was $252 and $242 for the years ended December 31, 2015 and 2014, respectively.

Note 12 - Related Party Transactions

Certain directors, executive officers, and principal shareholders 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 activity of related party loans through December 31 is as follows:

	2015	2014
Balance, beginning of year	$3,257	$3,011
New loans	1,207	383
Repayments	(885)	(137)
Balance, end of year	$3,579	$3,257

There were $7,777 and $5,837 of related party deposits at December 31, 2015 and 2014, respectively.

Note 13 - Significant Group Concentrations of Credit Risk

Most of the Bank's business activity is with customers located within Kitsap County, 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. The Bank also has purchased leases, which are primarily collateralized by business equipment. Although the Bank has a diversified loan and lease portfolio, local economic conditions may affect borrowers' ability to meet the stated repayment terms.

The distribution of commitments to extend credit approximates the distribution of loans outstanding. Commercial credit was granted primarily to commercial borrowers. The Bank, as a matter of policy, does not extend credit in excess of 20% of unimpaired capital and surplus, to any single borrower or group of related borrowers.

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. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of these 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 these 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, standby letters of 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 50% of loan commitments are drawn upon by customers. The Bank evaluates customers' creditworthiness on a case-by-case basis. 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.

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 and financial guarantees 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		
Real estate secured	$2,790	$1,688
Commercial real estate, construction, and land development	2,176	7,947
Other	4,435	3,872
Total commitments to extend credit	$9,401	$13,507
Financial standby letters of credit	$-	$-

Contingencies - At periodic intervals, the state of Washington and the 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 that the Bank's financial statements be adjusted in accordance with their findings.

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 defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. The accounting guidance establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value measurements. In determining fair value, the Bank maximizes the use of observable inputs and minimizes the use of unobservable inputs.

Observable inputs are those assumptions that market participants would use in pricing the particular asset or liability. These inputs are based on market data and are obtained from a source independent of the Bank.

Unobservable inputs are assumptions based on the Bank's own information or estimate of assumptions used by market participants in pricing the asset or liability. Unobservable inputs are based on the best and most current information available on the measurement date.

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820 establishes a three-level valuation hierarchy for determining fair value that is based on the transparency of the inputs used in the valuation process. The inputs used in determining fair value in each of the three levels of the hierarchy are as follows:

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.

There were no transfers between levels during the years ended December 31, 2015 or 2014.

Qualitative disclosures of valuation techniques

Securities available-for-sale - 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 particular instruments, assumptions must be made to determine their fair value. Such instruments are classified as Level 3.

Assets and liabilities measured at fair value on a recurring basis - Assets and liabilities 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 at December 31:

2015	Level 1	Level 2	Level 3	Total
Mortgage-backed securities	$-	$7,095	$-	$7,095
2014				
Obligations of U.S. government agencies	$-	$3,014	$-	$3,014
Mortgage-backed securities	-	6,397	-	6,397

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:

December 31, 2015	Level 1	Level 2	Level 3	Total
Impaired loans	$-	$-	$-	$-
Other real estate owned	-	-	1,248	1,248
December 31, 2014				
Impaired loans	$-	$-	$1,226	$1,226
Other real estate owned	-	-	1,248	1,248

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]
OREO	$1,248	Market comparable	Adjustment to appraisal value	0% - 10%

	Fair Value at December 31, 2014	Valuation Technique	Unobservable Input	Range[1]
Impaired loans	$1,226	Market comparable	Adjustment to appraisal value	0% - 10%
OREO	1,248	Market comparable	Adjustment to appraisal value	0% - 10%

[1] Discount for selling costs.

At December 31, 2015 and 2014, the Bank had $1,248 of other real estate recorded at fair value during the periods, respectively. Fair value was determined using market comparable data with discounts applied to appraisals for selling costs of 8% to 10%.

Fair value estimates 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, because 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.

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Headquartered in Poulsbo and serving clients and communities throughout Puget Sound.