OREGON

Bancorp

Annual Report 2011

Neil D Grossnicklaus
President and Chief Executive Officer

Ed Martin
Chairman of the Board

To Our Shareholders:

Against the backdrop of a still struggling economy, 2011 results for Oregon Bancorp have shown marked improvement. In our primary subsidiary, Willamette Valley Bank, profitability is up 65% year-over-year anchored in improving commercial loan quality and a solid increase in non-interest income. National political uncertainty coupled with a protracted slump in the local real estate market has left small businesses hesitant to expand their operations or make substantial economic commitments. This translates into overall lower commercial loan demand leading our company to emphasize additional income to bolster our core net interest earnings.

To that end the bank added new residential mortgage division Home Loan Centers in Hillsboro and Lake Oswego, Oregon and Everett and Vancouver, Washington. New production from additional loan originators and the implementation of capital markets activities increased gross revenues in the division to $6 million and provided over $400,000 to net income. The bank originated $148.5 million in new loans to help over 750 Northwest families purchase or refinance their homes. The historic low interest environment has continued to support the refinance business but a slowly improving homebuyers market has increased home purchase volume to nearly 60% of total originations.

Financial results for our company in 2011 have improved based on changes in our strategy and target market rather than the beneficial effect of a stronger economy. As net interest margins remain under pressure from the effects of the Federal Reserve Bank's low interest rate policy, the bank has placed considerable effort into cost containment and fee income generation until such time as commercial loan growth returns. Recent reductions in non-earning assets and OREO holdings are expected to continue which, in time, will translate into lower non-interest expense and increased net interest income. While total assets declined during the year, net income totaled $718,000 which is our second-best in the company's history and compares well to the stronger economy of five years ago. Our Tier 1 capital ratio of 13.44% places in the top five banks in Oregon and provides capacity for future growth.

Provisions to the loan loss reserve for the year equaled $145,000 bringing the total reserve to $1.7 million. The loan-loss allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectable based on our analysis of the loan portfolio. We are pleased to report that net loan recoveries exceeded net loan charge-offs during 2011 and we expect that trend to continue.

The bank has embarked on a segmented business development program targeting recession resistant industries. Our branch system continues to build on our relationship-based structure and emphasis on local banking. In the rapidly changing banking industry our tried and true message is still being well-received. The evolving real estate loan industry is leading us to new markets and an increasing market share. We continue to look for growth opportunities in this time of rapid change and wish to thank you for your ongoing support.

Neil D. Grossnicklaus　　　　　　　　Ed Martin

Certain statements in this letter may constitute forward-looking statements within the definition of the "safe-harbor" provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are based on reasonable assumptions by the Bank's management within its current knowledge of the Bank's business and operations. These forward-looking statements are subject to significant risks and uncertainties which could cause actual results to differ materially from those set forth in such statements. Readers are cautioned not to place undue reliance on forward-looking statements.

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MOSS ADAMS LLP
Certified Public Accountants | Business Consultants

REPORT OF INDEPENDENT AUDITORS

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

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Oregon Bancorp, Inc. and Subsidiaries as of December 31, 2011 and 2010, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Everett, Washington
February 27, 2012

ASSETS

	December 31, 2011	December 31, 2010
ASSETS		
Cash and due from banks	$ 9,781,233	$ 35,434,159
Investment securities available-for-sale	1,514,567	2,927,364
Loans held-for-sale	20,191,987	9,270,988
Loans, net of allowance for loan losses and unearned loan fees	77,217,189	84,234,644
Premises and equipment, net	3,074,326	3,207,888
Accrued interest receivable	387,783	400,367
Federal Home Loan Bank stock, at cost	535,900	496,100
Other real estate owned, net	5,740,796	5,099,951
Cash surrender value of life insurance, net	1,434,665	1,368,840
Deferred tax asset	1,019,492	807,886
Prepaid expenses	516,985	724,045
Other assets	174,385	39,855
Total assets	$ 121,589,308	$ 144,012,087

LIABILITIES AND SHAREHOLDERS' EQUITY

	2011	2010
LIABILITIES		
Noninterest-bearing demand deposits	$ 10,699,334	$ 26,889,506
Interest-bearing demand deposits and money market accounts	38,305,764	39,433,928
Time certificates of deposit	53,104,114	61,191,129
Total deposits	102,109,212	127,514,563
Borrowings	2,000,000	-
Accounts payable and accrued expenses	1,441,480	968,173
Accrued interest payable	74,296	141,600
Total liabilities	105,624,988	128,624,336
COMMITMENTS AND CONTINGENCIES (Note 12)		
SHAREHOLDERS' EQUITY		
Preferred stock, no par value, 2,000,000 shares authorized, 3,216 Series A and 161 Series B shares issued and outstanding as of December 31, 2011 and 2010	3,302,543	3,270,343
Common stock, no par value - 10,000,000 shares authorized, 920,443 and 900,718 shares issued and outstanding as of December 31, 2011 and 2010, respectively	10,336,315	10,336,315
Additional paid-in capital	423,060	384,715
Retained earnings	1,916,480	1,405,467
Accumulated other comprehensive loss	(14,078)	(9,089)
Total shareholders' equity	15,964,320	15,387,751
Total liabilities and shareholders' equity	$ 121,589,308	$ 144,012,087

See accompanying notes.

OREGON BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31, 2011	2010
INTEREST INCOME		
Interest and fees on loans	$ 5,753,604	$ 6,558,626
Interest on due from banks	48,205	46,251
Interest on investment securities	37,249	41,061
Total interest income	5,839,058	6,645,938
INTEREST EXPENSE		
Demand deposits	10,885	9,558
Savings and money market	219,004	346,069
Time certificates of deposit	847,491	1,325,672
Borrowings	1,547	3,992
Total interest expense	1,078,927	1,685,291
Net interest income before provision for loan losses	4,760,131	4,960,647
PROVISION FOR LOAN LOSSES	145,000	530,589
Net interest income after provision for loan losses	4,615,131	4,430,058
NONINTEREST INCOME		
Gain on sale of loans	4,191,962	3,347,056
Brokered loan fees	265,660	324,756
Service charge income	48,333	58,742
Increase in cash surrender value of life insurance	65,825	62,020
Other income	1,585,228	810,822
Total noninterest income	6,157,008	4,603,396
NONINTEREST EXPENSE		
Salaries	4,789,927	4,254,859
Employee benefits	1,273,458	1,078,465
Occupancy expenses	717,457	621,982
Write-down on other real estate owned, net	472,085	448,258
Regulatory assessment	226,878	304,001
Depreciation and amortization expense	205,479	205,964
Legal	172,226	177,483
Telephone	148,066	137,620
Data processing	152,897	131,662
Loss on sale of fixed assets	6,693	21,034
Other operating expenses	1,409,032	971,651
Total noninterest expense	9,574,198	8,352,979
INCOME BEFORE PROVISION FOR INCOME TAXES	1,197,941	680,475
Provision for income taxes	479,438	244,918
NET INCOME	718,503	435,557
Deemed dividend on preferred stock	32,200	32,200
Preferred stock cash dividends	175,290	175,290
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$ 511,013	$ 228,067
EARNINGS PER SHARE OF COMMON STOCK		
Basic	$ 0.56	$ 0.25
Diluted	$ 0.56	$ 0.25
Weighted-average number of common shares outstanding		
Basic	909,827	900,718
Diluted	911,166	900,875

See accompanying notes.

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

	Preferred Stock		Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity	Comprehensive Income
	Number of Shares	Stated Amount	Number of Shares	Stated Amount					
BALANCE, December 31, 2009	3,377	$ 3,238,143	900,718	$ 10,336,315	$ 368,312	$ 1,177,400	$ 7,112	$ 15,127,282	
Deemed dividend on preferred stock	-	32,200	-	-	-	(32,200)	-	-	
Preferred stock cash dividends	-	-	-	-	-	(175,290)	-	(175,290)	
Stock-based compensation	-	-	-	-	16,403	-	-	16,403	
Net income	-	-	-	-	-	435,557	-	435,557	$ 435,557
Other comprehensive loss Net unrealized losses arising during the period, net of tax	-	-	-	-	-	-	(16,201)	(16,201)	(16,201)
Comprehensive income									$ 419,356
BALANCE, December 31, 2010	3,377	3,270,343	900,718	10,336,315	384,715	1,405,467	(9,089)	15,387,751	
Deemed dividend on preferred stock	-	32,200	-	-	-	(32,200)	-	-	
Preferred stock cash dividends	-	-	-	-	-	(175,290)	-	(175,290)	
Stock-based compensation	-	-	-	-	38,345	-	-	38,345	
Issuance of restricted stock	-	-	19,725	-	-	-	-	-	
Net income	-	-	-	-	-	718,503	-	718,503	$ 718,503
Other comprehensive loss Net unrealized losses arising during the period, net of tax	-	-	-	-	-	-	(4,989)	(4,989)	(4,989)
Comprehensive income									$ 713,514
BALANCE, December 31, 2011	3,377	$ 3,302,543	920,443	$ 10,336,315	$ 423,060	$ 1,916,480	$ (14,078)	$ 15,964,320	

See accompanying notes.

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

	Years Ended December 31, 2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 718,503	$ 435,557
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	145,000	530,589
Depreciation and amortization	205,479	205,964
Accretion on investment securities	24,510	12,273
Deferred tax benefits	(208,497)	(72,845)
Gain on sale of loans	(4,191,962)	(3,347,056)
Loss on sale of assets	6,693	21,034
Gain on sale of OREO	(266,179)	(59,893)
Write-down of OREO	472,085	448,258
Stock-based compensation	38,345	16,403
Increase (decrease) in cash due to changes in certain assets and liabilities		
Origination of loans held-for-sale	(138,608,276)	(162,639,553)
Proceeds from loans held-for-sale	131,879,239	158,346,751
Accrued interest receivable	12,584	39,247
Prepaid expenses	207,060	256,418
Cash surrender value of life insurance	(65,825)	(62,020)
Other assets	(134,530)	(1,731)
Accounts payable and accrued expenses	473,307	502,230
Accrued interest payable	(67,304)	(75,462)
Net cash from operating activities	(9,359,768)	(5,443,836)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale and maturity of securities available-for-sale	1,380,189	1,567,923
Purchase of securities available-for-sale	-	(3,772,766)
Loan originations, net of principal collections	4,621,797	6,902,633
Purchase of premises and equipment	(78,610)	(153,108)
Purchase of FHLB stock	(39,800)	(32,100)
Proceeds from sale of other real estate owned	1,403,907	663,114
Net cash from investing activities	7,287,483	5,175,696
CASH FLOWS FROM FINANCING ACTIVITIES		
Net change in deposits	(25,405,351)	6,770,575
Repayments on borrowings	-	(3,000,000)
Advancement on borrowings	2,000,000	-
Dividends paid on preferred stock	(175,290)	(175,290)
Net cash from financing activities	(23,580,641)	3,595,285
Net (decrease) increase in cash and due from banks	(25,652,926)	3,327,145
CASH AND DUE FROM BANKS, beginning of year	35,434,159	32,107,014
CASH AND DUE FROM BANKS, end of year	$ 9,781,233	$ 35,434,159
SUPPLEMENTAL DISCLOSURES		
Cash paid during the year for		
Income taxes	$ 627,000	$ 260,000
Interest	$ 1,146,231	$ 1,760,753
SUPPLEMENTAL DISCLOSURES OF NONCASH ITEMS		
Deemed dividend on preferred stock	$ 32,200	$ 32,200
Unrealized loss on available-for-sale	$ 22,853	$ 14,755
Transfer of loans to other real estate owned	$ 2,250,658	$ 4,221,320

See accompanying notes.

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 or Bancorp), 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 Bancorp 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 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 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 Company 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 95% of the Bank's loan portfolio is secured by real estate. Over the last few years, there has been deterioration in the residential development market that has led to an increase in nonperforming loans and the allowance for loan losses (Note 4). 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 27, 2012, the date the consolidated financial statements were issued.

Cash and due from banks - For purposes of reporting cash flows, cash and cash equivalents 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.

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 Company had no held-to-maturity or trading securities at December 31, 2011 and 2010. Investment securities are categorized as held-to-maturity when the Company 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 (loss).

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

Federal Home Loan Bank (FHLB) stock - At December 31, 2011 and 2010, the Company held Seattle FHLB stock with a par value of $535,900 and $496,100, 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. In 2009, the Seattle FHLB announced that it would report a risk-based capital deficiency under the regulations of the Federal Housing Finance Agency (the FHFA), its primary regulator. As a result, the Seattle FHLB has stopped paying a dividend and stated that it would suspend the repurchase and redemption of outstanding common stock until its retained earnings deficiency was reclaimed.

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

The stock in the FHLB of Seattle is classified as restricted stock and is evaluated for impairment in accordance with FASB Accounting Standards Codification (ASC) 942-325-35, *Federal Home Loan Bank and Federal Reserve Stock*. The determination of whether the investment is impaired is based on the Company'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 with the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of the legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB, and (4) the liquidity position of the FHLB. Management reviews for impairment based on the ultimate recoverability of the cost basis in FHLB stock and has concluded that the FHLB stock investment is not impaired as of December 31, 2011.

Loans held-for-sale - Beginning in November 2011, the Company adopted ASC 825-10-25, *Fair Value Option*, related to the fair value option to all mortgage loans held-for-sale. Concurrent with the adoption of ASC 825-10-25, the Company applies ASC 820-10, *Fair Value Measurements and Disclosures*. 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 Company. 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.

In 2010 and through November 2011, loans originated and intended for sale in the secondary market were carried at the lower of individual loan cost or fair value. Net unrealized losses, if any, were recorded as a valuation allowance and charged to earnings. Gains and losses on sales of loans were recognized at settlement dates and are determined by the difference between sales proceeds and the carrying value of the loans.

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 locked 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 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 locked 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.

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

Loans, net of allowances for loan losses and unearned loan fees - 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.

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.

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. Accrual of interest is discontinued on impaired loans when management believes, after considering economic and business conditions, collection efforts, and collateral position, that the borrower's financial condition is such that collection of all amounts due is doubtful.

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

From time to time, concessions are granted to borrowers that are considered troubled debt restructuring (Note 4).

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

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.

Foreclosed assets - 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.

Income taxes - 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, 2011 or 2010. The Company files consolidated U.S. federal and Oregon income tax returns, which are subject to examination by the taxing authorities for years 2008 and later.

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.

Advertising - Advertising costs, which are principally included in operating expenses, are expensed as incurred. Advertising expense was $100,140 and $38,470 for the years ended December 31, 2011 and 2010, respectively.

Earnings per share of common stock - Basic earnings per share of common stock is 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 is 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 38,453 and 81,334 shares considered antidilutive at December 31, 2011 and 2010, that were excluded from the calculation of earnings per common share.

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

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.

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 straight-line 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.

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. This reserve for unfunded loan commitments is included in the consolidated balance sheets under the caption "accounts payable and accrued expenses."

Comprehensive income (loss) - Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the shareholders' equity section of the balance sheet, such items, along with net income, are components of comprehensive income. The reclassifications out of comprehensive income (loss) in 2011 and 2010 were not material.

Reclassifications - Certain reclassifications have been made to the 2010 consolidated financial statements to conform with current-year presentations. These reclassifications did not affect previously reported net income or shareholders' equity.

Note 2 - Investment Securities

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2011				
Agency-backed, mortgage-backed				
GNMA	$ 537,420	$ 26,682	$ -	$ 564,102
Corporate bonds	1,000,000	-	(49,535)	950,465
	$ 1,537,420	$ 26,682	$ (49,535)	$ 1,514,567
December 31, 2010				
Agency-backed collateralized agency securities				
FHLB	$ 1,000,000	$ 221	$ (9,574)	$ 990,647
FNMA	249,963	1,300	-	251,263
Agency-backed, mortgage-backed				
GNMA	692,156	-	(817)	691,339
Corporate bonds	1,000,000	-	(5,885)	994,115
	$ 2,942,119	$ 1,521	$ (16,276)	$ 2,927,364

The following table presents the gross unrealized losses and fair value of the Bank's investment securities aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31:

	Less Than 12 Months		12 Months or More		Totals	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2011						
Corporate bonds	$ 950,465	$ (49,535)	$ -	$ -	$ 950,465	$ (49,535)
December 31, 2010						
Agency-backed collateralized agency securities						
FHLB	$ 990,647	$ (9,574)	$ -	$ -	$ 990,647	$ (9,574)
Agency-backed, mortgage-backed						
GNMA	691,339	(817)	-	-	691,339	(817)
Corporate bonds	994,115	(5,885)	-	-	994,115	(5,885)
	$ 2,676,101	$ (16,276)	$ -	$ -	$ 2,676,101	$ (16,276)

There were two and five securities with unrealized losses at December 31, 2011 and 2010, respectively. Management believes that, while actual fluctuations in unrealized losses will occur over the life of an investment security, the temporary impairment on the investment securities in an unrealized loss position at December 31, 2011, will be incrementally relieved as the individual investment securities approach their contractual maturity date. The unrealized losses relate principally to the general change in interest rates and illiquidity, and not credit quality, that has occurred since the security purchase date, and such unrecognized losses or gains will continue to vary with general interest rate level fluctuations in the future. As management does not intend to sell the security, and it is likely that it will not be required to sell the security before its anticipated recovery, no declines are deemed to be other-than-temporary.

Note 2 - Investment Securities (continued)

The amortized cost and estimated fair value of investment securities available-for-sale at December 31, 2011, 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	$ 351,321	$ 370,460
Due after one year through five years	1,186,099	1,144,107
	$ 1,537,420	$ 1,514,567

Note 3 - Loans

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

	2011	2010
Residential	$ 18,099,895	$ 17,849,698
Commercial real estate		
Farmland	1,590,643	1,812,943
Multifamily	2,381,563	4,594,361
Nonresidential (owner occupied)	20,034,892	19,014,773
Nonresidential (non-owner occupied)	24,129,551	25,068,691
Total commercial real estate	48,136,649	50,490,768
Construction		
Residential 1-4 family	216,535	1,124,095
Land development	7,562,163	9,062,255
Other	744,500	2,265,700
Total construction	8,523,198	12,452,050
Commercial	3,847,071	4,682,779
Consumer	451,510	427,153
Total loans	79,058,323	85,902,448
Less allowance for loan losses	(1,738,611)	(1,559,000)
Less unearned loan fees	(102,523)	(108,804)
Loans, net of allowance for loan losses and losses and unearned loan fees	$ 77,217,189	$ 84,234,644

Note 3 - Loans (continued)

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

At December 31, 2011 and 2010, loans of $26,242,388 and $32,320,930, respectively, were pledged to support Federal Home Loan Bank borrowings, and loans as of December 31, 2011 and 2010, of $20,899,161 and $21,655,083, respectively, were pledged at Federal Reserve Bank of San Francisco for additional borrowing capacity.

Note 4 - Allowance for Loan Losses

The Company 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 the following key elements:

1. General valuation allowance consistent with the Contingencies topic of the FASB ASC.

2. Classified loan loss reserves on specific relationships. Specific allowances for identified problem loans are determined in accordance with the Receivables topic of the FASB ASC.

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 Company'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 Company'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 Company 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.

Note 4 - Allowance for Loan Losses (continued)

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.

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

December 31, 2011	Residential	Commercial Real Estate	Construction	Commercial	Consumer	Total
Allowance						
Balance, beginning of the period	$ 346,000	$ 890,000	$ 174,000	$ 146,000	$ 3,000	$ 1,559,000
Charge-offs	(32,477)	-	-	-	(13,112)	(45,589)
Recoveries	-	-	-	80,200	-	80,200
Provision for loan losses	227,000	(50,000)	21,000	(68,000)	15,000	145,000
Balance, end of the period	$ 540,523	$ 840,000	$ 195,000	$ 158,200	$ 4,888	$ 1,738,611
Ending balance individually evaluated for impairment	$ -	$ 61,518	$ -	$ -	$ -	$ 61,518
Ending balance collectively evaluated for impairment	$ 540,523	$ 778,482	$ 195,000	$ 158,200	$ 4,888	$ 1,677,093
Loans						
Ending balance	$ 18,099,895	$ 48,136,649	$ 8,523,198	$ 3,847,071	$ 451,510	$ 79,058,323
Ending balance individually evaluated for impairment	$ 2,576,288	$ 2,148,412	$ 199,761	$ 176,532	$ -	$ 5,100,993
Ending balance collectively evaluated for impairment	$ 15,523,607	$ 45,988,237	$ 8,323,437	$ 3,670,539	$ 451,510	$ 73,957,330
December 31, 2010						
Allowance						
Balance, beginning of the period	$ 325,000	$ 1,053,000	$ 321,000	$ 56,000	$ 6,000	$ 1,761,000
Charge-offs	(44,417)	(485,844)	(60,266)	(202,847)	-	(793,374)
Recoveries	-	39,742	-	21,043	-	60,785
Provision for loan losses	65,417	283,102	(86,734)	271,804	(3,000)	530,589
Balance, end of the period	$ 346,000	$ 890,000	$ 174,000	$ 146,000	$ 3,000	$ 1,559,000
Ending balance individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance collectively evaluated for impairment	$ 346,000	$ 890,000	$ 174,000	$ 146,000	$ 3,000	$ 1,559,000
Loans						
Ending balance	$ 17,849,698	$ 50,490,768	$ 12,452,050	$ 4,682,779	$ 427,153	$ 85,902,448
Ending balance individually evaluated for impairment	$ 1,145,460	$ 208,996	$ 485,255	$ 258,488	$ -	$ 2,098,199
Ending balance collectively evaluated for impairment	$ 16,704,238	$ 50,281,772	$ 11,966,795	$ 4,424,291	$ 427,153	$ 83,804,249

Note 4 - Allowance for Loan Losses (continued)

When the Company classifies problem assets as either substandard or doubtful, pursuant to federal regulations, the Company 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 FDIC, which can require the establishment of additional loss allowances.

Loan grades are used by the Company to identify and track potential problem loans that do not rise to the levels described for substandard, doubtful, or loss. The grades for watch and 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 criticized (special mention) or classified (substandard, doubtful, or loss) are subject to problem loan reporting every three months. There were no loans classified as watch, doubtful, or loss at December 31, 2011 and 2010.

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

	Residential		Commercial Real Estate		Construction	
	2011	2010	2011	2010	2011	2010
Grade						
Pass	$ 14,058,326	$ 16,704,238	$ 45,099,792	$ 50,281,772	$ 8,157,705	$ 11,966,795
Substandard	4,041,569	1,145,460	3,036,857	208,996	365,493	485,255
Total	$ 18,099,895	$ 17,849,698	$ 48,136,649	$ 50,490,768	$ 8,523,198	$ 12,452,050

	Commercial		Consumer		Total Loans	
	2011	2010	2011	2010	2011	2010
Grade						
Pass	$ 3,552,976	$ 4,424,291	$ 451,510	$ 427,153	$ 71,320,309	$ 83,804,249
Substandard	294,095	258,488	-	-	7,738,014	2,098,199
Total	$ 3,847,071	$ 4,682,779	$ 451,510	$ 427,153	$ 79,058,323	$ 85,902,448

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.

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.

Note 4 - Allowance for Loan Losses (continued)

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:

December 31, 2011	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
Residential	$ 164,585	$ -	$ -	$ 164,585	$ 17,935,310	$ 18,099,895	$ -
Commercial real estate	-	-	1,266,510	1,266,510	46,870,139	48,136,649	-
Construction	-	-	-	-	8,523,199	8,523,198	-
Commercial	232,333	-	176,532	408,865	3,438,206	3,847,071	176,532
Consumer	-	-	-	-	451,510	451,510	-
	$ 396,918	$ -	$ 1,443,042	$ 1,839,960	$ 77,218,364	$ 79,058,323	$ 176,532
December 31, 2010							
Residential	$ 276,220	$ 280,553	$ 708,307	$ 1,265,080	$ 16,584,618	$ 17,849,698	$ -
Commercial real estate	1,302,509	758,678	208,996	2,270,183	48,220,585	50,490,768	-
Construction	-	-	485,255	485,255	11,966,795	12,452,050	-
Commercial	559,121	-	258,488	817,609	3,865,170	4,682,779	258,488
Consumer	12,466	2,337	-	14,803	412,350	427,153	-
	$ 2,150,316	$ 1,041,568	$ 1,661,046	$ 4,852,930	$ 81,049,518	$ 85,902,448	$ 258,488

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

December 31, 2011	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Annual Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Residential	$ 1,078,819	$ 1,125,154	$ -	$ 1,158,810	$ 16,184
Construction	199,761	199,761	-	234,345	6,866
Commercial real estate	2,148,412	2,179,854	-	2,113,131	63,417
Commercial	176,532	176,532	-	208,356	15,580
Consumer	-	-	-	781	-
With allowance recorded					
Residential	$ 1,497,469	$ 1,497,469	$ 61,518	$ 374,367	$ 12,508
Total					
Residential	$ 2,576,288	$ 2,622,623	$ 61,518	$ 1,533,177	$ 28,692
Construction	199,761	199,761	-	234,345	6,866
Commercial real estate	2,148,412	2,179,854	-	2,113,131	63,417
Commercial	176,532	176,532	-	208,356	15,580
Consumer	-	-	-	781	-

Note 4 - Allowance for Loan Losses (continued)

December 31, 2010	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Annual Recorded Investment	Interest Income Recognized
With no related allowance recorded					
Residential	$ 1,145,460	$ 1,154,810	$ -	$ 1,147,870	$ 4,778
Construction	485,255	485,255	-	487,627	-
Commercial real estate	208,996	208,996	-	211,612	-
Commercial	258,488	258,488	-	271,079	29,845
Total					
Residential	$ 1,145,460	$ 1,154,810	$ -	$ 1,147,870	$ 4,778
Construction	485,255	485,255	-	487,627	-
Commercial real estate	208,996	208,996	-	211,612	-
Commercial	258,488	258,488	-	271,079	29,845

The following table shows the recorded investment balance of loans on nonaccrual status as of December 31:

	2011	2010
Residential	$ 1,078,819	$ 708,307
Commercial real estate	2,148,412	208,996
Construction	-	485,255
	$ 3,227,231	$ 1,402,558

The amount of interest income forgone as a result of these loans being placed on nonaccrual status totaled $101,146 and $47,067 for the years ended December 31, 2011 and 2010, respectively.

Loans classified as troubled debt restructurings totaled $3,537,412 and $0 at December 31, 2011 and 2010, 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 Company has granted a variety of concessions to borrowers in the form of loan modifications. The modifications granted can generally be described in the following categories:

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

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

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

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

Note 4 - Allowance for Loan Losses (continued)

Upon identifying those receivables as troubled debt restructurings, the Company 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.

The following table presents newly restructured loans by class that occurred during the year ended December 31, 2011, by type of concession granted:

	Number of Contracts	Rate Modification	Term Modification	Payment Modification	Combination Modification	Total Modifications
Pre-modification outstanding recorded investment						
Residential	16	$ 693,356	$ 280,553	$ -	$ 1,513,682	$ 2,487,591
Construction	1	-	-	-	251,711	251,711
Commercial real estate	2	-	-	-	917,224	917,224
	19	$ 693,356	$ 280,553	$ -	$ 2,682,617	$ 3,656,526
Post-modification outstanding recorded investment						
Residential	16	$ 693,356	$ 280,553	$ -	$ 1,513,682	$ 2,487,591
Construction	1	-	-	-	201,711	201,711
Commercial real estate	2	-	-	-	917,224	917,224
	19	$ 693,356	$ 280,553	$ -	$ 2,632,617	$ 3,606,526

There were no loans restructured during 2011 that subsequently defaulted.

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

Note 5 - Derivatives

The Bank is engaged principally 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 locked loan commitment until the loans are sold (typically 30 to 90 days).

The following is a summary of the interest rate locked loan commitments and open forward commitments at December 31, 2011:

	Notional Amount	Fair Value
Interest rate locked loan commitments	$ 4,185,766	$ 106,796
Forward sales of mortgage-backed securities commitments	$ 6,500,000	$ 35,520

The notional amount of the derivatives does 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.

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. Interest rate locked commitments with a fair value of $106,796 at December 31, 2011, are included in other assets, in the consolidated balance sheet. Forward sales of mortgage-backed securities commitments represented a liability with a fair value of $35,520 at December 31, 2011, which is included in accounts payable and accrued expenses on the consolidated balance sheet.

Note 6 - Premises and Equipment

Depreciation and amortization expense amounted to $205,479 and $205,964 for the years ended December 31, 2011 and 2010, respectively.

	2011	2010
Land	$ 975,881	$ 975,881
Furniture and equipment	1,176,605	1,133,936
Buildings	1,035,937	1,035,937
Leasehold improvements	908,342	908,342
Software	42,105	42,105
	4,138,870	4,096,201
Less accumulated depreciation and amortization	(1,064,544)	(888,313)
Premises and equipment, net of accumulated depreciation	$ 3,074,326	$ 3,207,888

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 other real estate owned and other repossessed assets as of December 31:

	2011	2010
Beginning balance	$ 5,099,951	$ 1,930,110
Loans transferred to other real estate owned	3,117,317	4,221,320
Sales	(2,004,387)	(603,221)
Write-downs	(472,085)	(448,258)
Ending balance	$ 5,740,796	$ 5,099,951

Note 8 - Time Certificates of Deposits

Time certificates of deposit of $100,000 or more aggregated to $14,141,441 and $19,783,807 at December 31, 2011 and 2010, respectively.

The scheduled contractual maturities of certificates of deposit at December 31, 2011, are as follows:

2012	$ 29,658,636
2013	10,208,002
2014	3,928,387
2015	5,986,032
2016	3,123,057
Thereafter	200,000
	$ 53,104,114

Time deposits included brokered deposits of $11,753,661 and $8,419,983 at December 31, 2011 and 2010, respectively.

Note 9 - Borrowings

Federal Home Loan Bank advances - The Bank, as a member of the Federal Home Loan Bank (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 had a cash management advance (CMA) to the FHLB of Seattle in the amount of $2,000,000 at December 31, 2011, with a maturity of December 7, 2012. Maximum borrowings available from the FHLB for notes payable, lines of credit, and the CMA program totaled $16,145,080 at December 31, 2011. Available borrowings and their respective terms are subject to eligible collateral being pledged and are reduced by outstanding letters of credit. At December 31, 2010, there were no outstanding letters of credit at the FHLB.

Correspondent bank lines of credit - The Bank has a federal funds line-of-credit agreement with Pacific Coast Bankers' Bank. The maximum borrowing available under this agreement is $3,750,000, subject to certain collateral requirements. At December 31, 2011 and 2010, there were no outstanding balances owed. The line-of-credit agreement expires on June 30, 2012.

Federal Reserve borrowings - The Bank has established a line of credit under the discount window program. As of December 31, 2011 and 2010, there were no outstanding borrowings under this program and the available borrowing limit was $12,087,014 and $12,082,560, respectively. The Bank has pledged certain loans to collateralize these borrowings (Note 3).

Note 10 - Income Taxes

The provision for income taxes consisted of the following:

	2011	2010
Income tax expense (benefit)		
Current		
Federal	$ 551,022	$ 249,696
State	136,914	68,067
Deferred		
Federal	(185,724)	(62,668)
State	(22,774)	(10,177)
	$ 479,438	$ 244,918

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

	2011	2010
Federal tax at statutory rates	$ 407,300	$ 231,363
State income taxes, net of federal effect	58,024	33,407
Increase in cash surrender value	(25,813)	(24,320)
Permanent difference	9,669	8,728
Other	30,258	(4,260)
	$ 479,438	$ 244,918

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

	2011	2010
Assets		
Allowance for loan losses	$ 546,020	$ 491,930
Other real estate owned	602,269	438,471
Deferred compensation	143,206	129,248
Nonaccrual interest	-	18,457
Unrealized loss on securities	8,775	5,666
Other	18,183	8,466
Total deferred tax assets	1,318,453	1,092,238
Liabilities		
Depreciation	(226,404)	(238,613)
Prepaid expenses	(41,667)	(42,350)
Other	(30,890)	(3,389)
Total deferred tax liabilities	(298,961)	(284,352)
Net deferred tax assets	$ 1,019,492	$ 807,886

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 percent. At management's discretion, the Bank can make a matching contribution. For the years ended December 31, 2011 and 2010, the Bank contributed $50,350 and $67,479, 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.

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

	2011	2010
Commitments to extend credit	$ 4,259,210	$ 5,066,864
Standby letters of credit	190,177	175,177
	$ 4,449,387	$ 5,242,041

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 is being recognized as a "deemed dividend" over a period of five years. At the end of five years, the combined value of both series of preferred stock will be $3,377,000, the redemption price of the preferred stock, plus any unpaid dividends. Should the Company redeem the preferred stock prior to the fifth anniversary, the redemption price remains $3,377,000, plus any unpaid dividends.

The preferred stock carries no voting rights and may be redeemed in whole or in part, at any time and from time to time, at the option of the Company. All redemptions shall be subject to the approval of the FDIC, and all Series A preferred stock must be redeemed prior to redeeming Series B preferred stock. If the Company has not redeemed all preferred stock by the tenth anniversary of the issuance, all common stock dividends and repurchases of common stock will be prohibited until all preferred stock has been redeemed or transferred to a third party.

Dividends are cumulative and are paid on a quarterly basis. Series A dividends are at the rate of 5.00% per annum until the fifth anniversary, when the rate increases to 9.00%. Series B dividends are paid at 9.00% per annum.

Note 14 - Stock Incentive Plan

During 2011, the Bank formed a new stock incentive plan, 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 replaced the 2001 Stock Incentive Plan, which expired ten years after issuance. 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 105,270 options and restricted stock shares available for grant at December 31, 2011.

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.

Note 14 - Stock Incentive Plan (continued)

The following schedule reflects the weighted-average assumptions included in this model as it relates to the valuation of options granted for the years ended December 31.

	2011	2010
Expected dividends	0.00%	0.00%
Expected term (years)	5	5
Expected volatility	37.18%	40.00%
Risk-free rate	1.93%	3.31%

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, 2010	84,334	$ 10.83	
Options granted	2,500	7.00	
Options exercised	-	-	
Options forfeited	(45,381)	9.67	
Options outstanding, December 31, 2011	41,453	$ 11.53	3.89
Options exercisable, December 31, 2011	41,453	$ 11.53	3.89

The weighted-average grant-date fair value of options granted was $2.49 and $3.26 for the years ended December 31, 2011 and 2010, respectively. As of December 31, 2011, there was $10,856 of unrecognized compensation expense related to nonvested stock options, which is expected to be recognized over a period of approximately four years. There were no tax benefits realized in 2011 and 2010.

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 2011 and the shares are issued and outstanding; however, they are subject to service requirements before restrictions are lifted. A summary of restricted stock activity is presented below:

	Restricted Stock	Weighted-Average Grant-Date Fair Value
Restricted stock at December 31, 2010	$ -	$ -
Stock granted	19,725	8.50
Stock vested	-	
Restricted stock at December 31, 2011	$ 19,725	$ 8.50

As of December 31, 2011, there was $127,802 of unrecognized compensation expense related to nonvested 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 2011 through 2016, 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 at December 31:

2012	$ 167,413
2013	132,463
2014	92,053
2015	93,973
2016	71,584
Thereafter	-
	$ 557,486

Rental expense under all operating leases was $519,660 and $433,986 for 2011 and 2010, respectively.

Note 16 - Regulatory Matters

The Bank and Bancorp 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 Bancorp. 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, 2011, the Bank and Bancorp met all capital adequacy requirements to which they are subject.

At December 31, 2011, according to the most recent notifications from its regulatory agencies, the Bank and Bancorp was 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 Bancorp 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 Bancorp.

Note 16 - Regulatory Matters (continued)

The Bank and Bancorp's actual and required capital amounts and ratios are as follows (dollars in thousands):

	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, 2011						
Total capital to risk-weighted assets						
Oregon Bancorp, Inc.	$ 17,190	17.62%	$ 7,805	≥8%	N/A	N/A
Willamette Valley Bank	$ 17,127	17.57%	$ 7,800	≥8%	$ 9,750	≥10%
Tier 1 capital to risk-weighted assets						
Oregon Bancorp, Inc.	$ 15,964	16.36%	$ 3,902	≥4%	N/A	N/A
Willamette Valley Bank	$ 15,901	16.31%	$ 3,900	≥4%	$ 5,850	≥6%
Tier 1 capital to average assets						
Oregon Bancorp, Inc.	$ 15,964	13.49%	$ 4,733	≥4%	N/A	N/A
Willamette Valley Bank	$ 15,901	13.44%	$ 4,733	≥4%	$ 5,196	≥5%
As of December 31, 2010						
Total capital to risk-weighted assets						
Oregon Bancorp, Inc.	$ 16,628	16.82%	$ 7,936	≥8%	N/A	N/A
Willamette Valley Bank	$ 16,595	16.81%	$ 7,898	≥8%	$ 9,872	≥10%
Tier 1 capital to risk-weighted assets						
Oregon Bancorp, Inc.	$ 15,388	15.56%	$ 3,968	≥4%	N/A	N/A
Willamette Valley Bank	$ 15,354	15.55%	$ 3,949	≥4%	$ 5,923	≥6%
Tier 1 capital to average assets						
Oregon Bancorp, Inc.	$ 15,388	10.99%	$ 5,600	≥4%	N/A	N/A
Willamette Valley Bank	$ 15,354	10.97%	$ 5,600	≥4%	$ 6,999	≥5%

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.

Note 17 - Fair Value of Financial Instruments (continued)

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 measured at fair value on a recurring basis - Assets are considered to be fair valued on a recurring basis if fair value is measured regularly (i.e., daily, weekly, monthly, or quarterly) 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.

Loans held-for-sale - Loans held-for-sale are valued at the market value as determined by outstanding commitments from investors or current investor yield requirements calculated on the aggregate loan basis. In the absence of a commitment, the best source of fair value is a current estimated market price as reflected in the Company's hedge reporting model that is provided by a reputable third party. In assessing the value of the uncommitted loans, it must be noted that open forward commitments or obligations to sell loans are a component of the loan value at any given date. These are typically classified as Level 1.

Interest rate lock commitments - The Bank considers its commitments to extend secondary market qualifying loans (the pipeline) with interest rate lock commitments to be derivatives. These derivatives are recognized at their estimated fair values as reflected in the Company's hedge reporting model that is provided by a reputable third party based on market prices for similar assets. These are typically classified as Level 2.

Forward sale commitments - The Bank considers its futures contracts and its positions taken in put options to be derivatives, which are recognized at their estimated fair value as reflected in the Company's hedge reporting model that is provided by a reputable third party based on market prices for similar assets. These are typically classified as Level 2.

Note 17 - Fair Value of Financial Instruments (continued)

The following table presents information about the Bank's assets measured at fair value on a recurring 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 12/31/2011	Level 1	Level 2	Level 3
Recurring items				
Agency-backed, mortgage-backed				
GNMA	$ 564,102	$ -	$ 564,102	$ -
Corporate bonds	950,465	-	950,465	-
Loans held-for-sale	20,191,987	20,191,987	-	-
Interest rate lock commitments	106,796	-	106,796	-
Forward sale commitments	35,520	-	35,520	-
Total assets measured at fair value	$ 21,848,870	$ 20,191,987	$ 1,656,883	$ -

	Fair Value Measurements			
	Fair Value 12/31/2010	Level 1	Level 2	Level 3
Recurring items				
Agency-backed collateralized agency securities				
FHLB	$ 990,647	$ -	$ 990,647	$ -
FNMA	251,263	-	251,263	-
Agency-backed, mortgage-backed				
GNMA	691,339	-	691,339	-
Corporate bonds	994,115	-	994,115	-
Total assets measured at fair value	$ 2,927,364	$ -	$ 2,927,364	$ -

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.

Note 17 - Fair Value of Financial Instruments (continued)

Other real estate owned - Other real estate owned assets are measured and recorded at the lower of cost basis or fair value on a nonrecurring basis. The other real estate owned 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				Total Period Losses
	Fair Value 12/31/2011	Level 1	Level 2	Level 3	Included in Earnings
Nonrecurring items					
Impaired loans, net of specific reserves	$ 5,039,475	$ -	$ -	$ 5,039,475	$ 34,610
Other real estate owned	5,740,796	-	-	5,740,796	208,982
Total assets measured at fair value	$ 10,780,271	$ -	$ -	$ 10,780,271	$ 243,592

	Fair Value Measurements				Total Period Losses
	Fair Value 12/31/2010	Level 1	Level 2	Level 3	Included in Earnings
Nonrecurring items					
Impaired loans, net of specific reserves	$ 2,098,199	$ -	$ -	$ 2,098,199	$ -
Other real estate owned	5,099,951	-	-	5,099,951	448,248
Total assets measured at fair value	$ 7,198,150	$ -	$ -	$ 7,198,150	$ 448,248

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

	2011		2010	
	Carrying Amounts	Estimated Fair Value	Carrying Amounts	Estimated Fair Value
Financial assets				
Cash and due from banks	$ 9,781,233	$ 9,781,233	$ 35,434,159	$ 35,434,159
Available-for-sale investment securities	1,514,567	1,514,567	2,927,364	2,927,364
Federal Home Loan Bank stock, at cost	535,900	535,900	496,100	496,100
Loans held-for-sale	20,191,987	20,191,987	9,152,482	9,152,482
Loans, net of allowance for loan losses	77,217,189	78,351,302	84,234,644	86,034,864
Interest rate lock commitments	106,796	106,796	-	-
Accrued interest receivable	387,783	387,783	400,367	400,367
Financial liabilities				
Noninterest-bearing demand deposits	$ 10,699,334	$ 10,699,334	$ 26,889,506	$ 26,889,506
Interest-bearing demand and money market	38,305,764	37,077,997	39,433,928	37,332,228
Time certificates of deposit	53,104,114	53,747,201	61,191,129	60,364,783
Borrowings	2,000,000	2,000,000	-	-
Forward commitments	35,520	35,520	-	-
Accrued interest payable	100,893	100,893	141,600	141,600

Note 17 - Fair Value of Financial Instruments (continued)

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

Federal Home Loan Bank 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 CDs 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 Federal Home Loan Bank 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 at December 31, 2011 and 2010, 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 at December 31, 2011 and 2010, 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.

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:

	2011	2010
Balance, beginning of year	$ 2,463,122	$ 4,256,791
Additional	213,153	224,630
Repayments	(1,089,363)	(2,018,299)
Balance, end of year	$ 1,586,912	$ 2,463,122

At December 31, 2011 and 2010, deposits held for related parties were $4,873,006 and $3,850,474, respectively.