2014 ANNUAL REPORT



POSITIONED *for* GROWTH

COMMENCEMENT BANK
A local bank. A world of possibilities.

In 2014, Commencement Bank continued to exhibit system-wide signs of strength and stability providing us the opportunity to expand in exciting, new directions.

Cover: 21st Street Bridge by Mike Lane Studios (mikelanestudios.com)

Dear Shareholders, Customers, and Friends,

Two-thousand fourteen witnessed a number of events, accomplishments, and milestones, each differentiating us from peers and competitors.

Total loans reached record highs, non-interest bearing deposits ended the year at 17% of total deposits, the Bank's Texas ratio (problem loans to capital) is one of the lowest in Washington State, cost of funds (interest expense to total deposits) decreased to 0.53%, and our first expansion took place via a loan production office in Enumclaw, Washington.

Additionally, Commencement Bank was identified as the 84th Healthiest Bank in America and received top honors from Bauer Financial Services with a 5-star rating. Considering that there are over 6,500 banks in America, I am very proud of what we have accomplished in such a short period of time.

Our first expansion last year was very gratifying. We are now a proud business partner in Enumclaw, Washington and look forward to delivering a style of banking this wonderful community has been asking for.

Expansion is not always in the form of adding buildings. We have been methodically and strategically adding staff to help us grow. Kirk Parce and Sue Androsko paved the way into Enumclaw as new Commencement Bank employees and long-time residents of that community. And we are in various stages of discussion with other experienced bankers entrenched in like markets in the Puget Sound area.

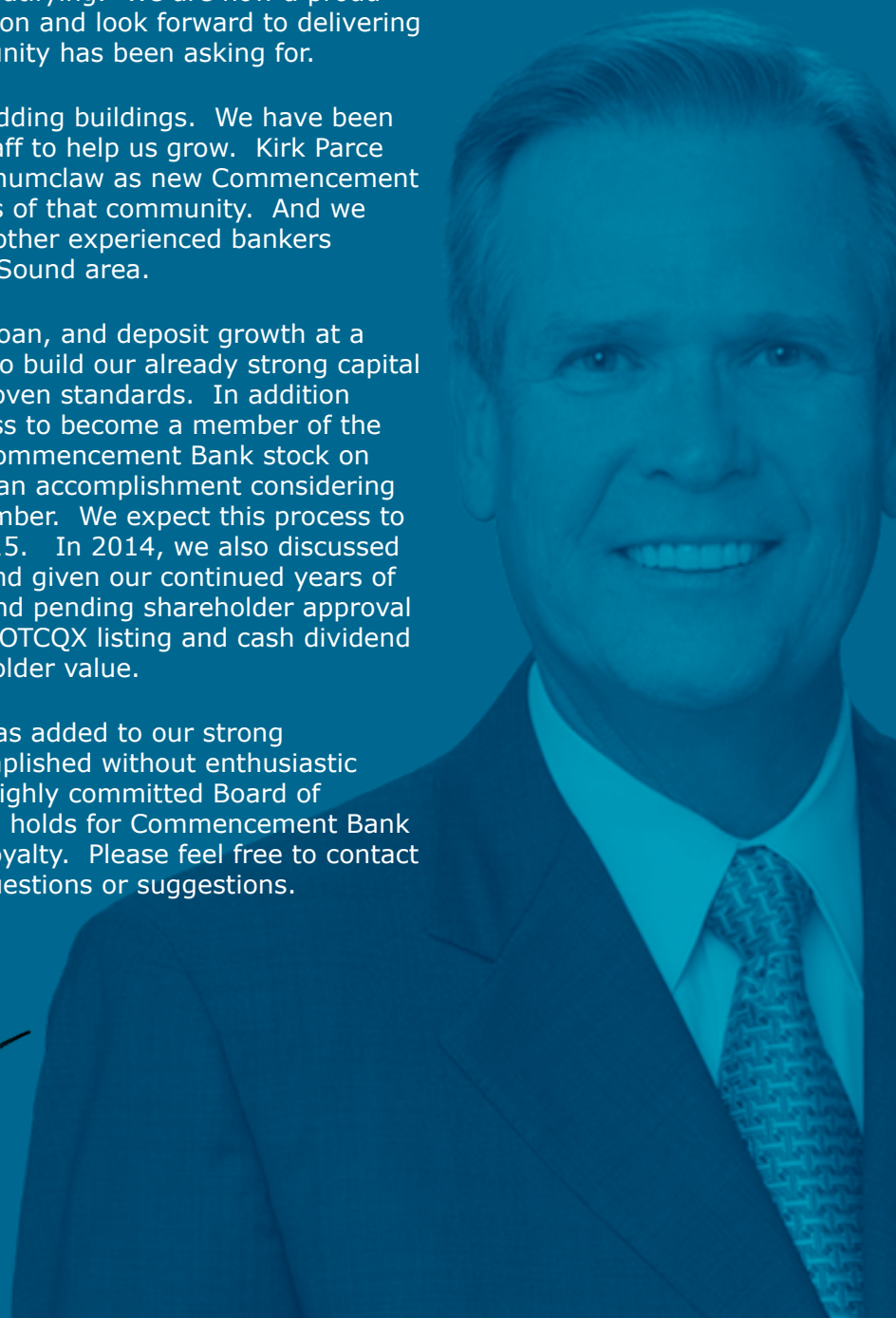
Two-thousand fourteen also saw asset, loan, and deposit growth at a controlled pace allowing us to continue to build our already strong capital base without having to sacrifice time-proven standards. In addition to financial growth, we began the process to become a member of the OTCQX Banks stock exchange. Listing Commencement Bank stock on this over-the-counter exchange is quite an accomplishment considering the standards required to become a member. We expect this process to be final within the second quarter of 2015. In 2014, we also discussed the possibility of a one-time cash dividend given our continued years of profitability. We plan to issue this dividend pending shareholder approval at our Annual Meeting and see both the OTCQX listing and cash dividend initiative as a means to increase shareholder value.

Although each topic I have mentioned has added to our strong reputation, none could have been accomplished without enthusiastic employees and prudent oversight by a highly committed Board of Directors. I am excited about what 2015 holds for Commencement Bank and appreciate all of your support and loyalty. Please feel free to contact me directly should you ever have any questions or suggestions.

Sincerely,



H. R. Russell
President/Chief Executive Officer



Seizing Opportunities

Veteran lending team launches Enumclaw LPO



Cobber's Pet Pantry

"Since I started working with Kirk, he fills in all the blanks for me. I would recommend him to anyone who needs a local, honest business banker."

Tamie Waugh | *Cobber's Pet Pantry*



DP West

"As a local business, I value working with a community bank that understands my needs. Kirk Parce is not just my banker, he is my business partner."

Jennifer Kohler | *DP West, Inc.*

Strategic expansion involves not just the right location, but the right people.

The opening of a Loan Production Office (LPO) in Enumclaw marked the beginning of a new phase for Commencement Bank. With a solid financial base established, the Bank is now actively pursuing strategic opportunities for expansion.

Enumclaw stood out for several reasons: the small town feel and welcoming atmosphere, its lack of true community banking options, and the availability of a trusted, local lender in Kirk Parce who has been in the industry and lived in Enumclaw for over 25 years.

"We've always planned to expand, but our model is to find the right banker and build the branch around them. When we found Kirk Parce, we knew the timing was right," said Hal Russell, Commencement Bank's President and CEO. The Enumclaw office also benefits from the addition of Sue Androsko, a Loan Support Specialist with over 20 years of experience in that market.

Standing Tall

Eight full years after opening, Commencement Bank stands apart as a true leader.

Banking Leadership

Since Commencement Bank started in 2006, economic factors, both nationally and locally, forced most banks to modify their management oversight. Commencement Bank stayed true to its original growth objectives resulting in your Bank being one of four remaining Pierce County-headquartered banks. During that time, your Bank continued to grow strategically while becoming stronger and meeting the needs of its client base. But, this isn't a story of mere survival. In 2014, Commencement Bank saw a steady stream of accolades flowing its way, all telling the same story of financial health, strength, and stability.

Small Business Leadership

University of Washington Tacoma's Milgard School of Business selected Commencement Bank CEO, Hal Russell, as the 2014 Small Business Leader of the Year for his strong leadership within the organization, for encouraging and facilitating growth in his company and the industry, and actively serving in the community. Chairman of the Board, Tom Valentine agrees. "Hal has done an exceptional job navigating this company."



5 Star Rating

Bauer Financial

Commencement Bank is proud to be recognized as one of the strongest financial institutions in the country.



Top 200 Banks

Deposit Accounts

Commencement Bank is ranked 84th out of 6,500 financial institutions in America by DepositAccounts.com.



Best of 2014

Showcase Magazine

Commencement Bank was the only Tacoma-based bank selected for Showcase Magazine's Best of 2014 Awards.

Building Together

As local businesses gain momentum, they continue to choose the bank that invests in its customers and community.

Local Businesses

Business owners like the idea of working with Commencement Bank because of their commitment to support the local economy. In 2014, Commencement Bank's commitment to local businesses went well beyond providing excellent lending and deposit services. The Bank championed twelve Featured Businesses, one local business for each month of the year, including businesses like Gray Lumber.

In the economic downturn of '08, Gray Lumber felt the effects, as we all did, but their resolve didn't falter, nor did their commitment to give back 10% of their profits to the community. Like many local businesses, their excellence, optimism, and commitment saw them through the hard times. It sounds old fashioned, but Commencement Bank is proud to serve institutions like Gray Lumber, believing that together we are building prosperity for all by doing the right thing.



Lunch & Learn

In 2014, Commencement Bank invested in the business community by hosting quarterly, complimentary luncheons for customers and non-customers alike, featuring relevant topics and training from business experts.

Serving Together



Oso Mudslide

When last March's tragic mudslide buried much of Oso, WA, our employees coordinated donations to provide struggling families with the financial assistance needed to rebuild.



Wildfire Relief

Washington's 2014 wildfires were six-times more destructive than the average. Last summer, we coordinated fundraising for the Wildfire Relief Fund which gives assistance to families affected by the fires.

As a community, we stand together, give together, and serve together.

The bank donated to charity last year, but what we're most proud of is our people. In 2014, you could find Commencement Bank employees volunteering in every corner of our community, in at least 35 different organizations right here in Tacoma and spread across Pierce and King counties.

Our employees gave of their time, getting their hands dirty, and also gave of their expertise while serving on boards. Commencement Bank employees also coordinated efforts to respond to crises here and in neighboring communities.

Senior Management



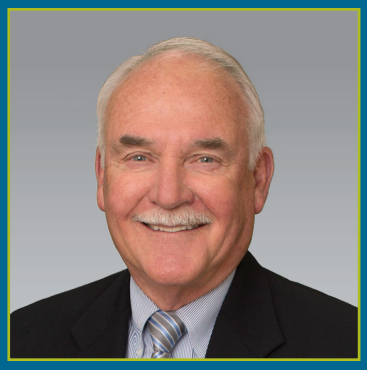
Hal Russell
President/Chief
Executive Officer

Jennifer Nino
EVP/Chief
Financial Officer

Mary Ann Haglund
EVP/Chief
Operations Officer

John Manolides
EVP/Chief
Credit Officer

Board of Directors



Tom
VALENTINE
Chairman



Hal
RUSSELL



Tom
NIXON
Vice-Chairman



Rose
LINCOLN HAMILTON



James
WALTON



Dan
MCFARLAND



Ed
ZITTEL



Charles
DIESING



Pete
LEMCKE



John
JAMES

Financial Statements 2014

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FORTNER, BAYENS, LEVKULICH
■
& GARRISON, P.C.

Independent Auditors' Report

Board of Directors
Commencement Bank
Tacoma, Washington

Report on the Financial Statements

We have audited the accompanying financial statements of Commencement Bank, which are comprised of the balance sheets as of December 31, 2014 and 2013, and the related statements of comprehensive income, shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Commencement Bank as of December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Fortner, Bayens, Levkulich & Garrison, P.C.

Denver, Colorado
March 30, 2015

1580 Lincoln Street • Suite 700 • Denver, CO 80203
303/296-6033 • FAX 303/296-8553
Certified Public Accountants • A Professional Corporation

Balance Sheets

(Dollars in Thousands)

Commencement Bank
December 31, 2014 and 2013

	2014	2013
Assets		
Cash and due from banks	$ 3,795	$ 4,458
Interest-bearing deposits in other financial institutions	22,007	27,328
Cash and cash equivalents	**25,802**	**31,786**
Federal Funds Sold	-	10
Securities available for sale	2,929	4,622
Federal Home Loan Bank stock, at cost	284	296
Federal Reserve Bank stock, at cost	631	602
Loans	133,410	128,124
Allowance for credit losses	(1,851)	(1,732)
Net loans	**131,559**	**126,392**
Premises and equipment, net	698	800
Other real estate owned	642	700
Cash surrender value of life insurance	4,217	4,076
Accrued interest receivable	327	348
Other assets	565	1,005
Total assets	**$167,654**	**$170,637**
Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Demand, noninterest-bearing	$ 24,394	$ 20,660
Savings and interest-bearing demand	65,183	79,766
Time	53,060	46,298
Total deposits	**142,637**	**146,724**
FHLB Borrowings	3,200	3,200
Accrued interest payable	23	29
Other liabilities	273	130
Total liabilities	**146,133**	**150,083**
Commitments and Contingencies (Note 9)	**- -**	**- -**
Shareholders' Equity		
Common stock (par value: $1); authorized 10,000,000 shares; 2,219,500 shares issued and outstanding in 2014 and 2013	2,219	2,219
Additional paid in capital	20,911	20,893
Accumulated deficit	(1,631)	(2,551)
Accumulated other comprehensive income (loss)	22	(7)
Total shareholders' equity	**21,521**	**20,554**
Total liabilities and shareholders' equity	**$167,654**	**$170,637**

See notes to financial statements.

Statements of Comprehensive Income

(Dollars in Thousands)

Commencement Bank
For the Years Ended December 31, 2014 and 2013

	2014	2013
Interest and Dividend Income		
Loans	$6,564	$5,920
Interest-bearing deposits in other financial institutions	45	26
Securities available for sale	66	44
Dividends on Federal Reserve Bank Stock	37	35
Total interest income	**6,712**	**6,025**
Interest Expense		
Deposits	726	661
Long-term borrowings	28	32
Total interest expense	**754**	**693**
Net interest income	**5,958**	**5,332**
Provision for Credit Losses	45	15
Net interest income after provision for credit losses	**5,913**	**5,317**
Noninterest Income		
Service charges on deposit accounts	175	154
Loss on other real estate owned	(5)	(287)
Gain on sale of available for sale security	8	- -
Other	237	143
Total noninterest income	**415**	**10**
Noninterest Expense		
Salaries and employee benefits	2,973	2,440
Occupancy	352	338
Furniture and equipment	103	113
Data processing	342	325
Marketing and development	109	125
Other	1,129	1,135
Total noninterest expense	**5,008**	**4,476**
Net Income Before Income Taxes	**1,320**	**851**
Income Tax Expense (Benefit)	400	(602)
Net Income	**920**	**1,453**
Other Comprehensive Income		
Unrealized gains (losses) on available for sale securities	$51	$(52)
Reclassification adjustment for gain realized in net income	(8)	- -
Tax effect	(14)	3
Total other comprehensive income (loss)	**29**	**(49)**
Total Comprehensive Income	**$949**	**$1,404**

See notes to financial statements.

Statements of Shareholders' Equity

(Dollars in Thousands, Except Share Information)

Commencement Bank
For the Years Ended December 31, 2014 and 2013

	Shares of Common Stock	Common Stock	Additional Paid in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (loss)	Total
Balance at December 31, 2012	**2,219,500**	**$2,219**	**$20,875**	**($4,004)**	**$42**	**$19,132**
Net income	- -	- -	- -	1,453	- -	1,453
Other comprehensive loss	- -	- -	- -	- -	(49)	(49)
Stock-based compensation expense	- -	- -	18	- -	- -	18
Balance at December 31, 2013	**2,219,500**	**2,219**	**20,893**	**(2,551)**	**(7)**	**20,554**
Net income	- -	- -	- -	920	- -	920
Other comprehensive income	- -	- -	- -	- -	29	29
Stock-based compensation expense	- -	- -	18	- -	- -	18
Balance at December 31, 2014	**2,219,500**	**$2,219**	**$20,911**	**($1,631)**	**$22**	**$21,521**

See notes to financial statements.

Statements of Cash Flows

(Dollars in Thousands)

Commencement Bank
For the Years Ended December 31, 2014 and 2013

	2014	2013
Cash Flows from Operating Activities		
Net Income	$920	$1,453
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	45	15
Loan recoveries	224	91
Depreciation and amortization	166	165
Stock-based compensation expense	18	18
Net amortization of premium on securities available for sale	45	128
Gain on sale of available for sale investment securities	(8)	- -
Deferral of loan origination costs and fees, less amortization	38	55
Increase in cash surrender value of life insurance	(141)	(72)
Loss on sale of other real estate owned	- -	238
Write-down of other real estate owned	5	49
Deferred federal income tax	415	(593)
Decrease in accrued interest receivable	21	35
Decrease in accrued interest payable	(6)	(30)
Other	182	(301)
Net cash provided by operating activities	**1,924**	**1,251**
Cash Flows from Investing Activities		
Activity in securities available for sale:		
Maturities, prepayments and calls	703	2,834
Sales	995	- -
Purchases	- -	(1,979)
(Increase) decrease in federal funds sold	10	(10)
Purchase of Federal Home Loan Bank and Federal Reserve Bank stock	(28)	(65)
Sale of Federal Home Loan Bank and Federal Reserve Bank stock	11	11
Increase in loans made to customers, net of principal collections	(5,474)	(19,349)
Proceeds from sale of other real estate owned	53	3,962
Purchases of premises, equipment and software	(91)	(23)
Net cash used in investing activities	**(3,821)**	**(14,619)**
Cash Flows from Financing Activities		
Net increase (decrease) in deposits	(4,087)	22,684
Proceeds from issuance of long-term debt	- -	3,200
Repayments of long-term debt	- -	(2,000)
Net cash provided by (used in) financing activities	**(4,087)**	**23,884**
Net change in cash and cash equivalents	**(5,984)**	**10,516**
Cash and Cash Equivalents		
Beginning of period	31,786	21,270
End of period	**$25,802**	**$31,786**
Supplemental Disclosure of Cash Flow Information		
Interest paid	$760	$723
Supplemental Disclosure of Non-Cash Investing Activities		
Foreclosed real estate acquired in settlement of loans	- -	$1,045

See notes to financial statements.

Commencement Bank
December 31, 2014 and 2013

Note 1 - Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Commencement Bank (the Bank), opened December 11, 2006, and operates one branch in Tacoma, Washington and one loan production office in Enumclaw, Washington. The Bank provides loan and deposit services to customers, who are predominately individuals and small and midsized businesses in western Washington.

Financial Statement Presentation

Preparation of financial statements in conformity with accounting principles generally accepted in the United States of America and practices within the banking industry requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, as of the date of the balance sheet, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for credit losses and the valuation of deferred tax assets. All dollar amounts are stated in thousands.

Subsequent Events

Management evaluates events occurring subsequent to the balance sheet date, through the date the financial statements are eligible to be issued, to determine whether the events require recognition or disclosure in the financial statements. If a subsequent event evidences conditions existing at the balance sheet date, the effects are recognized in the financial statements (recognized subsequent event). If a subsequent event evidences conditions arising after the balance sheet date, the effects are not recognized in the financial statements but rather disclosed in the notes to the financial statements (non-recognized subsequent events). The effects of subsequent events are only recognized if material, or disclosed if the financial statements would otherwise be misleading.

With respect to the December 31, 2014 financial statements, Management has considered subsequent events though March 30, 2015, which is the date the financial statements were available to be issued.

Securities Available for Sale

Securities available for sale consist of debt securities that the Bank intends to hold for an indefinite period but not necessarily to maturity. Such securities may be sold to implement the Bank's asset and liability management strategies and in response to changes in interest rates and similar factors. Securities available for sale are reported at fair value. Unrealized gains and losses, net of the related deferred tax effect, are reported as a net amount in a separate component of shareholders' equity entitled "accumulated other comprehensive income." Realized gains and losses on securities available for sale, determined using the specific-identification method, are included in earnings. Amortization of premiums and accretion of discounts are recognized in interest income over the period to maturity. For mortgage-backed securities, actual maturity may differ from contractual maturity due to principal payments and amortization of premiums and accretion of discounts may vary due to prepayment speed assumptions.

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

Securities Available for Sale (continued)

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as an impairment charge to earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which is recognized as an impairment charge to earnings, and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Federal Home Loan Bank of Seattle Stock

The Bank, as a member of the Federal Home Loan Bank of Seattle (FHLB), is required to maintain an investment in capital stock of the FHLB in an amount equal to the greater of 1 percent of its outstanding home loans or 4.5 percent of advances from the FHLB. The recorded amount of the FHLB stock equals its fair value because the shares can be redeemed only by the FHLB at the $100 per share par value**.** The Bank views its investment in the FHLB stock as a long-term investment. Accordingly, when evaluating for impairment, the value is determined based on the ultimate recovery of the par value rather than recognizing temporary declines in value. The determination of whether a decline affects the ultimate recovery is influenced by criteria such as: 1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount and length of time a decline has persisted; 2) impact of legislative and regulatory changes on the FHLB and 3) the liquidity position of the FHLB.

Federal Reserve Bank of San Francisco Stock

The Bank, as a member of the Federal Reserve Bank of San Francisco (FRB), is required to subscribe to Federal Reserve Stock in an amount equivalent to 6 percent of its capital and surplus. Although the par value of the stock is $100 per share, banks pay only $50 per share at the time of purchase, with the understanding that the other half of the subscription amount is subject to call at any time. The recorded amount of the FRB stock equals its fair value because the shares can be redeemed only by the FRB at the par value**.**

Loans Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balances and adjusted for any charge-offs, the allowance for credit losses, any deferred fees or costs on originated loans, and unamortized premiums or discounts on purchased loans. Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income.

Because some loans may not be repaid in full, an allowance for credit losses is recorded. An allowance for credit losses is a valuation allowance for probable incurred credit losses. The allowance for credit losses is increased by a provision for credit losses charged to expense and decreased by charge-offs (net of recoveries). The allowance is based on ongoing, quarterly assessments of the probable and estimable losses inherent in the loan portfolio. The Bank's methodology for assessing the appropriateness of the allowance consists of several key elements, which include the formula allowance and specific allowances.

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

Loans Receivable (continued)

Troubled debt restructurings are loans for which concessions in terms have been made as a result of the borrower experiencing financial difficulty. Generally, concessions granted to customers include lower interest rates and modification of the payment stream to lower or defer payments. Interest on troubled debt restructurings is accrued under the new terms if the loans are performing and full collection of principal and interest is expected. However, interest accruals are discontinued on troubled debt restructurings that meet the Bank's nonaccrual criteria.

Interest income on loans is accrued over the term of the loans based upon the principal outstanding. The accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. Past due status is based on contractual terms of loans. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent that cash payments are received until, in management's judgment, the borrower has the ability to make contractual interest and principal payments, in which case the loan is returned to accrual status.

Generally, loans are charged off in whole or in part on a loan-by-loan basis after they become significantly past due and based upon management's review of the collectability of all or a portion of the loan unless the loan is in the process of restructuring. Charge off amounts are determined based upon the carrying amount of loans and the amount estimated to be collectible as determined by analyses of expected future cash flows and liquidation of loan collateral.

Allowance for Credit Losses

The allowance for credit losses is a valuation allowance for probable incurred credit losses and is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for credit losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. Impaired loans are all specifically identified loans for which it is probable that the Bank will not collect all amounts due according to the contractual terms of the loan agreement. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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

Allowance for Credit Losses (continued)

The formula portion of the general credit loss allowance is established by applying a loss percentage factor to the different loan types. The allowances are provided based on management's continuing evaluation of the pertinent factors underlying the quality of the loan portfolio, including changes in the size and composition of the loan portfolio, actual loan loss experience, current economic conditions, geographic concentrations, seasoning of the loan portfolio, specific industry conditions, and the duration of the current business cycle. The recovery of the carrying value of loans is susceptible to future market conditions beyond the Bank's control, which may result in losses or recoveries differing from those provided. Specific allowances are established for loans evaluated for impairment in accordance with guidance which requires an allowance to be established as a component of the allowance for credit losses when it is probable all amounts due will not be collected pursuant to the contractual terms of the loan and the recorded investment in the loan exceeds its fair value. Fair value is measured using either the present value of expected future cash flows discounted at the loan's effective interest rate, the observable market price of the loan, or the fair value of the collateral, if the loan is collateral dependent. All loans subject to evaluation and considered impaired are included in nonperforming assets. Smaller balances are excluded from this analysis.

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

Large groups of smaller balance homogenous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures.

The general component relates to non-impaired loans, and is based on historical loss experience adjusted for the effects of qualitative factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio's historical loss experience. Qualitative factors include the following: Economic conditions; industry conditions; changes in lending policies and procedures; trends in the volume and terms of loans; the experience, ability and depth of lending staff; levels and trends in delinquencies; levels and trends in charge-off and recovery activity; levels and trends of loan quality as determined by an internal loan grading system; portfolio concentrations.

On a quarterly basis, management estimates the allowance balance required using the criteria identified above in relation to the relevant risks for each of the Bank's major loan segments. For construction, land and land development loans, major risk factors include demand levels for residential and commercial development, and real estate prices. For mortgage loans secured by residential real estate, major risk factors include unemployment levels and real estate prices. For mortgage loans secured by commercial real estate, major risk factors include demand levels for products and services, rental rates and real estate prices. For commercial and industrial loans, major risk factors include demand for products and services, and operating cash flows. For consumer and other loans, the major risk factor is unemployment levels.

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

Allowance for Credit Losses (continued)

The quality of the Bank's loan portfolio is assessed as a function of the levels of past due loans and impaired loans, and internal credit quality ratings which are updated quarterly by management. The ratings on the Bank's internal credit scale are broadly grouped into the categories "non-classified" and "classified." Non-classified loans are those loans with minimal identified credit risk, as well as loans with potential credit weaknesses which deserve management's attention but for which full collection of contractual principal and interest is not significantly at risk. Classified loans are those loans that have well-defined weakness that put full collection of contractual principal and interest at risk, and classified loans for which it is probable that the Bank will not collect all contractual principal or interest are also considered impaired. The credit quality ratings are an important part of the Bank's overall credit risk management process and are considered in the determination of the allowance for credit losses.

Determination of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance. Such agencies may require the Bank to recognize additional losses based on their judgments about information available to them at the time of their examination.

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation, which is computed on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the term of the lease or the estimated useful life of the improvement, whichever is less. Asset lives range from three to ten years. Gains or losses on dispositions are reflected in earnings.

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.

Bank Owned Life Insurance

The Bank has purchased single premium life insurance policies for certain officers. The value of the policies is recorded at the amount that would be received if the policies were surrendered. Increases or decreases in the cash value of the policies are recognized as income or expense in the period of change. The Bank entered into a Split Dollar Life insurance agreement with certain officers and key employees on these policies.

Deferred Rent and Lease Incentives

Rental payments under operating leases for the Bank are charged to expense on the straight-line basis, after consideration of rent holidays, step-rent provisions and escalation clauses.

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

Income Taxes

Deferred tax assets and liabilities result from differences between the financial statement carrying amounts and the tax bases of assets and liabilities, and are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. The deferred tax provision represents the difference between the net deferred tax asset and liability at the beginning and end of the year. Deferred tax assets are reduced by a valuation allowance, when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with the presumption that a tax examination will occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely to be realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Bank is no longer subject to examination by taxing authorities for years before 2011.

Cash Equivalents and Cash Flows

The Bank considers all amounts included in the balance sheet caption "Cash and due from banks," interest-bearing deposits in other financial institutions and federal funds sold to be cash equivalents. Cash flows from loans, deposits and short-term borrowings are reported net. At times, cash balances on deposit in other financial institutions exceed FDIC insurance limits; however, the Bank has not experienced any losses due to these concentrations.

Advertising

The Bank expenses advertising costs as incurred.

Stock-Based Compensation

The Bank has a stock-based compensation option plan and stock warrants, which are described more fully in Note 11. The Bank accounts for the stock option plan under the recognition and measurement principles as defined by guidance, which requires the cash flows related to the tax benefits resulting from tax deductions in excess of compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. The Bank did not have any excess tax benefits resulting from disqualifying dispositions of shares acquired upon exercise of incentive stock options for the years ended December 31, 2014 and 2013. For the years ended December 31, 2014 and 2013, the Bank recognized stock-based compensation expense of $18 and $18, respectively.

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

Stock-Based Compensation (continued)

At December 31, 2014, stock-based compensation expense related to unvested stock options granted aggregated approximately $66 and is expected to be recognized as follows:

2015	$22
2016	18
2017	14
2018	9
2019	3
Total	**$66**

Comprehensive Income

Components of comprehensive income are net income and all other non-owner changes in equity. Other comprehensive income consists of unrealized holding gains and losses on available for sale securities.

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants, excluding transaction costs. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

When measuring fair value, entities should maximize the use of observable inputs and minimize the use of unobservable inputs. The following describes the three levels of inputs that may be used to measure fair value:

- *Level 1 Inputs* - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

- *Level 2 Inputs*— Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

- *Level 3 Inputs* - Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

Commencement Bank
December 31, 2014 and 2013

Note 2 - Securities

Debt securities have been classified according to management's intent. The amortized cost of the Bank's securities and their approximate fair value are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2014				
Mortgage-backed securities	$1,900	$43	$- -	$1,943
US Treasury	997	- -	(11)	986
Total	**$2,897**	**$43**	**($11)**	**$2,929**
December 31, 2013				
Mortgage-backed securities	$2,651	$16	$- -	$2,667
US Treasury	996	- -	(22)	974
US Agency	986	- -	(5)	981
Total	**$4,633**	**$16**	**($27)**	**$4,622**

The amortized cost and estimated fair value of debt securities by contractual maturity at December 31, 2014 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	Fair Value
Due less than one year	$ - -	$ - -
Due after one year through five years	997	986
Due after five years through ten years	- -	- -
Due after ten years	- -	- -
Mortgage-backed securities	1,900	1,943
Total	**$2,897**	**$2,929**

The following tables present the gross unrealized losses and fair value of securities available for sale aggregated by the length of time the individual securities have been in a continuous unrealized loss position at December 31, 2014 and 2013:

	Less than 12 months		12 months or more	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2014				
US Treasury	$ - -	$ - -	$ 986	$ (11)
December 31, 2013				
US Treasury	$ 974	$ (22)	$ - -	$ - -
US Agency	981	(5)	- -	- -

Note 2 – Securities (continued)

The investment securities shown in the previous tables have fair values less than amortized cost and therefore contain unrealized losses. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. There are one and two investment securities with unrealized losses at December 31, 2014 and 2013, respectively. The Bank anticipates full recovery of amortized cost with respect to these securities at maturity or earlier in the event of a more favorable market interest rate environment.

There was $8 in gross gains realized on sales of securities in 2014 and none in 2013. There were no gross losses realized on sales of securities in 2014 or 2013.

The fair value of pledged securities totaled $1,943 and $2,667 at December 31, 2014 and 2013, respectively.

Note 3 – Loans and Allowance for Credit Losses

Loans at December 31 consist of the following:

	2014	2013
Commercial	$41,305	$46,889
Real estate:		
Residential 1-4 family	10,497	10,078
Multi-Family	11,915	9,448
Commercial	64,783	59,713
Construction and land	3,651	1,355
Consumer	1,521	865
	133,672	**128,348**
Less net deferred loan origination fees	262	224
Loans, net of deferred fees	**$133,410**	**$128,124**

Transactions in the allowance for credit losses for the year ended December 31, 2014 are as follows:

	Year ended December 31, 2014			
	Real Estate	Commercial	Consumer	Total
Balance at beginning of period	$ 1,179	$ 492	$ 61	$ 1,732
Provision for loan losses	(9)	162	(108)	45
Charge-offs	-	(150)	-	(150)
Recoveries	97	62	65	224
Balance at end of period	**$ 1,267**	**$ 566**	**$ 18**	**$ 1,851**

Note 3 – Loans and Allowance for Credit Losses (continued)

Transactions in the allowance for credit losses for the year ended December 31, 2013 are as follows:

	Year ended December 31, 2013			
	Real Estate	Commercial	Consumer	Total
Balance at beginning of period	$ 1,393	$ 655	$ 16	$ 2,064
Provision for loan losses	66	(197)	146	15
Charge-offs	(280)	(57)	(101)	(438)
Recoveries	-	91	-	91
Balance at end of period	**$ 1,179**	**$ 492**	**$ 61**	**$ 1,732**

Components of the allowance for credit losses, and the related carrying amount of loans for which the allowance is determined, are as follows:

	December 31, 2014			
	Real Estate	Commercial	Consumer	Total
Allocation of Allowance to:				
Impaired loans – evaluated individually	$ -	$ -	$ -	$ -
Impaired loans – evaluated collectively	-	-	-	-
Total impaired loans	-	-	-	-
Unimpaired loams – evaluated collectively	1,267	566	18	1,851
	$ 1,267	**$ 566**	**$ 18**	**$ 1,851**

	December 31, 2014			
	Real Estate	Commercial	Consumer	Total
Recorded Investment In:				
Impaired loans – evaluated individually	$ -	$ -	$ -	$ -
Impaired loans – evaluated collectively	-	-	-	-
Total impaired loans	-	-	-	-
Unimpaired loans – evaluated collectively	90,846	41,305	1,521	133,672
	$ 90,846	**$ 41,305**	**$ 1,521**	**$133,672**

Note 3 – Loans and Allowance for Credit Losses (continued)

	December 31, 2013			
	Real Estate	Commercial	Consumer	Total
Allocation of Allowance to:				
Impaired loans – evaluated individually	$ -	$ -	$ -	$ -
Impaired loans – evaluated collectively	-	-	-	-
Total impaired loans	-	-	-	-
Unimpaired loams – evaluated collectively	1,179	492	61	1,732
	$ 1,179	**$ 492**	**$ 61**	**$ 1,732**

	December 31, 2013			
	Real Estate	Commercial	Consumer	Total
Recorded Investment In:				
Impaired loans – evaluated individually	$ 218	$ 80	$ -	$ 298
Impaired loans – evaluated collectively	-	-	-	-
Total impaired loans	218	80	-	298
Unimpaired loans – evaluated collectively	80,376	46,809	865	128,050
	$ 80,594	**$ 46,889**	**$ 865**	**$128,348**

The carrying amounts of loans by performance status at December 31, 2014, are as follows:

	Accruing Loans				
	Current	30-89 Days Past Due	90 Days or More Past Due	Nonaccrual Loans	Total Loans
Real Estate	$ 90,846	$ -	$ -	$ -	$ 90,846
Commercial	40,883	-	422	-	41,305
Consumer	1,521	-	-	-	1,521
	$ 133,250	**$ -**	**$ 422**	**$ -**	**$ 133,672**

Note 3 – Loans and Allowance for Credit Losses (continued)

The carrying amounts of loans by credit quality at December 31, 2014 are as follows:

		Classified	
	Non-Classified	Unimpaired	Impaired
Real Estate	$ 90,596	$ 250	$ -
Commercial	40,841	491	-
Consumer	1,521	-	-
	$ 132,931	**$ 741**	**$ -**

The carrying amounts of loans by performance status at December 31, 2013 are as follows:

	Accruing Loans				
	Current	30-89 Days Past Due	90 Days or More Past Due	Nonaccrual Loans	Total Loans
Real Estate	$ 80,376	$ -	$ -	$ 218	$ 80,594
Commercial	46,809	-	-	80	46,889
Consumer	865	-	-	-	865
	$ 128,050	**$ -**	**$ -**	**$ 298**	**$ 128,348**

The carrying amounts of loans by credit quality at December 31, 2013 are as follows:

		Classified	
	Non-Classified	Unimpaired	Impaired
Real Estate	$ 80,376	$ -	$ 218
Commercial	46,410	399	80
Consumer	865	-	-
	$ 127,651	**$ 399**	**$ 298**

Note 3 – Loans and Allowance for Credit Losses (continued)

Information relative to impaired loans at December 31, 2014 is as follows:

	December 31, 2014						Year Ended December 31, 2014	
	Recorded Investment In Impaired Loans With No Valuation Allowance	Recorded Investment In Impaired Loans With A Valuation Allowance	Total Impaired Loans	Valuation Allowance on Impaired Loans	Contractual principal of impaired loans	Commitments to Extend Credit on Impaired Loans	Average Impaired Loans	Interest Income Recognized On Impaired Loans
Real Estate	$ -	$ -	$ -	$ -	$ -	$ -	$ 56	$ -
Commercial	-	-	-	-	-	-	58	-
Consumer	-	-	-	-	-	-	-	-
Reserve	-	-	-	-	-	-	-	-
Overdrafts	-	-	-	-	-	-	-	-
	$ -	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ 114**	$ -

Information relative to impaired loans at December 31, 2013 is as follows:

	December 31, 2013						Year Ended December 31, 2013	
	Recorded Investment In Impaired Loans With No Valuation Allowance	Recorded Investment In Impaired Loans With A Valuation Allowance	Total Impaired Loans	Valuation Allowance on Impaired Loans	Contractual principal of impaired loans	Commitments to Extend Credit on Impaired Loans	Average Impaired Loans	Interest Income Recognized On Impaired Loans
Real Estate	$ 218	$ -	$ 218	$ -	$ 568	$ -	$ 1,361	$ -
Commercial	80	-	80	-	122	-	127	-
Consumer	-	-	-	-	-	-	-	-
Reserve	-	-	-	-	-	-	-	-
Overdrafts	-	-	-	-	-	-	-	-
	$ 298	**$ -**	**$ 298**	**$ -**	**$ 690**	**$ -**	**$ 1,488**	$ -

The Bank had no troubled debt restructurings outstanding as of December 31, 2014 and 2013.

Certain related parties of the Bank, principally directors and their associates were loan customers of the Bank in the ordinary course of business during the year ended December 31, 2014 and 2013. Loans outstanding at December 31, 2014 and 2013, to key officers and directors totaled $3,489 and $6,071, respectively. During the years ended December 31, 2014 and 2013, loan advances totaled $5,930 and $8,728 and principal payments totaled $8,512 and $7,860, respectively.

Commencement Bank
December 31, 2014 and 2013

Note 4 - Premises and Equipment

Components of premises and equipment at December 31 are as follows:

	2014	2013
Leasehold improvements	$ 688	$ 687
Furniture and equipment	639	592
	$1,327	**1,279**
Less accumulated depreciation and amortization	629	479
Premises and equipment, net	**$ 698**	**$ 800**

Note 5 - Deposits

The composition of deposits at December 31 is as follows:

	2014	2013
Demand deposits, non-interest-bearing	$ 24,394	$ 20,660
NOW and money market accounts	63,981	78,863
Savings deposits	1,202	903
Time certificates over $250,000	12,303	12,938
Other time certificates	40,757	33,360
Total deposits	**$142,637**	**$146,724**

Scheduled maturities of time certificates of deposit for future years ending December 31 are as follows:

2015	$34,635
2016	12,991
2017	2,207
2018	3,152
2019	75
Total	**$53,060**

Certain related parties of the Bank, principally directors and their affiliates were deposit customers of the Bank in the ordinary course of business during year ended December 31, 2014, and 2013. Deposits from these customers at December 31, 2014 and 2013 totaled $4,949 and $4,620, respectively.

Note 6 – FHLB Borrowings

The Bank has long-term borrowings with the FHLB of Seattle with total credit on the lines equal to 20% of the Bank's total assets or $27,095, which is available dependent upon sufficient collateral and FHLB stock ownership. The Bank has borrowings of $3,200 and $3,200 as of December 31, 2014 and 2013, respectively. As of December 31, 2014 the maturity date related to these borrowings was April 2018 and they bear an interest rate of 0.88%. The Bank also has letters of credit outstanding for $3,000 and $3,000, which are used to pledge for public deposits as of December 31, 2014 and 2013, respectively.

Note 6 – FHLB Borrowings (continued)

The Bank has a blanket pledge of $81,788 in loans as collateral for these borrowings at December 31, 2014. In addition the Bank has pledged $21,982 of loans as collateral for borrowings with the Federal Reserve Bank. Available borrowings through this facility are approximately $12,250.

The Bank has agreements with commercial banks for lines of credit totaling $9,500 at December 2014 and $9,500 at December 2013, none of which was used at both December 31, 2014 and 2013.

Note 7 - Employee Benefits

The Bank has a 401(k) profit sharing plan covering substantially all employees. Contributions to the 401(k) profit sharing plan consist of matching contributions, which match 100% of the employees' contributions up to 3% and then match 50% of the following 2%. The Bank may also make profit sharing contributions which are at the discretion of its board of directors. There were $69 in contributions by the Bank to this plan for the year ended December 31, 2014 and $58 in contributions for the year ended December 31, 2013.

The Bank has also established a non-qualified Supplemental Executive Retirement Plan ("SERP") to provide its President with supplemental retirement benefits. The periodic pension expense for the supplemental plan amounted to $162 for the year ended December 31, 2014. The present value of the projected benefit obligation and the vested benefit obligation was $162 at December 31, 2014, all of which is unfunded. A discount rate of 4.8% was used in determining the actuarial projected benefit at December 31, 2014.

Note 8 - Income Taxes

Allocation of income taxes between current and deferred portions is as follows:

	2014	2013
Income Taxes		
Current benefit	$ (15)	$(9)
Deferred expense (benefit)	415	(593)
Total income taxes	**$400**	**$(602)**

Note 8 - Income Taxes (continued)

Tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities at December 31 are as follows:

	2014	2013
Deferred Tax Assets		
Allowance for credit losses	$ 303	$ 285
Stock option expense	-	25
Charitable contributions	12	42
Organizational costs	118	135
Capital loss	21	21
Operating loss carryforward	-	445
Writedowns on other real estate owned	18	17
Unrealized loss on available for sale securities	-	4
SERP expense	55	-
Total deferred tax assets	**527**	**974**
Deferred Tax Liabilities		
Cash basis accounting	33	67
Accumulated depreciation	17	21
Deferred income	94	84
Unrealized gain on available for sale securities	11	-
Total deferred tax liabilities	**155**	**172**
Net deferred tax assets before valuation allowance	**372**	**802**
Valuation Allowance	**(21)**	**(21)**
Net deferred tax assets	**$ 351**	**$ 781**

At December 31, 2013, the Bank had a net operating loss carryforward, totaling $1,308, which was entirely utilized in 2014.

Note 9 - Commitments and Contingencies

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized on the accompanying balance sheet.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit 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 Bank's commitments at December 31 is as follows:

	2014	2013
Commitments to extend credit	$41,292	$30,752

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. 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 Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the party. Collateral held varies, but may include accounts receivable, inventory, property and equipment, residential real estate and income-producing commercial properties.

Note 9 - Commitments and Contingencies (continued)

At December 31, 2014, the Bank had an allowance for credit losses on unfunded commitments of $43 carried as a component of other liabilities.

Because of the nature of its activities, the Bank is subject to various pending and threatened legal actions which may arise in the ordinary course of business. In the opinion of management, liabilities arising from these claims, if any, will not have a material effect on the financial position of the Bank. Management has not been informed of any such claims at December 31, 2014.

The Bank has entered into an employment contract with its President, Chief Financial Officer, Chief Credit Officer and Chief Operations Officer which provide for contingent payments subject to future events.

In November, 2011, the Bank executed a lease for a new facility that it occupies beginning in March, 2012. The term of the lease is for 10 years, beginning March 1, 2012, with two options to extend the lease term for five years each. Rental expense of leased premises was $269 and $236 for the years ended December 31, 2014 and 2013, respectively, which is included in occupancy expense.

Minimum net rental commitments under noncancellable leases having an original or remaining term of one year or more for future years ending December 31 are as follows:

2015	$273
2016	279
2017	286
2018	294
2019	301
Thereafter	677
Total net rental commitments required	**$2,110**

Note 10 - Significant Concentrations of Credit Risk

Most of the Bank's business activity is with customers located in the state of Washington. Loans are generally limited, by federal and state banking regulations, to 20 percent of the Bank's shareholders' equity, excluding accumulated other comprehensive income plus allowance for loan and lease losses.

Note 11 - Stock Compensation Plans

Stock Warrants

In 2006, the Bank granted organizing shareholders 148,500 warrants to purchase the Bank's common stock, at $10 per share. Warrants are vested upon grant, have a ten-year contractual life and expire in 2016. No warrants have been exercised to date. The estimated remaining life is 1.92 years.

Note 11 - Stock Compensation Plans (continued)

Employee Stock Options

Under the Bank's employee stock option plan, the Bank may grant both incentive and nonqualified options for up to 450,000 shares of its common stock to certain key employees, 90,000 of which may be granted as restricted stock. The exercise price of each option equals the fair market value of the Bank's stock on the date of grant, and an option's maximum term is eight years. Options vest ratably over five years. The Bank has 406,500 options available, of which 90,000 may be granted as restricted stock.

The fair value of each option grant is estimated on the date of grant, based on the Black-Scholes option pricing model and using the following weighted-average assumptions at December 31:

	2014	2013
Dividend yield	0.00%	0.00%
Expected life	5.5 years	5.5 years
Risk-free interest rate	1.67%	1.37%
Expected volatility	50.73%	55.57%

At the time of the stock grant there were no plans to issue a cash dividend in the near term; therefore, management assumed no dividend yield. The Bank elected to apply the simplified method prescribed by guidance to calculate the expected life of the options. The Bank utilized a five-year, risk-free yield rate for the interest rate utilized. The Bank used historical data to determine expected volatility. The weighted-average fair value of options granted during 2014 and 2013 was $5.08 and $4.78, respectively.

The Black-Scholes model used by the Bank to calculate option values and other currently accepted option valuation models was developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Bank's stock option awards. These models require highly subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values.

A summary of the status of the Bank's stock option plans and stock warrants as of December 31, 2014, along with activities during the year are presented below:

	Shares	Weighted Exercise Price	Weighted-Average Grant Date Fair Value	Aggregate Intrinsic Value	Weighted-Average Contractual Life (Years)
Outstanding at beginning of year	360,250	$9.98	$6.37	$--	2.14
Options granted	4,000	10.83	5.08		
Options forfeited	(176,750)	9.99	3.78		
Outstanding at end of year	**187,500**	**$ 9.99**	**$8.79**	**$--**	**2.41**
Vested or expected to vest at end of year	**185,686**	**$ 10.00**	**$8.84**	**$--**	**2.38**
Exercisable at end of year	**169,400**	**$10.01**	**$9.24**	**$--**	**2.02**

Note 11 - Stock Compensation Plans (continued)

Employee Stock Options (continued)

A summary of the status of the Bank's stock option plans and stock warrants as of December 31, 2013, along with activities during the year are presented below:

	Shares	Weighted Exercise Price	Weighted-Average Grant Date Fair Value	Aggregate Intrinsic Value	Weighted-Average Contractual Life (Years)
Outstanding at beginning of year	360,950	$9.89	$6.30	$--	3.09
Options granted	10,000	9.47	4.78		
Options forfeited	(10,700)	7.46	2.82		
Outstanding at end of year	**360,250**	**$ 9.98**	**$6.37**	**$--**	**2.14**
Vested or expected to vest at end of year	**358,435**	**$ 9.98**	**$6.39**	**$--**	**2.12**
Exercisable at end of year	**340,650**	**$10.02**	**$6.50**	**$--**	**1.89**

No warrants were exercised during the years ended December 31, 2014 and 2013.

Note 12 - Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory -- and possibly additional discretionary -- actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines of the regulatory framework for prompt corrective action, the Bank must meet specific capital adequacy guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items, as calculated under regulatory accounting practices. The Bank's capital classification is 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 table below) of Tier 1 capital (as defined in the regulations) to total average assets (as defined), and minimum ratios of Tier 1 and total capital (as defined) to risk-weighted assets (as defined).

As of December 31, 2014, the most recent notification from the Bank's regulator categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios, as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category.

Note 12 - Regulatory Matters (continued)

The Bank's actual capital amounts and ratios are also presented in the table.

	Actual Amount	Ratio	Capital Adequacy Purposes Amount	Ratio	To be Well-Capitalized Under Prompt Corrective Action Provisions Amount	Ratio
December 31, 2014						
Tier 1 capital (to average assets)	$21,500	12.63%	$6,807	4.00%	$8,508	5.00%
Tier 1 capital (to risk-weighted assets)	21,500	16.28	5,282	4.00	7,923	6.00
Total capital (to risk-weighted assets)	23,154	17.54	10,564	8.00	13,204	10.00
December 31, 2013						
Tier 1 capital (to average assets)	$20,251	13.50%	$6,000	4.00%	$7,500	5.00%
Tier 1 capital (to risk-weighted assets)	20,251	15.96	5,074	4.00	7,611	6.00
Total capital (to risk-weighted assets)	21,839	17.22	10,148	8.00	12,685	10.00

Note 13 – Fair Value of Financial Instruments

The following is a description of the Bank's valuation methodologies for financial assets and liabilities recorded at fair value:

Securities Available for Sale – The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1) or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2).

Collateral-Dependent Impaired Loans – The Bank does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect (1) partial write-downs that are based on the current appraised or market-quoted value of the underlying collateral or (2) the full charge-off of the loan carrying value. In some cases, the properties for which market quotes or appraised values have been obtained are located in areas where comparable sales data is limited, outdated, or unavailable. Fair value estimates for collateral-dependent impaired loans are obtained from real estate brokers or other third-party consultants (Level 3).

Note 13 – Fair Value of Financial Instruments (continued)

Other Real Estate Owned – The Bank does not record other real estate owned at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these properties to reflect the current appraised value (less an estimate of cost to sell). In some cases, the properties for which appraised values have been obtained are located in areas where comparable sales data is limited, outdated, or unavailable. Fair value estimates for real estate held for sale are obtained from independent appraisers (Level 3).

The following table provides the hierarchy and fair value for each major category of assets and liabilities measured at fair value:

	December 31, 2014			
	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total
Assets and liabilities measured at fair value on a recurring basis				
Assets:				
Securities available for sale	$ -	$2,929	$ -	$2,929
Assets measured at fair value on a non-recurring basis				
Collateral dependent impaired loans	-	-	-	-
Other real estate owned	-	-	642	642

	December 31, 2013			
	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total
Assets and liabilities measured at fair value on a recurring basis				
Assets:				
Securities available for sale	$ -	$4,622	$ -	$4,622
Assets measured at fair value on a non-recurring basis				
Collateral dependent impaired loans	-	-	298	298
Other real estate owned	-	-	700	700

As of December 31, 2014 and 2013, there were collateral dependent impaired loans totaling $0 and $298, respectively, with valuation allowances of $0 and $0, respectively, which are measured for impairment using the fair value of the collateral. At December 31, 2014, other real estate owned with a book value of $695 is carried at its fair value of $642. The valuation allowance of $49 has been recorded through earnings. At December 31, 2013, other real estate owned with a book value of $749 is carried at its fair value of $700.

During 2014 and 2013, there were no changes or amounts in Level 3 assets or liabilities measured at fair value on a recurring basis.

Note 13 – Fair Value of Financial Instruments (continued)

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and due from banks, interest-bearing deposits in banks, and federal funds sold

The carrying amount approximates fair value because of the short maturity of these investments.

Securities available for sale, Federal Home Loan Bank and Federal Reserve Bank stock

The fair values of marketable securities are based on quoted market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. Federal Home Loan Bank and Federal Reserve Bank stock fair value is based on current redemption values.

Loans receivable

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as real estate, commercial, consumer, credit card, and other. Each loan category is further segmented into fixed and adjustable rate interest terms. The fair values for fixed-rate loans are estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. 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 loans held for sale are based on estimated market prices. Fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Cash surrender value of life insurance

The carrying amount of life insurance approximates its fair value.

Deposits

The fair value of demand deposits, savings accounts, and NOW and money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity time deposits is estimated using the rates currently offered for deposits of similar remaining maturities.

Federal Home Loan Bank advances and other borrowings

The fair values of the Bank's long-term debt are estimated using discounted cash flow analyses based on the Corporation's current incremental borrowing rates for similar types of borrowing arrangements.

Accrued interest

The carrying amounts of accrued interest approximate their fair values.

Note 13 – Fair Value of Financial Instruments (continued)

Off-balance-sheet instruments

Fair values of off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value the fees at December 31, 2014 and 2013, were insignificant. See Note 9 for the notional amount of the commitments to extend credit.

The estimated fair values of the Bank's financial instruments as of December 31 are as follows:

	2014		2013	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial Assets:				
Cash and due from banks	$ 3,795	$ 3,795	$ 4,458	$ 4,458
Interest-bearing deposits	22,007	22,007	27,328	27,328
Federal funds sold	-	-	10	10
Securities available for sale	2,929	2,929	4,622	4,622
Federal Home Loan Bank stock	284	284	296	296
Federal Reserve Bank stock	631	631	602	602
Loans receivable	131,559	135,723	126,392	127,577
Cash surrender value of life insurance	4,217	4,217	4,076	4,076
Accrued interest receivable	327	327	348	348
Financial Liabilities:				
Deposits	$142,637	$142,870	$146,724	$146,932
FHLB Borrowings	3,200	3,147	3,200	3,118
Accrued interest payable	23	23	29	29

Integrity

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Respect

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Dedication

•

Teamwork



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