



Report of Independent Auditors
and Consolidated Financial Statements With
Supplementary Schedules for

**Oregon Bancorp, Inc.
and Subsidiaries**

December 31, 2013 and 2012

MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

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REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareholders
Oregon Bancorp, Inc. and Subsidiaries

Report on Financial Statements

We have audited the accompanying consolidated financial statements of Oregon Bancorp, Inc. and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Oregon Bancorp, Inc. and Subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary consolidating balance sheet as of December 31, 2013, and consolidating statement of income for the year ended December 31, 2013, included on pages 39 and 40 are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Moss Adams LLP

Everett, Washington
February 28, 2014

OREGON BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

ASSETS

| | December 31, | |
|--|----------------|----------------|
| | 2013 | 2012 |
| ASSETS | | |
| Cash and due from banks | \$ 2,587,556 | \$ 4,609,129 |
| Federal funds sold | 12,460,000 | 3,130,000 |
| Total cash equivalents | 15,047,556 | 7,739,129 |
| Investment securities available-for-sale | 1,267,940 | 1,392,955 |
| Loans held-for-sale | 7,409,445 | 29,652,708 |
| Loans, net of allowance for loan losses and unearned loan fees | 85,945,422 | 74,954,652 |
| Federal Home Loan Bank stock, at cost | 603,200 | 569,600 |
| Other real estate owned, net | 2,749,075 | 4,691,805 |
| Premises and equipment, net | 2,995,973 | 3,092,069 |
| Cash surrender value of life insurance, net | 1,572,596 | 1,502,476 |
| Accrued interest receivable | 373,444 | 347,270 |
| Deferred tax asset | 1,002,408 | 1,100,500 |
| Prepaid expenses | 405,181 | 205,732 |
| Other assets | 179,536 | 456,659 |
| Total assets | \$ 119,551,776 | \$ 125,705,555 |

LIABILITIES AND SHAREHOLDERS' EQUITY

| | | |
|--|---------------|---------------|
| LIABILITIES | | |
| Noninterest-bearing demand deposits | \$ 14,750,240 | \$ 12,422,296 |
| Interest-bearing demand deposits and money market accounts | 45,688,973 | 41,649,208 |
| Time certificates of deposit | 40,069,997 | 48,627,586 |
| Total deposits | 100,509,210 | 102,699,090 |
| Borrowings | 3,450,000 | 4,000,000 |
| Accounts payable and accrued expenses | 1,291,741 | 1,723,375 |
| Accrued interest payable | 44,024 | 60,698 |
| Total liabilities | 105,294,975 | 108,483,163 |

COMMITMENTS AND CONTINGENCIES (Note 12)

SHAREHOLDERS' EQUITY

| | | |
|---|----------------|----------------|
| Preferred stock, no par value; 2,000,000 shares authorized; No shares of Series A and Series B issued and outstanding as of December 31, 2013; 3,216 Series A and 161 Series B shares issued and outstanding as of December 31, 2012 | - | 3,334,743 |
| Common stock, at stated value; 10,000,000 shares authorized; 1,045,352 shares issued and 1,010,364 outstanding as of December 31, 2013; 935,101 shares issued and 904,768 outstanding as of December 31, 2012 | 11,563,513 | 10,336,315 |
| Additional paid-in capital | 622,941 | 531,695 |
| Retained earnings | 2,056,928 | 3,001,618 |
| Accumulated other comprehensive income | 13,419 | 18,021 |
| Total shareholders' equity | 14,256,801 | 17,222,392 |
| Total liabilities and shareholders' equity | \$ 119,551,776 | \$ 125,705,555 |

OREGON BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

| | Years Ended December 31, | |
|---|--------------------------|---------------------|
| | 2013 | 2012 |
| INTEREST INCOME | | |
| Interest and fees on loans | \$ 5,153,144 | \$ 5,507,042 |
| Interest on due from banks | 34,549 | 35,731 |
| Interest on investment securities | 26,910 | 20,494 |
| Total interest income | <u>5,214,603</u> | <u>5,563,267</u> |
| INTEREST EXPENSE | | |
| Demand deposits | 5,263 | 7,575 |
| Savings and money market | 82,808 | 154,160 |
| Time certificates of deposit | 526,966 | 664,908 |
| Borrowings | 36,333 | 649 |
| Total interest expense | <u>651,370</u> | <u>827,292</u> |
| Net interest income before provision for loan losses | 4,563,233 | 4,735,975 |
| PROVISION FOR LOAN LOSSES | | |
| Net interest income after provision for loan losses | <u>-</u> | <u>-</u> |
| NONINTEREST INCOME | | |
| Mortgage banking revenue, net | 11,765,142 | 11,758,844 |
| Brokered loan fees | 538,176 | 194,294 |
| Service charge income | 46,973 | 50,098 |
| Increase in cash surrender value of life insurance | 70,120 | 67,811 |
| Other income | 434,699 | 417,046 |
| Total noninterest income | <u>12,855,110</u> | <u>12,488,093</u> |
| NONINTEREST EXPENSE | | |
| Salaries | 8,870,610 | 7,930,445 |
| Employee benefits | 2,331,235 | 2,169,937 |
| Occupancy expenses | 1,046,784 | 982,336 |
| Write-down and losses on other real estate owned, net | 243,924 | 444,569 |
| Regulatory assessment | 176,791 | 182,226 |
| Depreciation and amortization expense | 224,648 | 211,160 |
| Other operating expenses | 3,545,114 | 3,274,171 |
| Total noninterest expense | <u>16,439,106</u> | <u>15,194,844</u> |
| INCOME BEFORE PROVISION FOR INCOME TAXES | 979,237 | 2,029,224 |
| PROVISION FOR INCOME TAXES | <u>390,676</u> | <u>736,596</u> |
| NET INCOME | <u>588,561</u> | <u>1,292,628</u> |
| Deemed dividend on preferred stock | 42,257 | 32,200 |
| Preferred stock cash dividends | 169,256 | 175,290 |
| NET INCOME AVAILABLE TO COMMON SHAREHOLDERS | <u>\$ 377,048</u> | <u>\$ 1,085,138</u> |
| EARNINGS PER SHARE OF COMMON STOCK | | |
| Basic | <u>\$ 0.38</u> | <u>\$ 1.20</u> |
| Diluted | <u>\$ 0.37</u> | <u>\$ 1.19</u> |
| Weighted-average number of common shares outstanding | | |
| Basic | <u>993,659</u> | <u>902,743</u> |
| Diluted | <u>1,007,333</u> | <u>914,588</u> |

OREGON BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| | Years Ended December 31, | |
|--|--------------------------|----------------------------|
| | <u>2013</u> | <u>2012</u> |
| NET INCOME | <u>\$ 588,561</u> | <u>\$ 1,292,628</u> |
| Other comprehensive income (loss), net of tax | | |
| Unrealized gain (loss) on securities | | |
| Unrealized holding gain (loss), net of taxes (benefit) | | |
| of \$(2,869) and \$20,009, respectively | <u>(4,602)</u> | <u>32,099</u> |
| COMPREHENSIVE INCOME | <u><u>\$ 583,959</u></u> | <u><u>\$ 1,324,727</u></u> |

OREGON BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| | Preferred Stock | | Common Stock | | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|---------------------|------------------|---------------------|------------------|----------------------------------|----------------------|--|----------------------------------|
| | Number of Shares | Stated Amount | Number of Shares | Stated Amount | | | | |
| BALANCE, December 31, 2011 | 3,377 | \$ 3,302,543 | 900,718 | \$ 10,336,315 | \$ 423,060 | \$ 1,916,480 | \$ (14,078) | \$ 15,964,320 |
| Deemed dividend on preferred stock | - | 32,200 | - | - | - | (32,200) | - | - |
| Preferred stock cash dividends | - | - | - | - | - | (175,290) | - | (175,290) |
| Stock-based compensation | - | - | - | - | 108,635 | - | - | 108,635 |
| Vesting of restricted stock | - | - | 4,050 | - | - | - | - | - |
| Net income | - | - | - | - | - | 1,292,628 | - | 1,292,628 |
| Other comprehensive income, net of tax | - | - | - | - | - | - | 32,099 | 32,099 |
| BALANCE, December 31, 2012 | 3,377 | 3,334,743 | 904,768 | 10,336,315 | 531,695 | 3,001,618 | 18,021 | 17,222,392 |
| Deemed dividend on preferred stock | - | 42,257 | - | - | - | (42,257) | - | - |
| Preferred stock cash dividends | - | - | - | - | - | (169,256) | - | (169,256) |
| Stock-based compensation | - | - | - | - | 91,246 | - | - | 91,246 |
| Exercised or issued shares | - | - | 3,842 | 9,995 | - | - | - | 9,995 |
| Common stock stock dividend | - | - | 90,590 | 1,217,203 | - | (1,217,203) | - | - |
| Common stock cash dividend | - | - | - | - | - | (104,535) | - | (104,535) |
| Vesting of restricted stock | - | - | 11,157 | - | - | - | - | - |
| Redemption of preferred stock | (3,377) | (3,377,000) | - | - | - | - | - | (3,377,000) |
| Net income | - | - | - | - | - | 588,561 | - | 588,561 |
| Other comprehensive income, net of tax | - | - | - | - | - | - | (4,602) | (4,602) |
| BALANCE, December 31, 2013 | - | \$ - | 1,010,357 | \$ 11,563,513 | \$ 622,941 | \$ 2,056,928 | \$ 13,419 | \$ 14,256,801 |

OREGON BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Years Ended December 31, | |
|--|--------------------------|---------------------|
| | 2013 | 2012 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$ 588,561 | \$ 1,292,628 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation and amortization | 224,648 | 211,160 |
| Accretion on investment securities | 2,681 | 16,463 |
| Deferred tax benefits | 100,961 | (101,017) |
| Origination of loans held-for-sale | (279,824,877) | (275,291,717) |
| Proceeds from loans held-for-sale | 313,833,282 | 277,589,840 |
| Gain on sale of loans | (11,341,191) | (11,500,829) |
| Net gain on derivatives | (423,951) | (258,015) |
| Loss on sale of premises and equipment | 1,300 | 2,369 |
| Loss on sale of other real estate owned | 81,457 | 197,173 |
| Write-down of other real estate owned | 159,092 | 247,396 |
| Stock-based compensation | 91,246 | 108,635 |
| Increase (decrease) in cash due to changes in certain assets and liabilities | | |
| Accrued interest receivable | (26,174) | 40,513 |
| Prepaid expenses | (199,449) | 311,253 |
| Cash surrender value of life insurance | (70,120) | (67,811) |
| Other assets | 276,509 | (280,892) |
| Accounts payable and accrued expenses | (431,634) | 281,895 |
| Accrued interest payable | (16,674) | (13,598) |
| Net cash from operating activities | <u>23,025,667</u> | <u>(7,214,554)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from maturity of securities available-for-sale | 114,863 | 157,257 |
| Loan originations, net of principal collections | (10,990,770) | 939,147 |
| Purchase of premises and equipment | (129,238) | (239,654) |
| Proceeds from sale of premises and equipment | - | 7,000 |
| Purchase of Federal Home Loan Bank stock | (55,000) | (33,700) |
| Redemption of Federal Home Loan Bank stock | 21,400 | - |
| Proceeds from sale of other real estate owned | <u>1,702,181</u> | <u>1,927,812</u> |
| Net cash from investing activities | <u>(9,336,564)</u> | <u>2,757,862</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Net change in deposits | (2,189,880) | 589,878 |
| Proceeds from borrowings | - | 2,000,000 |
| Repayment on borrowings | (550,000) | - |
| Repurchase of preferred stock | (3,377,000) | - |
| Issuance of common stock | 9,995 | - |
| Dividends paid on common stock | (104,535) | - |
| Dividends paid on preferred stock | <u>(169,256)</u> | <u>(175,290)</u> |
| Net cash from financing activities | <u>(6,380,676)</u> | <u>2,414,588</u> |
| Net decrease in cash and due from banks | 7,308,427 | (2,042,104) |
| CASH AND DUE FROM BANKS, beginning of year | <u>7,739,129</u> | <u>9,781,233</u> |
| CASH AND DUE FROM BANKS, end of year | <u>\$ 15,047,556</u> | <u>\$ 7,739,129</u> |
| SUPPLEMENTAL DISCLOSURES | | |
| Cash paid during the year for | | |
| Income taxes | <u>\$ 504,000</u> | <u>\$ 966,000</u> |
| Interest | <u>\$ 668,044</u> | <u>\$ 840,890</u> |
| SUPPLEMENTAL DISCLOSURES OF NONCASH ITEMS | | |
| Deemed dividend on preferred stock | <u>\$ 42,257</u> | <u>\$ 32,200</u> |
| Unrealized gain (loss) on available-for-sale | <u>\$ 7,471</u> | <u>\$ 52,108</u> |
| Transfer of loans to other real estate owned | <u>\$ -</u> | <u>\$ 1,323,390</u> |

See accompanying notes.

OREGON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Organization and Summary of Significant Accounting Policies

Organization and nature of operations - In October 2000, Willamette Valley Bank (the Bank) received regulatory approval to become a state-chartered institution authorized to provide banking services in the state of Oregon; and in 2008, Oregon Bancorp, Inc. (the Company), an Oregon corporation, was formed for the purpose of becoming a holding company for the Bank. The Company is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended, and is subject to the supervision and examination by the Federal Reserve Board. In 2010, the Company formed a single-member LLC, OR Resolutions, LLC, for the purpose of holding notes and/or deeds of trusts for properties acquired through the foreclosure process of the Bank.

The Bank, operating from its headquarters in Salem, Oregon, provides banking services to businesses and individuals located primarily in the markets from which the Bank operates its four full-service branches in Salem, Albany, Keizer, and Silverton, Oregon. In addition to the full-service branches, the Bank has various locations throughout Oregon and Washington that function as residential mortgage loan production offices. The Bank is subject to regulations of certain federal and state agencies and, from time to time, undergoes periodic examinations by those regulatory authorities.

All significant intercompany accounts and transactions between Oregon Bancorp, Inc. and its subsidiaries have been eliminated in preparation of the consolidated financial statements.

Significant concentrations of credit risk - Note 2 discusses the types of securities that the Bank invests in. Most of the Bank's business activity is with customers located within the Mid-Willamette Valley. The Bank originates commercial, real estate, construction, residential mortgage, 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 93% of the Bank's loan portfolio is secured by real estate (Note 3). The Company does not have any significant concentrations to any one customer.

Use of estimates - The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America and reporting practices applicable to the banking industry. In preparing the consolidated 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 consolidated balance sheets and revenues and expenses for the reporting periods. Actual results could differ significantly from those estimates. The most significant accounting estimates made by management involve the calculation of the allowance for loan losses, valuation of other real estate owned, and deferred tax assets. Management believes the assumptions used in arriving at these estimates are appropriate.

Subsequent events - In preparing these consolidated financial statements, management has evaluated events and transactions for potential recognition or disclosure through February 28, 2014, the date the consolidated financial statements were issued.

Cash and due from banks - For purposes of reporting cash flows, cash and due from banks include cash, due from banks, and federal funds sold, all with maturities of three months or less. The Bank, at times, may have cash deposits at other financial institutions in excess of FDIC-insured limits.

OREGON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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 held-to-maturity or trading securities as of December 31, 2013 and 2012. 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 amortized cost.

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 carried at estimated fair value, with unrealized holding gains or losses reported in accumulated other comprehensive income.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Management reviews investment securities on an ongoing basis for the presence of other-than-temporary impairment (OTTI) or permanent impairment, taking into consideration current market conditions; fair value in relationship to cost; extent and nature of the change in fair value; issuer rating changes and trends; whether management intends to sell a security or if it is likely that the Bank will be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity; and other factors. For debt securities, if management intends to sell the security or it is likely that the Bank will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If management does not intend to sell the security and it is not likely that the Bank will be required to sell the security, but management does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, i.e., the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income. Impairment losses related to all other factors are presented as separate categories within other comprehensive income.

Loans held-for-sale - The Bank records all mortgage loans held-for-sale at fair value. Fair value is determined by outstanding commitments from investors or current investor yield requirements calculated on the aggregate loan basis. Origination fees and costs are recognized in earnings at the time of origination. Mortgage loans held-for-sale are sold with the mortgage service rights released by the Bank. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold. All sales are made without recourse.

OREGON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Accounting for derivatives - The Bank is engaged in the production of loans for sale to buyers and investors in the secondary mortgage market. These loan production activities expose the Bank to risk that a loan's market value may decline between the date the Bank enters into an interest rate lock commitment (IRLC) with a borrower to fund a loan, or with a buyer to purchase a loan, and the loan's ultimate sale into the secondary market. The Bank reduces its exposure to this risk by entering into contracts to sell loans to buyers at specified prices, entering into futures contracts designed to hedge against the economic risk of market value declines. The Bank accounts for these items as freestanding derivatives.

The Bank formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objectives and strategy for undertaking various hedge transactions. The Bank considers its hedges to be fair value hedges. As such, derivatives are recognized at their estimated fair values in the accompanying consolidated balance sheets with changes in fair values of derivatives recognized currently in earnings. The Bank considers its commitments to extend secondary market qualifying loans (the pipeline) with interest rate lock commitments to be derivatives, as well as its firm commitments to deliver loans, its futures contracts, and its positions taken in put options, all of which are recognized at their estimated fair values.

Loans - Loans are stated at the amount of unpaid principal, adjusted for unearned income, the allowance for loan losses, and any unamortized deferred fees or costs on originated loans and premiums or discounts on purchased loans.

The accrual of interest on loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Consumer loans are typically charged off no later than 120 days past due. Past due status is based on the 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 assured.

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

OREGON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts 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 collection of the 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. Impaired loans are carried at the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's market price, or the fair value of the collateral if the loan is collateral-dependent.

Large groups of smaller-balance homogeneous loans or leases are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral-dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accounting policy for the allowance for loan losses.

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the most recent three years. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; level of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

OREGON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Federal Home Loan Bank (FHLB) stock - As of December 31, 2013 and 2012, the Bank held FHLB of Seattle stock with a par value of \$603,200 and \$569,600, respectively. As a member of the FHLB system, the Bank is required to maintain a minimum investment level in FHLB stock based on specific percentages of the Bank's outstanding mortgages, total assets, or FHLB advances. This security is reported at par value, which represents the Bank's cost.

Stock in the FHLB of Seattle is classified as restricted stock and is evaluated for impairment at each reporting date. The determination of whether the investment is impaired is based on the Bank's assessment of the ultimate recoverability of par value rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability is influenced by criteria such as (1) the significance of the decline in the net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of the legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB, and (4) the liquidity position of the FHLB. The Bank has concluded that the FHLB stock investment is not impaired as of December 31, 2013.

Transfer of financial assets - Transfers of an entire financial asset, a group of financial assets, or a participating interest in an entire financial asset are accounted for as sales when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, 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 the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Other real estate owned - Property and assets acquired through foreclosure or deed in lieu of foreclosure are stated at the lower of the loan balance on the property at the date of transfer or the fair value of the assets received, less estimated costs to sell. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less costs to sell. Costs relating to the development and improvement of property are capitalized and holding costs are charged to expense as incurred.

Premises and equipment - Premises and equipment are recorded at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method based principally on the estimated useful lives of the assets. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. Gains and losses on dispositions are included in current operations.

Impairment of long-lived assets - The 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.

OREGON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Bank owned life insurance - The Company has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Advertising - Advertising costs, which are principally included in operating expenses, are expensed as incurred. Advertising expense was \$385,639 and \$383,002 for the years ended December 31, 2013 and 2012, respectively.

Earnings per share of common stock - Basic earnings per share of common stock are computed by dividing net income available to common shareholders, which consists of net income less dividends declared and required interest payments on preferred stock, by the weighted-average number of common shares outstanding during the period. Diluted earnings per share of common stock are computed similar to basic earnings per share of common stock using the treasury stock method, where the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued. There were 27,326 and 36,968 shares considered antidilutive as of December 31, 2013 and 2012. These shares were excluded from the calculation of earnings per common share.

Stock-based compensation - The Company grants stock options and restricted stock. For the recognition of stock-based compensation, the Company measures and recognizes as compensation expense, the grant-date fair market value for all share-based awards. That portion of the grant-date fair value that is ultimately expected to vest is recognized as expense over the requisite service period, typically the vesting period, using the graded attribution method. The Company uses the Black-Scholes option-pricing model to value stock-based awards. The Black-Scholes model requires the use of assumptions regarding the risk-free interest rate, the expected dividend yield, the expected life of the options, and the expected volatility of the stock price.

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 Company evaluates the realizability of its deferred tax assets by assessing its valuation allowance and by adjusting the amount of such allowance, if necessary.

OREGON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The Company 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 Company recognizes interest and penalties related to income tax matters in income tax expense. The Company does not anticipate that the amount of unrecognized tax benefits will significantly increase or decrease in the next 12 months. There were no interest and penalties accrued for the year ended December 31, 2013 or 2012. The Company files consolidated U.S. federal and Oregon income tax returns, which are subject to examination by the taxing authorities for years 2010 and later.

Comprehensive income - Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available-for-sale which are recognized as a separate component of equity.

Fair value of financial instruments - Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully 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.

Segment reporting - The Company operates in one segment and makes management decisions based on consolidated results. The Company's operations are solely in the financial services industry and include providing to its customers traditional banking and other financial services.

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

The allowance for off-balance-sheet credit losses related to unfunded loan commitments is increased through charges to noninterest expense and is decreased by charge-offs or transfers to the allowance for loan losses at the time that the related loan is funded. Management periodically evaluates the adequacy of this allowance based on the Bank's off-balance-sheet credit loss experience, known and inherent risks in the portfolio, adverse situations that may increase the likelihood of loss, and current economic conditions. The reserve for unfunded loan commitments is not material to the consolidated financial statements.

Reclassifications - Certain reclassifications have been made to the prior-year consolidated financial statements to conform with current-year presentations. These reclassifications did not affect previously reported net income or shareholders' equity.

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Investment Securities

The amortized cost and estimated fair values of available-for-sale investment securities as of December 31 are summarized as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|-------------------------------------|---------------------|------------------------------|-------------------------------|----------------------------|
| December 31, 2013 | | | | |
| Agency-backed, mortgage-backed GNMA | \$ 246,157 | \$ 16,083 | \$ - | \$ 262,240 |
| Corporate bonds | 1,000,000 | 5,700 | - | 1,005,700 |
| | <u>\$ 1,246,157</u> | <u>\$ 21,783</u> | <u>\$ -</u> | <u>\$ 1,267,940</u> |
| December 31, 2012 | | | | |
| Agency-backed, mortgage-backed GNMA | \$ 363,700 | \$ 27,142 | \$ - | \$ 390,842 |
| Corporate bonds | 1,000,000 | 2,113 | - | 1,002,113 |
| | <u>\$ 1,363,700</u> | <u>\$ 29,255</u> | <u>\$ -</u> | <u>\$ 1,392,955</u> |

There were no securities in a loss position as of December 31, 2013 and 2012, and no sales of securities in 2013 or 2012.

The amortized cost and estimated fair value of investment securities available-for-sale as of December 31, 2013, by contractual maturities are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Amortized Cost | Estimated Fair Value |
|---------------------------------------|---------------------|----------------------------|
| Due within one year | \$ 83,030 | \$ 88,573 |
| Due after one year through five years | <u>1,163,127</u> | <u>1,179,367</u> |
| | <u>\$ 1,246,157</u> | <u>\$ 1,267,940</u> |

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3 - Loans

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

| | <u>2013</u> | <u>2012</u> |
|--|----------------------|----------------------|
| Residential | \$ 20,397,198 | \$ 16,718,526 |
| Commercial real estate | | |
| Farmland | 1,046,526 | 1,533,101 |
| Multifamily | 9,396,839 | 6,136,307 |
| Nonresidential (owner-occupied) | 20,390,181 | 17,505,022 |
| Nonresidential (non-owner-occupied) | <u>22,239,079</u> | <u>23,986,685</u> |
| Total commercial real estate | <u>53,072,625</u> | <u>49,161,115</u> |
| Construction | | |
| Residential 1-4 family | 751,750 | 438,928 |
| Land development | 4,653,772 | 5,196,979 |
| Other | <u>2,697,136</u> | <u>619,139</u> |
| Total construction | <u>8,102,658</u> | <u>6,255,046</u> |
| Commercial | <u>5,557,131</u> | <u>3,920,226</u> |
| Consumer | <u>411,996</u> | <u>473,586</u> |
| Total loans | 87,541,608 | 76,528,499 |
| Less allowance for loan losses | (1,461,737) | (1,453,009) |
| Less unearned loan fees | <u>(134,449)</u> | <u>(120,838)</u> |
| Loans, net of allowance for loan losses and losses and unearned loan fees | <u>\$ 85,945,422</u> | <u>\$ 74,954,652</u> |

All of the Bank's loans and loan commitments are geographically concentrated in its service areas within Oregon.

As of December 31, 2013 and 2012, loans of \$45,105,926 and \$41,767,027, respectively, were pledged to support FHLB borrowings, and loans as of December 31, 2013 and 2012, of \$24,651,621 and \$19,765,938, respectively, were pledged at Federal Reserve Bank of San Francisco for additional borrowing capacity.

OREGON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Allowance for Loan Losses

The 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 methodology for making such assessments and determining the adequacy of the ALLL includes a general valuation allowance and a classified loan loss reserve on specific relationships.

The general valuation allowance is systematically calculated quarterly using quantitative and qualitative information about specific loan classes. The minimum required level in which an entity develops a systematic methodology to determine its allowance for loan and lease losses is at the segment level. However, the Bank's systematic methodology in determining its allowance for loan and lease losses is prepared at the class level, which is more detailed than the segment level. 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, including recent appraisal values for collateral-dependent loans. The qualitative information takes into account general economic and business conditions affecting the marketplace, seasoning of the loan portfolio, duration of the business cycle, etc. to ensure the methodologies reflect the current economic environment and other factors; using historical loss information exclusively may not give an accurate estimate of inherent losses within the Bank's loan portfolio.

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 impairment value.

The ALLL is increased by provisions for loan and lease losses (provision) charged to expense, and is reduced by loans charged off, net of recoveries. Although the Company'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 net income if circumstances differ from the assumptions used in determining the ALLL.

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

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Allowance for Loan Losses (continued)

An analysis of the change in the allowance for loan losses follows:

| December 31, 2013 | Residential | Commercial Real Estate | Construction | Commercial | Consumer | Total |
|--|----------------------|---------------------------|---------------------|---------------------|-------------------|----------------------|
| Allowance | | | | | | |
| Balance, beginning of the period | \$ 250,584 | \$ 844,337 | \$ 195,000 | \$ 158,200 | \$ 4,888 | \$ 1,453,009 |
| Charge-offs | - | - | - | - | - | - |
| Recoveries | 8,728 | - | - | - | - | 8,728 |
| Provision for loan losses | - | - | - | - | - | - |
| Balance, end of the period | <u>\$ 259,312</u> | <u>\$ 844,337</u> | <u>\$ 195,000</u> | <u>\$ 158,200</u> | <u>\$ 4,888</u> | <u>\$ 1,461,737</u> |
| Ending balance individually evaluated for impairment | <u>\$ 57,000</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 57,000</u> |
| Ending balance collectively evaluated for impairment | <u>\$ 202,312</u> | <u>\$ 844,337</u> | <u>\$ 195,000</u> | <u>\$ 158,200</u> | <u>\$ 4,888</u> | <u>\$ 1,404,737</u> |
| Loans | | | | | | |
| Ending balance | <u>\$ 20,397,198</u> | <u>\$ 53,072,625</u> | <u>\$ 8,102,658</u> | <u>\$ 5,557,131</u> | <u>\$ 411,996</u> | <u>\$ 87,541,608</u> |
| Ending balance individually evaluated for impairment | <u>\$ 988,270</u> | <u>\$ 1,760,435</u> | <u>\$ 192,059</u> | <u>\$ 54,829</u> | <u>\$ -</u> | <u>\$ 2,995,593</u> |
| Ending balance collectively evaluated for impairment | <u>\$ 19,408,928</u> | <u>\$ 51,312,190</u> | <u>\$ 7,910,599</u> | <u>\$ 5,502,302</u> | <u>\$ 411,996</u> | <u>\$ 84,546,015</u> |
| December 31, 2012 | | | | | | |
| Allowance | | | | | | |
| Balance, beginning of the period | \$ 540,523 | \$ 840,000 | \$ 195,000 | \$ 158,200 | \$ 4,888 | \$ 1,738,611 |
| Charge-offs | (290,342) | - | - | - | - | (290,342) |
| Recoveries | 403 | 4,337 | - | - | - | 4,740 |
| Provision for loan losses | - | - | - | - | - | - |
| Balance, end of the period | <u>\$ 250,584</u> | <u>\$ 844,337</u> | <u>\$ 195,000</u> | <u>\$ 158,200</u> | <u>\$ 4,888</u> | <u>\$ 1,453,009</u> |
| Ending balance individually evaluated for impairment | <u>\$ 32,000</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 32,000</u> |
| Ending balance collectively evaluated for impairment | <u>\$ 218,584</u> | <u>\$ 844,337</u> | <u>\$ 195,000</u> | <u>\$ 158,200</u> | <u>\$ 4,888</u> | <u>\$ 1,421,009</u> |
| Loans | | | | | | |
| Ending balance | <u>\$ 16,718,526</u> | <u>\$ 49,161,115</u> | <u>\$ 6,255,046</u> | <u>\$ 3,920,226</u> | <u>\$ 473,586</u> | <u>\$ 76,528,499</u> |
| Ending balance individually evaluated for impairment | <u>\$ 1,025,878</u> | <u>\$ 1,503,721</u> | <u>\$ 122,424</u> | <u>\$ 128,380</u> | <u>\$ -</u> | <u>\$ 2,780,403</u> |
| Ending balance collectively evaluated for impairment | <u>\$ 15,692,648</u> | <u>\$ 47,657,394</u> | <u>\$ 6,132,622</u> | <u>\$ 3,791,846</u> | <u>\$ 473,586</u> | <u>\$ 73,748,096</u> |

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Allowance for Loan Losses (continued)

When the Bank classifies problem assets as either substandard or doubtful, pursuant to federal regulations, it may establish a specific allowance in an amount it deems prudent and approved by management to address the risk specifically, or it 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 the particular problem assets. When an insured institution classifies problem assets as a loss, pursuant to federal regulations, it is required to charge off such assets in the period in which they are deemed uncollectible. The determination as to the classification of assets and the amount of valuation allowances is subject to review by the Federal Deposit Insurance Corporation (FDIC), which can require the establishment of additional loss allowances.

Loan grades are used by the Bank to identify and track potential problem loans that do not rise to the levels described for substandard, doubtful, or loss. The grades for special mention are assigned to loans that have been criticized based upon known characteristics such as periodic payment delinquency or stale financial information from the borrower and/or guarantors. Loans identified as classified (substandard, doubtful, or loss) are subject to problem loan reporting every three months. There were no loans classified as doubtful or loss as of December 31, 2013 and 2012.

The following tables show credit quality indicators as of December 31:

| | Residential | | Commercial Real Estate | | Construction | |
|-------------|----------------------|----------------------|------------------------|----------------------|----------------------|----------------------|
| | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| Grade | | | | | | |
| Pass | \$ 17,177,306 | \$ 12,017,028 | \$ 51,092,947 | \$ 46,613,038 | \$ 7,910,599 | \$ 5,927,979 |
| Substandard | 3,219,892 | 4,701,498 | 1,979,678 | 2,548,077 | 192,059 | 327,067 |
| Total | <u>\$ 20,397,198</u> | <u>\$ 16,718,526</u> | <u>\$ 53,072,625</u> | <u>\$ 49,161,115</u> | <u>\$ 8,102,658</u> | <u>\$ 6,255,046</u> |
| | | | | | | |
| | Commercial | | Consumer | | Total Loans | |
| | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| Grade | | | | | | |
| Pass | \$ 5,416,469 | \$ 3,688,465 | \$ 402,110 | \$ 448,758 | \$ 81,999,431 | \$ 68,695,268 |
| Substandard | 140,662 | 231,761 | 9,886 | 24,828 | 5,542,177 | 7,833,231 |
| Total | <u>\$ 5,557,131</u> | <u>\$ 3,920,226</u> | <u>\$ 411,996</u> | <u>\$ 473,586</u> | <u>\$ 87,541,608</u> | <u>\$ 76,528,499</u> |

Pass - Credit exposure in this category ranges between the highest credit quality to average credit quality. Primary repayment sources generate satisfactory debt service coverage under normal conditions. Cash flow from recurring sources is expected to continue to produce adequate debt service capacity.

Substandard - A substandard loan is inadequately protected by the current sound worth and paying capacity of the borrower or of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of debt. Loans in this category are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

OREGON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Allowance for Loan Losses (continued)

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

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

The following table shows the age analysis of past due loans as of December 31:

| | 30 - 59 Days Past Due | 60 - 89 Days Past Due | Greater Than 90 Days | Total Past Due | Current | Total Loans | Recorded Investment > 90 Days and Accruing | Recorded Investment on Nonaccrual Status |
|---------------------------|--------------------------|--------------------------|----------------------------|---------------------|----------------------|----------------------|---|---|
| December 31, 2013 | | | | | | | | |
| Residential | \$ 242,237 | \$ - | \$ - | \$ 242,237 | \$ 20,154,961 | \$ 20,397,198 | \$ - | \$ 228,989 |
| Commercial real estate | 244,173 | 348,050 | 534,714 | 1,126,937 | 51,945,688 | 53,072,625 | - | 880,710 |
| Construction | - | - | - | - | 8,102,658 | 8,102,658 | - | - |
| Commercial | - | 81,825 | 58,837 | 140,662 | 5,416,469 | 5,557,131 | 54,829 | - |
| Consumer | - | - | - | - | 411,996 | 411,996 | - | - |
| | <u>\$ 486,410</u> | <u>\$ 429,875</u> | <u>\$ 593,551</u> | <u>\$ 1,509,836</u> | <u>\$ 86,031,772</u> | <u>\$ 87,541,608</u> | <u>\$ 54,829</u> | <u>\$ 1,109,699</u> |
| December 31, 2012 | | | | | | | | |
| Residential | \$ - | \$ - | \$ - | \$ - | \$ 16,718,526 | \$ 16,718,526 | \$ - | \$ 361,494 |
| Commercial real estate | 760,072 | - | 87,121 | 847,193 | 48,313,922 | 49,161,115 | - | 606,928 |
| Construction | - | - | - | - | 6,255,046 | 6,255,046 | - | - |
| Commercial | - | - | 231,760 | 231,760 | 3,688,466 | 3,920,226 | 128,378 | - |
| Consumer | - | - | - | - | 473,586 | 473,586 | - | - |
| | <u>\$ 760,072</u> | <u>\$ -</u> | <u>\$ 318,881</u> | <u>\$ 1,078,953</u> | <u>\$ 75,449,546</u> | <u>\$ 76,528,499</u> | <u>\$ 128,378</u> | <u>\$ 968,422</u> |

The amount of interest income forgone as a result of these loans being placed on nonaccrual status totaled \$154,468 and \$146,607 for the years ended December 31, 2013 and 2012, respectively.

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Allowance for Loan Losses (continued)

The following table shows impaired loans for the years ended December 31:

| December 31, 2013 | <u>Recorded Investment</u> | <u>Unpaid Principal Balance</u> | <u>Related Allowance</u> | <u>Average Annual Recorded Investment</u> | <u>Interest Income Recognized</u> |
|------------------------------------|--------------------------------|---|------------------------------|---|---|
| With no related allowance recorded | | | | | |
| Residential | \$ 454,245 | \$ 491,786 | \$ - | \$ 466,554 | \$ 13,405 |
| Commercial real estate | 1,760,435 | 1,861,384 | - | 1,525,410 | 52,792 |
| Construction | 192,059 | 192,059 | - | 194,029 | 7,272 |
| Commercial | 54,829 | 54,829 | - | 87,267 | 6,404 |
| With allowance recorded | | | | | |
| Residential | \$ 534,025 | \$ 534,025 | \$ 57,000 | \$ 542,978 | \$ 27,144 |
| Total | | | | | |
| Residential | \$ 988,270 | \$ 1,025,811 | \$ 57,000 | \$ 1,009,532 | \$ 40,549 |
| Commercial real estate | 1,760,435 | 1,861,384 | - | 1,525,410 | 52,792 |
| Construction | 192,059 | 192,059 | - | 194,029 | 7,272 |
| Commercial | 54,829 | 54,829 | - | 87,267 | 6,404 |
| December 31, 2012 | | | | | |
| With no related allowance recorded | | | | | |
| Residential | \$ 474,235 | \$ 537,143 | \$ - | \$ 508,385 | \$ 4,842 |
| Commercial real estate | 1,503,721 | 1,564,562 | - | 1,575,188 | 33,448 |
| Construction | 122,424 | 122,424 | - | 125,933 | 9,466 |
| Commercial | 128,380 | 128,380 | - | 152,909 | 11,721 |
| With allowance recorded | | | | | |
| Residential | \$ 551,643 | \$ 551,643 | \$ 32,000 | \$ 560,631 | \$ 31,226 |
| Total | | | | | |
| Residential | \$ 1,025,878 | \$ 1,088,786 | \$ 32,000 | \$ 1,069,016 | \$ 36,068 |
| Commercial real estate | 1,503,721 | 1,564,562 | - | 1,575,188 | 33,448 |
| Construction | 122,424 | 122,424 | - | 125,933 | 9,466 |
| Commercial | 128,380 | 128,380 | - | 152,909 | 11,721 |

Loans classified as troubled debt restructurings totaled \$1,945,412 and \$2,000,807 as of December 31, 2013 and 2012, respectively. 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 Company 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.

OREGON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Allowance for Loan Losses (continued)

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 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 new troubled debt restructured loans during the year ended December 31, 2013 or 2012. The Company had no commitments to extend additional credit to borrowers owing receivables whose terms have been modified in troubled debt restructurings.

Subsequent to a loan being classified as a troubled debt restructuring, a borrower may become unwilling or unable to abide by the terms of the modified agreement. In such cases of default, the Bank takes appropriate action to secure additional payments including the use of foreclosure proceedings. There were no troubled debt restructurings that defaulted in the last 12 months as of December 31, 2013 and 2012.

Note 5 - Derivatives

The Bank is engaged in providing first mortgage permanent financing for residential property. Residential home mortgages are originated for sale into the secondary market and are hedged against interest rate fluctuations with forward sales commitments, futures, and option contracts from the time of an interest rate lock loan commitment until the loans are sold (typically 30 to 90 days).

The following is a summary of the interest rate lock loan commitments and open forward commitments as of December 31, 2013 and 2012:

| | December 31, 2013 | | December 31, 2012 | |
|---|--------------------|---------------|--------------------|---------------|
| | Notional Amount | Fair Value | Notional Amount | Fair Value |
| Interest rate lock loan commitments | \$ 4,240,062 | \$ 82,345 | \$ 14,242,113 | \$ 371,280 |
| Forward sales of mortgage-backed securities commitments | 4,701,000 | (57,158) | 13,239,821 | 7,762 |

The notional amounts of the derivatives do not represent amounts exchanged by the parties and, thus, are not a measure of the Company's exposure through its use of derivatives. The amounts exchanged are determined by reference to the notional amounts and the other terms of the individual derivatives.

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Derivatives (continued)

The derivatives expose the Company to credit risk in the event of nonperformance by counterparties to such agreements. The risk consists primarily of the termination value of the agreements where the Company is in a favorable position. The Company controls credit risk associated with its derivative instruments through management review and approval of counterparties.

The following table summarizes the types of derivatives, separately by assets and liabilities, their locations on the consolidated balance sheets, and the fair values of such derivatives as of December 31, 2013 and 2012:

| Derivatives | Balance Sheet Location | Asset Derivatives | | Liability Derivatives | |
|---|---------------------------------------|-------------------|------------|-----------------------|-------|
| | | December 31, | | December 31, | |
| | | 2013 | 2012 | 2013 | 2012 |
| Interest rate lock loan commitments | Other assets | \$ 82,345 | \$ 371,280 | \$ - | \$ - |
| Forward sales of mortgage-backed securities commitments | Accounts payable and accrued expenses | - | - | (57,158) | 7,762 |

The following table summarizes the types of derivatives, their locations within the consolidated statements of income, and the gains (losses) recorded in 2013 and 2012:

| Derivatives | Income Statement Location | December 31, | |
|---|---------------------------|--------------|------------|
| | | 2013 | 2012 |
| Interest rate lock loan commitments | Mortgage banking revenue | \$(288,935) | \$ 264,484 |
| Forward sales of mortgage-backed securities commitments | Mortgage banking revenue | 712,886 | (522,499) |

Note 6 - Premises and Equipment

Depreciation and amortization expense amounted to \$224,648 and \$211,160 for the years ended December 31, 2013 and 2012, respectively.

| | 2013 | 2012 |
|--|---------------------|---------------------|
| Land | \$ 975,881 | \$ 975,881 |
| Furniture and equipment | 1,416,985 | 1,322,299 |
| Buildings | 1,035,937 | 1,035,937 |
| Leasehold improvements | 984,987 | 959,270 |
| | 4,413,790 | 4,293,387 |
| Less accumulated depreciation and amortization | (1,417,817) | (1,201,318) |
| Premises and equipment, net of accumulated depreciation and amortization | <u>\$ 2,995,973</u> | <u>\$ 3,092,069</u> |

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Other Real Estate Owned

Other real estate owned (OREO) includes property acquired by the Bank through foreclosure and is carried at the lower of the estimated fair value, less costs to sell, or the principal balance of the foreclosed loans.

The following table presents OREO and other repossessed assets as of December 31:

| | <u>2013</u> | <u>2012</u> |
|---------------------------|---------------------|---------------------|
| Beginning balance | \$ 4,691,805 | \$ 5,740,796 |
| Loans transferred to OREO | - | 1,323,390 |
| Sales proceeds | (1,702,181) | (1,927,812) |
| Loss on sale of OREO | (81,457) | (197,173) |
| Write-downs | <u>(159,092)</u> | <u>(247,396)</u> |
| Ending balance | <u>\$ 2,749,075</u> | <u>\$ 4,691,805</u> |

Note 8 - Time Certificates of Deposit

Time certificates of deposit of \$100,000 or more aggregated to \$12,565,320 and \$15,087,106 as of December 31, 2013 and 2012, respectively.

The scheduled contractual maturities of certificates of deposit as of December 31, 2013, are as follows:

| | |
|------|----------------------|
| 2014 | \$ 20,054,851 |
| 2015 | 11,929,866 |
| 2016 | 3,426,321 |
| 2017 | 3,392,561 |
| 2018 | <u>1,266,398</u> |
| | <u>\$ 40,069,997</u> |

Time deposits included brokered deposits of \$9,996,644 and \$10,986,722 as of December 31, 2013 and 2012, respectively.

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 9 - Borrowings

FHLB advances - The Bank, as a member of the FHLB of Seattle, has entered into a credit arrangement with the FHLB under which authorized borrowings are collateralized by the Bank's loans (Note 3). The Bank has notes payable to the FHLB of Seattle in the amount of \$0 and \$4,000,000 as of December 31, 2013 and 2012, respectively. Maximum borrowings available from the FHLB for notes payable, lines of credit, and the CMA program totaled \$24,191,228 as of December 31, 2013, and bear interest at the then-stated rate. Available borrowings and their respective terms are subject to eligible collateral being pledged and are reduced by outstanding letters of credit. As of December 31, 2013, there were no outstanding balances.

Correspondent bank lines of credit - The Bank has federal funds line-of-credit agreements with Pacific Coast Bankers' Bank, Zions Bank, and US Bank. As of December 31, 2013 and 2012, there were no outstanding balances owed under these agreements. The maximum borrowings available under the Pacific Coast Bankers' Bank agreement was \$4,000,000 as of December 31, 2013 and 2012. This line of credit expires on June 30, 2014, and had a floating interest rate of 1.13% as of December 31, 2013. The Zions Bank line of credit was opened in October 2012. The maximum borrowings available under this agreement was \$4,000,000 as of December 31, 2013 and 2012. This line of credit has no expiration date and is unsecured and had a floating interest rate of 0.39% as of December 31, 2013. The US Bank line of credit was opened in January 2013. The maximum borrowings available under this agreement was \$2,000,000 as of December 31, 2013. This line of credit has no expiration date and is unsecured and had a floating interest rate of 0.75% as of December 31, 2013.

Federal Reserve borrowings - The Bank has established a line of credit under the discount window program. As of December 31, 2013 and 2012, there were no outstanding borrowings under this program and the available borrowing limit was \$16,000,771 and \$12,077,131, respectively. The borrowings bear interest at the then stated rate. The Bank has pledged certain loans to collateralize these borrowings (Note 3).

Long-term debt - The Company has entered into a long-term note payable secured by Bank stock with United Bankers' Bank on October 4, 2013, in the original principal amount of \$3,450,000 at 4.250%, maturing October 15, 2018. As discussed further in Note 13, the debt was obtained to repurchase the preferred stock originally issued as part of the United States Department of the Treasury's Capital Purchase Program. Scheduled future principal payments are as follows as of December 31:

| | |
|------|---------------------|
| 2014 | \$ 268,387 |
| 2015 | 284,766 |
| 2016 | 296,895 |
| 2017 | 310,238 |
| 2018 | <u>2,289,714</u> |
| | <u>\$ 3,450,000</u> |

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10 - Income Taxes

The provision for income taxes consisted of the following:

| | <u>2013</u> | <u>2012</u> |
|------------------------------|-------------------|-------------------|
| Income tax expense (benefit) | | |
| Current | | |
| Federal | \$ 226,589 | \$ 710,615 |
| State | 63,126 | 126,998 |
| Deferred | | |
| Federal | 84,051 | (92,834) |
| State | <u>16,910</u> | <u>(8,183)</u> |
| | <u>\$ 390,676</u> | <u>\$ 736,596</u> |

The provision for current income taxes is different from that computed by applying the statutory rates as follows:

| | <u>2013</u> | <u>2012</u> |
|---|-------------------|-------------------|
| Federal tax at statutory rates | \$ 332,941 | \$ 689,936 |
| State income taxes, net of federal effect | 38,027 | 93,367 |
| Increase in cash surrender value | (27,573) | (26,458) |
| Permanent difference | 15,035 | 22,447 |
| Other | <u>32,246</u> | <u>(42,696)</u> |
| | <u>\$ 390,676</u> | <u>\$ 736,596</u> |

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10 - Income Taxes (continued)

The components of the net deferred tax asset as of December 31 are as follows:

| | 2013 | 2012 |
|--------------------------------|--------------|--------------|
| Assets | | |
| Allowance for loan losses | \$ 450,505 | \$ 477,825 |
| Other real estate owned | 593,300 | 587,502 |
| Deferred compensation | 206,974 | 194,734 |
| Other | 21,686 | 146,673 |
| Total deferred tax assets | 1,272,465 | 1,406,734 |
| Liabilities | | |
| Depreciation | (232,923) | (251,420) |
| Prepaid expenses | (28,769) | (43,580) |
| Unrealized gain on securities | (8,365) | (11,234) |
| Total deferred tax liabilities | (270,057) | (306,234) |
| Net deferred tax assets | \$ 1,002,408 | \$ 1,100,500 |

Note 11 - Retirement Plan

The Bank has established a 401(k) plan to which employees can elect to defer a portion of their pay, up to a maximum of 15%. At management's discretion, the Bank can make a matching contribution. For the years ended December 31, 2013 and 2012, the Bank contributed \$163,000 and \$108,835, respectively.

Note 12 - Commitments and Contingencies

In the normal course of business to meet the financing needs of its customers, the Bank is a party to financial instruments with off-balance-sheet risk. These financial instruments include commitments to extend credit and the issuance of letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amounts recognized in the consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit written is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

OREGON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Commitments and Contingencies (continued)

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

| | <u>2013</u> | <u>2012</u> |
|------------------------------|---------------------|---------------------|
| Commitments to extend credit | \$ 6,240,470 | \$ 3,536,670 |
| Standby letters of credit | <u>175,177</u> | <u>175,177</u> |
| | <u>\$ 6,415,647</u> | <u>\$ 3,711,847</u> |

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

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

Note 13 - Preferred Stock Issuance

Preferred stock issuance - On April 24, 2009, the Company issued two series of preferred stock as part of the United States Department of the Treasury's Capital Purchase Program for gross proceeds of \$3,216,000. The Company issued 3,216 shares of Series A preferred stock, and warrants for 161 shares of Series B preferred stock with an exercise price of \$.01 per share, which were immediately exercised. The allocation of the fair value of the warrants was recorded as a discount to the Series A preferred stock, and was being recognized as a "deemed dividend" over a period of five years.

On October 7, 2013, the Company's Series A Preferred Stock, originally issued to the U.S. Treasury (Treasury) as part of its Capital Purchase Program, was sold through auction by the Treasury as part of its efforts to manage and recover its investments under the Troubled Asset Relief Program (TARP) with a liquidation value of \$1,000 per share. The Company purchased 2,516 shares of Series A Preferred Stock at this time, with the remaining shares sold to independent investors. While the sale of these preferred shares to independent investors did not result in any proceeds to the Company and did not change the Company's capital position or accounting for these securities, it did eliminate restrictions put in place by the Treasury on TARP recipients. Subsequent to the sale on October 7, 2013, the Company redeemed all remaining Series A and Series B Preferred Stock.

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 14 - Stock Incentive Plan

During 2011, the Bank formed the 2011 Stock Incentive Plan (the Plan), approved by the board of directors and ratified by the shareholders, authorizing the grant of up to 125,000 shares of common stock. The Plan allows for granting of both incentive and nonqualified stock options, and restricted stock. For all options, the option price, number of shares granted, and duration for the stock options are determined and approved by the board of directors. However, the exercise price for stock options will be 100% of fair market value as of the date on which the option is granted. If the optionee is a significant shareholder, the exercise price will be 110% of fair market value as of the date on which the option is granted. The maximum life for stock options granted is ten years from the date of grant or five years if the optionee is a significant shareholder. Restricted stock is granted with the same terms and restrictions as options. There are 74,798 options and restricted stock shares available for grant as of December 31, 2013.

The risk-free rate for periods within the contractual life of the award is based on the U.S. Treasury yield curve in effect at the time of grant. The expected dividend yield is based on management's estimate of future cash dividends at the time of grant. Cash dividends are not paid on unexercised options. The Company attempts to use historical data to estimate option exercise and employee termination behavior in order to estimate an expected life for each option grant. The expected life falls between the end of the vesting period or requisite service period and the contractual term for each award. Expected volatility is estimated to approximate historical volatility determined using the weekly closing stock price for the Company's common stock.

The following table summarizes stock options outstanding under this plan:

| | Nonstatutory Options | Weighted- Average Exercise Price | Average Remaining Contractual Life (in years) |
|--|-------------------------|---|--|
| Options outstanding, December 31, 2012 | 39,453 | \$ 12.97 | 3.30 |
| Options granted | - | - | |
| Stock dividend | 3,946 | 11.79 | |
| Options exercised | (1,213) | 8.25 | |
| Options forfeited | <u>(12,128)</u> | 8.25 | |
| Options outstanding, December 31, 2013 | <u>30,058</u> | \$ 13.37 | 3.48 |
| Options exercisable, December 31, 2013 | <u>29,068</u> | \$ 13.59 | 3.37 |

As of December 31, 2013, there was \$2,472 of unrecognized compensation expense related to nonvested stock options, which is expected to be recognized over a period of approximately two years. There were no tax benefits realized in 2013 and 2012.

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 14 - Stock Incentive Plan (continued)

Restricted stock grants - The fair value of restricted stock grants is determined based on the last trade price on the grant date. The Company granted restricted stock during 2012 and the shares are issued; however, they are subject to service requirements before restrictions are lifted. The restricted stock grants are participating securities. In 2013, a 10% stock dividend was granted. There were no dividends in 2012. A summary of restricted stock activity is presented below:

| | <u>Restricted Stock</u> | <u>Weighted- Average Grant-Date Fair Value</u> |
|---------------------------------------|-----------------------------|--|
| Restricted stock at December 31, 2012 | 30,333 | \$ 8.16 |
| Stock granted | 13,328 | 11.67 |
| Stock dividend | 3,041 | 8.16 |
| Stock vested | (11,157) | 7.56 |
| Stock forfeited | <u>(550)</u> | 6.81 |
| Restricted stock at December 31, 2013 | <u><u>34,995</u></u> | \$ 9.71 |

As of December 31, 2013, there was \$203,098 of unrecognized compensation expense related to nonvested restricted stock options, which is expected to be recognized over a period of approximately five years.

Note 15 - Operating Lease

The Bank is obligated under noncancelable operating leases with initial or remaining terms in excess of one year on various facilities. These leases expire from 2014 through 2018, require periodic adjustments to the minimum rental payments based on published price indexes, and contain various extension options, which may be exercised by management.

The following is a schedule of estimated future minimum rental payments based upon price indexes currently in effect as of December 31:

| | |
|------|----------------------------|
| 2014 | \$ 535,888 |
| 2015 | 258,782 |
| 2016 | 223,408 |
| 2017 | <u>94,289</u> |
| | <u><u>\$ 1,112,367</u></u> |

Rental expense under all operating leases was \$741,562 and \$747,771 for 2013 and 2012, respectively.

OREGON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 16 - Regulatory Matters

The Bank and Company are subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum requirements can initiate certain mandatory—and possibly additional discretionary—actions by regulators that, if undertaken, could have a direct material effect on the Bank and Company. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, banks must meet specific capital guidelines that involve quantitative measures of a bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to average assets (as defined). Management believes, as of December 31, 2013, the Bank and Company met all capital adequacy requirements to which they are subject.

As of December 31, 2013, according to the most recent notifications from its regulatory agencies, the Bank and Company were categorized as well-capitalized under the applicable regulatory framework. There are no conditions or events that management believes may have changed the Bank's category. To be categorized as well-capitalized, the Bank and Company must maintain minimum total risk-based capital, Tier 1 risk-based capital, and Tier 1 leverage capital ratios. The following table presents selected regulatory capital information for the Bank and Company.

The Bank and Company's actual and required capital amounts and ratios are as follows:

| | Actual Capital | | Capital Adequacy Purpose | | To Be Well Capitalized Under Prompt Corrective Action Provision | |
|--|---------------------|--------|--------------------------|-------|---|-------|
| | Amount in Thousands | Ratio | Amount in Thousands | Ratio | Amount in Thousands | Ratio |
| As of December 31, 2013 | | | | | | |
| Total capital to risk-weighted assets | | | | | | |
| Oregon Bancorp, Inc. | \$ 15,466 | 16.06% | \$ 7,705 | ≥8% | N/A | N/A |
| Willamette Valley Bank | \$ 18,545 | 19.31% | \$ 7,685 | ≥8% | \$ 9,606 | ≥10% |
| Tier 1 capital to risk-weighted assets | | | | | | |
| Oregon Bancorp, Inc. | \$ 14,259 | 14.80% | \$ 3,853 | ≥4% | N/A | N/A |
| Willamette Valley Bank | \$ 17,342 | 18.05% | \$ 3,842 | ≥4% | \$ 5,764 | ≥6% |
| Tier 1 capital to average assets | | | | | | |
| Oregon Bancorp, Inc. | \$ 14,259 | 11.83% | \$ 4,820 | ≥4% | N/A | N/A |
| Willamette Valley Bank | \$ 17,342 | 14.39% | \$ 4,820 | ≥4% | \$ 6,025 | ≥5% |
| As of December 31, 2012 | | | | | | |
| Total capital to risk-weighted assets | | | | | | |
| Oregon Bancorp, Inc. | \$ 18,446 | 18.69% | \$ 7,897 | ≥8% | N/A | N/A |
| Willamette Valley Bank | \$ 18,277 | 18.53% | \$ 7,891 | ≥8% | \$ 9,864 | ≥10% |
| Tier 1 capital to risk-weighted assets | | | | | | |
| Oregon Bancorp, Inc. | \$ 17,209 | 17.43% | \$ 3,949 | ≥4% | N/A | N/A |
| Willamette Valley Bank | \$ 17,041 | 17.28% | \$ 3,946 | ≥4% | \$ 5,919 | ≥6% |
| Tier 1 capital to average assets | | | | | | |
| Oregon Bancorp, Inc. | \$ 17,209 | 14.19% | \$ 4,851 | ≥4% | N/A | N/A |
| Willamette Valley Bank | \$ 17,041 | 14.06% | \$ 4,848 | ≥4% | \$ 6,060 | ≥5% |

OREGON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 17 - 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.

These two types of inputs create the following fair value hierarchy:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liability. Unobservable inputs are used to measure fair value to the extent that observable inputs are not available. The Bank's own data used to develop unobservable inputs shall be adjusted for market consideration when reasonably available.

The 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

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) and are as follows:

Available-for-sale 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.

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 17 - 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. Assets measured on a nonrecurring basis are as follows:

Impaired loans - A loan is considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due (both interest and principal) according to the contractual terms of the loan agreement. Impaired loans are evaluated and valued at the time the loan is identified as impaired, at the lower of cost or fair value. As a practical expedient, fair value may be measured based on a loan's observable market price or the underlying collateral securing the loan. Collateral may be real estate or business assets including equipment. The value of collateral is determined based on independent appraisals, and is typically categorized as a Level 3 in the hierarchy.

OREO - OREO assets are measured and recorded at the lower of cost basis or fair value on a nonrecurring basis. The OREO assets are collateral-dependent and, accordingly, are measured based on the fair value of such collateral. The fair value of each asset's collateral is generally based on estimated market prices from an independently prepared appraisal, which is then adjusted for the cost related to liquidating such collateral; such valuation inputs result in a nonrecurring fair value measurement that is categorized as a Level 3 measurement.

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

| | Fair Value Measurements | | | |
|--|--------------------------|----------|----------|------------------|
| | Fair Value 12/31/2013 | Level 1 | Level 2 | Level 3 |
| Nonrecurring items | | | | |
| Impaired loans, net of specific reserves | \$ 477,025 | \$ - | \$ - | \$ 477,025 |
| Other real estate owned | 1,590,500 | - | - | 1,590,500 |
| Total assets measured at fair value | \$ 2,067,525 | \$ - | \$ - | \$ 2,067,525 |

| | Fair Value Measurements | | | |
|--|--------------------------|----------|----------|------------------|
| | Fair Value 12/31/2012 | Level 1 | Level 2 | Level 3 |
| Nonrecurring items | | | | |
| Impaired loans, net of specific reserves | \$ 519,643 | \$ - | \$ - | \$ 519,643 |
| Other real estate owned | 2,008,703 | - | - | 2,008,703 |
| Total assets measured at fair value | \$ 2,528,346 | \$ - | \$ - | \$ 2,528,346 |

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 17 - Fair Value of Financial Instruments (continued)

The range and weighted average of the significant unobservable inputs used to fair value Level 3 nonrecurring assets during the year ending December 31, 2013, along with the valuation techniques used, are shown in the following table:

| | Fair Value at December 31, 2013 | Valuation Technique | Unobservable Input | Range (Weighted- Average) ¹ |
|---|------------------------------------|------------------------|-------------------------------|---|
| Impaired loans, net of specific reserve | \$ 477,025 | Market comparable | Adjustment to appraisal value | 6% |
| OREO | \$ 2,749,075 | Market comparable | Adjustment to appraisal value | 6%-7% |

¹ Discount to appraised value, typically selling costs.

The following table discloses the estimated fair value and the related carrying value of the Bank's financial assets and liabilities as of December 31:

| December 31, 2013 | Carrying Value | Total | Level 1 | Level 2 | Level 3 |
|---|-------------------|--------------|---------------|------------|---------|
| Financial assets | | | | | |
| Cash and due from banks | \$ 2,587,556 | \$ 2,587,556 | \$ 2,587,556 | \$ - | \$ - |
| Federal funds sold | 12,460,000 | 12,460,000 | 12,460,000 | - | - |
| Investment securities available-for-sale | 1,267,940 | 1,267,940 | - | 1,267,940 | - |
| Loans held-for-sale | 7,409,445 | 7,409,445 | - | 7,409,445 | - |
| Interest rate lock commitments | 82,345 | 82,345 | - | 82,345 | - |
| Accrued interest receivable | 373,444 | 373,444 | - | 373,444 | - |
| Federal Home Loan Bank stock | 603,200 | 603,200 | - | 603,200 | - |
| Loans, net of allowance for loan losses | 85,945,422 | 82,652,763 | - | 82,652,763 | - |
| Financial liabilities | | | | | |
| Noninterest-bearing demand deposits | \$ 14,750,240 | \$14,750,240 | \$ 14,750,240 | \$ - | \$ - |
| Interest-bearing demand and money market accounts | 45,688,973 | 45,688,973 | - | 45,688,973 | - |
| Time deposits | 40,069,997 | 40,427,571 | - | 40,427,571 | - |
| Lines of credit and other borrowings | 3,450,000 | 3,450,000 | - | 3,450,000 | - |
| Forward commitments | (57,158) | (57,158) | - | (57,158) | - |
| Accrued interest payable | 44,024 | 44,024 | 44,024 | - | - |
| December 31, 2012 | | | | | |
| Financial assets | | | | | |
| Cash and due from banks | \$ 4,609,129 | \$ 4,609,129 | \$ 4,609,129 | \$ - | \$ - |
| Federal funds sold | 3,130,000 | 3,130,000 | 3,130,000 | - | - |
| Investment securities available-for-sale | 1,392,955 | 1,392,955 | - | 1,392,955 | - |
| Loans held-for-sale | 29,652,708 | 29,652,708 | - | 29,652,708 | - |
| Interest rate lock commitments | 371,280 | 371,280 | - | 371,280 | - |
| Accrued interest receivable | 347,270 | 347,270 | - | 347,270 | - |
| Federal Home Loan Bank stock | 569,600 | 569,600 | - | 569,600 | - |
| Loans, net of allowance for loan losses | 74,954,652 | 75,229,062 | - | 75,229,062 | - |
| Financial liabilities | | | | | |
| Noninterest-bearing demand deposits | \$ 12,422,296 | \$12,422,296 | \$ 12,422,296 | \$ - | \$ - |
| Interest-bearing demand and money market accounts | 41,649,208 | 41,649,208 | - | 41,649,208 | - |
| Time deposits | 48,627,586 | 49,323,069 | - | 49,323,069 | - |
| Lines of credit and other borrowings | 4,000,000 | 4,000,000 | - | 4,000,000 | - |
| Forward commitments | 7,762 | 7,762 | - | 7,762 | - |
| Accrued interest payable | 60,698 | 60,698 | 60,698 | - | - |

OREGON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 17 - Fair Value of Financial Instruments (continued)

Cash, due from banks, and federal funds sold - For these financial instruments, the carrying value as presented is a reasonable estimate of fair value.

FHLB stock, at cost - The FHLB stock is carried at par value (\$100/share) and does not have a readily determinable fair value.

Loans, net - For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (for example, one-to-four-family residential), credit card loans, and other consumer loans are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics. Fair values for commercial real estate and commercial loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for impaired loans are estimated using a discounted cash flow analysis or underlying collateral values, where applicable.

Noninterest-bearing demand deposits and interest-bearing demand and money market accounts - The fair values disclosed for noninterest-bearing demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate money market accounts approximate their fair values at the reporting date. Fair values for fixed-rate time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Borrowings - Rates currently available to the Bank for FHLB borrowings with similar terms and remaining maturities are used to estimate the fair value of these borrowings.

Off-balance-sheet instruments - The Bank's off-balance-sheet instruments include unfunded commitments to extend credit and standby letters of credit. The fair value of these instruments is not considered practicable to estimate because of the lack of quoted market prices and the inability to estimate fair value without incurring excessive costs.

Although estimates of fair value are based on management's judgment of the most appropriate factors, there can be no assurance that were the Bank to have disposed of such items as of December 31, 2013 and 2012, the estimated fair values would necessarily have been achieved at that date. Since market values may differ depending on various circumstances, the estimated fair values as of December 31, 2013 and 2012, should not necessarily be considered to apply at subsequent dates.

The Bank normally intends to hold the majority of its financial instruments until maturity; it does not expect to realize many of the estimated amounts disclosed. In addition, other assets and liabilities of the Bank that are not defined as financial instruments are not included in the above disclosures, such as furniture and equipment. Also, nonfinancial instruments typically not recognized in the consolidated financial statements nevertheless may have value but are not included in the above disclosures. These include, among other items, the estimated earnings power of core deposit accounts, the trained work force, customer goodwill, and similar items.

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18 - Related-Party Transactions

In the ordinary course of business, the Bank has granted loans to certain directors and executive officers and the companies with which they are associated. In the Bank's opinion, all loans and loan commitments to such parties are made on substantially the same terms, including interest rate and collateral, as those prevailing at the time for comparable transactions with other persons.

An analysis of activity with respect to loans to directors, executive officers, and principal shareholders of the Bank is as follows:

| | <u>2013</u> | <u>2012</u> |
|-------------------------------|-------------------|-------------------|
| Balance, beginning of year | \$ 192,672 | \$ 1,586,912 |
| Additions and repayments, net | (150,264) | 2,581 |
| Transfer | - | (1,396,821) |
| | <u> </u> | <u> </u> |
| Balance, end of year | <u>\$ 42,408</u> | <u>\$ 192,672</u> |

As of December 31, 2013 and 2012, deposits held for related parties were \$4,651,661 and \$6,449,665, respectively.

Note 19 - Other Income and Noninterest Expenses

Other income included in noninterest income included the following for the years ended December 31:

| | <u>2013</u> | <u>2012</u> |
|-----------------|-------------------|-------------------|
| Processing fees | \$ 243,750 | \$ 205,374 |
| Other income | 190,949 | 211,672 |
| | <u> </u> | <u> </u> |
| | <u>\$ 434,699</u> | <u>\$ 417,046</u> |

Other operating expenses included in noninterest expense included the following for the years ended December 31:

| | <u>2013</u> | <u>2012</u> |
|-------------------------|---------------------|---------------------|
| Software licensing fees | \$ 451,887 | \$ 383,415 |
| Advertising | 385,639 | 383,002 |
| Investor fees | 341,620 | 271,345 |
| Credit reports | 202,399 | 199,511 |
| Data processing | 221,756 | 197,351 |
| Telephone | 206,088 | 186,887 |
| Legal | 90,650 | 90,600 |
| Other expenses | 1,645,075 | 1,562,060 |
| | <u> </u> | <u> </u> |
| | <u>\$ 3,545,114</u> | <u>\$ 3,274,171</u> |

OREGON BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 20 - Subsequent Event

Subsequent to year-end, the Company announced a \$0.10 cash dividend to all shareholders of record on December 31, 2013, and payable on January 15, 2014.

SUPPLEMENTARY SCHEDULES

OREGON BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF INCOME
YEAR ENDED DECEMBER 31, 2013

| | Willamette Valley Bank | Oregon Bancorp, Inc. | Eliminations | Consolidated Total |
|---|---------------------------|-------------------------|-----------------|-----------------------|
| INTEREST INCOME | | | | |
| Interest and fees on loans | \$ 5,153,144 | \$ - | \$ - | \$ 5,153,144 |
| Interest on due from banks | 34,549 | - | - | 34,549 |
| Interest on investment securities | 26,910 | - | - | 26,910 |
| Total interest income | 5,214,603 | - | - | 5,214,603 |
| INTEREST EXPENSE | | | | |
| Demand deposits | 5,263 | - | - | 5,263 |
| Savings and money market | 82,808 | - | - | 82,808 |
| Time certificates of deposit | 526,966 | - | - | 526,966 |
| Borrowings | 491 | 35,842 | - | 36,333 |
| Total interest expense | 615,528 | 35,842 | - | 651,370 |
| Net interest income (loss) before provision for loan losses | 4,599,075 | (35,842) | - | 4,563,233 |
| PROVISION FOR LOAN LOSSES | | | | |
| Net interest income (loss) after provision for loan losses | 4,599,075 | (35,842) | - | 4,563,233 |
| NONINTEREST INCOME | | | | |
| Mortgage banking revenue, net | 11,765,142 | - | - | 11,765,142 |
| Brokered loan fees | 538,176 | - | - | 538,176 |
| Service charge income | 46,973 | - | - | 46,973 |
| Increase in cash surrender value of life insurance | 70,120 | - | - | 70,120 |
| Other income | 449,843 | - | (15,144) | 434,699 |
| Total noninterest income | 12,870,254 | - | (15,144) | 12,855,110 |
| NONINTEREST EXPENSE | | | | |
| Salaries | 8,870,610 | - | - | 8,870,610 |
| Employee benefits | 2,331,235 | - | - | 2,331,235 |
| Occupancy expenses | 1,046,784 | - | - | 1,046,784 |
| Write-down and losses on other real estate owned, net | 243,924 | - | - | 243,924 |
| Regulatory assessment | 176,791 | - | - | 176,791 |
| Depreciation and amortization expense | 224,648 | - | - | 224,648 |
| Other operating expenses | 3,417,780 | 142,478 | (15,144) | 3,545,114 |
| Total noninterest expense | 16,311,772 | 142,478 | (15,144) | 16,439,106 |
| Income (loss) before provision for income taxes (benefit) | 1,157,557 | (178,320) | - | 979,237 |
| PROVISION FOR INCOME TAXES (BENEFIT) | 500,301 | (109,625) | - | 390,676 |
| NET INCOME (LOSS) | \$ 657,256 | \$ (68,695) | \$ - | \$ 588,561 |