



Oregon Pacific Bank

2019 Annual Report

CELEBRATING 40 FORTY YEARS

COOS BAY | EUGENE | FLORENCE | MEDFORD | ROSEBURG

Not Your Ordinary Bank

MEMBER FDIC | EQUAL HOUSING LENDER

Oregon Business 100 Best companies to work for in Oregon 2020

Oregon Pacific Bank at a Glance

Established on December 17, 1979 and headquartered in Florence, Oregon, we are proud to have full service branches in Coos Bay, Eugene, Florence, Medford, and Roseburg. Staffed by local decision makers, we specialize in offering holistic financial services to our local families and business owners.

Together, we can make your future better, in a way that's anything but ordinary!

Board of Directors

Jon Thompson | Chairman of the Board /Owner, KCST Radio Station

Dan Jones | Vice Chair of the Board /Owner, DJ Financial

Joe Benetti | Owner, Benetti's Italian Fine Foods

Tim Campbell | Partner/Owner, Campbell Commercial Real Estate

Ron Green | President/CEO, Oregon Pacific Bank

Kerrie Johnson | Owner/Loan Originator, Gallic & Johnson Financial

Bob Mans, OD | Co-owner, Florence Eye Clinic

Sabrina Parsons | CEO, Palo Alto Software

Tim Salisbury | Retired CFO, Bay Area Hospital

Robbie Wright | Owner, Siuslaw Broadband

Rick Yecny, CPA | Certified Public Accountant, Holloway and Associates CPAs

Bank Executive Officers

Ron Green | President, Chief Executive Officer

Jay Boelter | Executive Vice President, Director of Trust and Wealth Management

Bob Edstrom | Executive Vice President, Chief Credit Officer

John Raleigh | Executive Vice President, Chief Lending Officer

Margaret Tibbets | Executive Vice President, Chief Administrative Officer

Amber White | Executive Vice President, Chief Financial Officer

Oregon Pacific Bank

To our Shareholders, Friends and the Communities we serve:

Oregon Pacific Bancorp and its wholly-owned subsidiary, Oregon Pacific Bank, reported a net operating income of $3.5 million for the 12 months ended December 31, 2019, compared to $2.6 million for the same period in 2018. This represents a 35% increase over the prior year and equates to $0.50 earnings per share as compared to $0.37 for the same period in 2018. We continue to be pleased with our growth and overall financial improvement, and the value we bring to our shareholders, clients, staff and the communities we serve.

The expansion of our Eugene branch in 2018 continues to produce great success and was the driver for much of the Bank's growth in 2019. Total bank-wide loan growth in 2019 was $46.8 million, 18.6% over 2018 year-end balances. Loan growth in Eugene was $40.2 million, or 85.9% of total growth. Bank-wide deposit growth was $48.3 million, 17.9% over 2018 year-end balances. Deposit growth in the Eugene market was $28.1 million, 58.2% of total growth.

Our Trust Services division, as well as our Residential Mortgage team, had a strong year. Maintaining and growing these non-traditional services is a critical part of our business model of increasing non-interest income, and we will continue to seek opportunities for future success. The Bank's wholly-owned subsidiary, Oregon Pacific Wealth Management, LLC, experienced steady growth in assets under management and should prove to be an additional source of non-interest income for the Bank going forward.

Our Board of Directors experienced notable changes in 2019. Founding Director and Chairman of the Board, Robert King, retired after 40 years of exemplary service. Mr. King was succeeded by Jon Thompson, who was unanimously voted by the Board as Chairman. The Board also added two directors to join Tim Campbell of Campbell Commercial Real Estate as our Eugene area Board representatives. Sabrina Parsons, CEO of Palo Alto Software and Kerrie Johnson, CEO of Gallic & Johnson Financial joined the Board late in the year. Both are contributing greatly to shape the Bank's strategic vision, as well as being outstanding ambassadors for the Bank in Eugene.

Oregon Pacific Bank is proud to have received regulatory approval to open its fifth full-service banking branch. Our Medford Branch was transformed from a Trust and Wealth Advisory office, to a full-service banking branch in early March of this year. The banking office will focus on offering relationship-based services and advocacy to local area businesses and professionals, non-profit agencies and commercial real estate investors. We were fortunate to attract several long-time bankers from the Rogue Valley to manage this office.

The culture of Oregon Pacific Bank has never been stronger. It is our commitment to create value for our shareholders, clients, staff and the communities we serve. The Board of Directors continues to look for opportunities to strengthen our commitment, but our ability to execute on our vision is attributed to our outstanding employees. We are very grateful to have some of the finest bankers in Oregon working with us. Their passion for serving our clients and community is what drives our success.

We hope you will be able to attend our annual meeting on Wednesday April 22, 2020. Feel free to contact CEO Ron Green by telephone at (541) 999-1908 or by email at ron.green@opbc.com if you have any questions. For more information about Oregon Pacific Bank, please visit us at www.opbc.com.

Respectfully submitted,

Jon Thompson
Chairman of the Board
Oregon Pacific Bancorp

Ronald S. Green
President & CEO
Oregon Pacific Bancorp

Oregon Pacific Bancorp and Subsidiary

Financial Highlights

	AS OF AND FOR THE YEARS ENDED DECEMBER 31,				
	2019	2018	2017	2016	2015
INCOME STATEMENT DATA					
Interest income	$ 15,093,216	$ 11,808,095	$ 9,128,585	$ 7,659,640	$ 6,734,942
Interest expense	1,337,346	788,086	579,551	472,371	448,249
Net interest income	13,755,870	11,020,009	8,549,034	7,187,269	6,286,693
Provision for loan losses	235,392	553,586	272,000	129,500	182,000
Net interest income after provision for loan losses	13,520,478	10,466,423	8,277,034	7,057,769	6,104,693
Noninterest income	4,744,746	4,805,706	4,292,541	4,059,637	3,834,770
Noninterest expense	13,600,591	11,870,598	9,755,733	9,374,020	9,050,244
Income before provision for income taxes	4,664,633	3,401,531	2,813,842	1,743,386	889,219
Provision for income taxes	1,146,760	796,036	1,392,033	608,304	176,708
Net income	$ 3,517,873	$ 2,605,495	$ 1,421,809	$ 1,135,082	$ 712,511
PER SHARE DATA					
Basic earnings per common share	$ 0.50	$ 0.37	$ 0.31	$ 0.26	$ 0.17
Diluted earnings per common share	$ 0.50	$ 0.37	$ 0.31	$ 0.26	$ 0.17
Book value per average common share	$ 5.36	$ 4.68	$ 4.38	$ 4.04	$ 3.87
Weighted average shares outstanding:					
Basic	6,973,920	6,964,036	4,584,778	4,318,321	4,263,127
Diluted	6,973,920	6,964,036	4,584,778	4,318,321	4,263,127
BALANCE SHEET DATA					
Investment securities	$ 27,601,278	$ 26,806,308	$ 28,346,358	$ 19,250,213	$ 17,116,524
Loans, net[(1)]	$ 295,254,620	$ 248,884,606	$ 189,974,983	$ 157,236,637	$ 141,514,219
Total assets	$ 364,188,423	$ 309,532,757	$ 261,273,034	$ 230,625,485	$ 203,368,175
Total deposits	$ 318,040,202	$ 269,728,286	$ 220,804,220	$ 196,265,554	$ 171,737,522
Stockholders' equity	$ 37,351,578	$ 32,610,844	$ 30,394,992	$ 17,512,361	$ 16,495,557
SELECTED RATIOS					
Return on average assets	1.02%	0.91%	0.58%	0.52%	0.36%
Return on average equity	10.14%	8.31%	7.29%	6.68%	4.41%
Net loans to deposits	92.84%	92.27%	86.04%	80.11%	82.40%
Net interest margin[(2)]	4.28%	4.20%	3.93%	3.62%	3.44%
Efficiency ratio[(3)]	73.51%	75.01%	75.97%	83.35%	89.42%
ASSET QUALITY RATIOS					
Reserve for loans losses to:					
Ending total loans	1.20%	1.26%	1.37%	1.48%	1.46%
Nonperforming assets[(4)]	222.58%	126.05%	141.30%	59.76%	37.15%
Non-performing assets to ending total assets	0.44%	0.82%	0.72%	1.72%	2.78%
Net loan (recoveries) charge-offs to average loans	-0.07%	0.01%	0.00%	-0.09%	-0.24%
CAPITAL RATIOS (BANK)					
Average stockholders' equity to average assets	10.09%	10.97%	9.60%	9.60%	10.30%
Tier I capital ratio[(5)]	13.80%	15.05%	18.57%	13.90%	14.20%
Total risk-based capital ratio[(6)]	15.03%	16.30%	19.82%	15.15%	15.46%
Leverage ratio[(7)]	11.13%	12.11%	13.21%	9.23%	9.60%

(1) Excludes loans held-for-sale.
(2) Used tax effective yield for non-taxable securities interest earned.
(3) Efficiency ratio is noninterest expense divided by the sum of net interest income plus noninterest income.
(4) Nonperforming assets consists of nonaccrual loans, loans contractually past due 90 days or more, and other real estate owned.
(5) Tier I capital divided by risk-weighted assets.
(6) Total capital divided by risk-weighted assets.
(7) Tier I capital divided by quarterly average total assets.

Oregon Pacific Bancorp
and Subsidiary

Consolidated
Financial Statements

Years Ended
December 31, 2019
and 2018

Oregon Pacific Bancorp and Subsidiary

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delap

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Independent Auditors' Report

To the Board of Directors and Stockholders
Oregon Pacific Bancorp and Subsidiary

We have audited the accompanying consolidated balance sheets of Oregon Pacific Bancorp and Subsidiary as of December 31, 2019 and 2018, and the related consolidated statements of comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Oregon Pacific Bancorp and Subsidiary as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Delap LLP

March 10, 2020

Oregon Pacific Bancorp and Subsidiary
Consolidated Balance Sheets
December 31, 2019 and 2018

	2019	2018
ASSETS		
Cash and cash equivalents	$ 4,982,204	$ 5,515,759
Interest-bearing deposits in banks	17,510,684	9,539,514
Available-for-sale debt securities, at fair value	27,601,278	26,806,308
Restricted equity securities	1,079,100	1,019,900
Loans, net of deferred loan fees	298,846,759	252,064,426
Allowance for loan losses	(3,592,139)	(3,179,820)
Premises and equipment, net of accumulated depreciation	7,041,720	6,777,174
Bank-owned life insurance	7,066,432	6,836,270
Other real estate owned	-	1,223,523
Deferred tax assets, net	534,654	1,220,487
Accrued interest receivable and other assets	3,117,731	1,709,216
TOTAL ASSETS	$ 364,188,423	$ 309,532,757
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Demand - non-interest bearing	$ 73,771,372	$ 70,216,894
Demand - interest bearing	106,241,968	83,168,457
Money market	71,026,837	49,583,417
Savings deposits	48,398,323	48,955,256
Time certificate accounts	18,601,702	17,804,262
Total deposits	318,040,202	269,728,286
Subordinated debentures	4,124,000	4,124,000
Deferred compensation liability	2,021,389	1,956,779
Accrued interest payable and other liabilities	2,651,254	1,112,848
Total liabilities	326,836,845	276,921,913
COMMITMENTS AND CONTINGENCIES (Note 10)		
Preferred stock; 200,000 shares authorized; no shares issued and oustanding	-	-
Common stock, no par value, 10,000,000 shares authorized; 6,975,084 and 6,972,584 shares issued and outstanding at December 31, 2019 and 2018, respectively	20,662,708	20,633,578
Undivided profits	16,164,004	12,646,131
Accumulated other comprehensive income (loss), net of tax	524,866	(668,865)
Total stockholders’ equity	37,351,578	32,610,844
TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY	$ 364,188,423	$ 309,532,757

The accompanying notes are an integral part of the consolidated financial statements

Oregon Pacific Bancorp and Subsidiary

Consolidated Statements of Comprehensive Income

Years Ended December 31, 2019 and 2018

	2019	2018
INTEREST INCOME		
Loans	$ 13,897,830	$ 10,600,313
Taxable securities	283,803	318,319
Tax-exempt securities	382,430	398,023
Interest-bearing deposits in banks	529,153	491,440
	15,093,216	11,808,095
INTEREST EXPENSE		
Interest on deposits	1,120,055	573,397
Interest on borrowed funds	217,291	214,689
	1,337,346	788,086
Net interest income	13,755,870	11,020,009
PROVISION FOR LOAN LOSSES	235,392	553,586
Net interest income after provision for loan losses	13,520,478	10,466,423
NONINTEREST INCOME		
Trust fee income	2,141,040	2,603,916
Service charges and fees	902,735	848,321
Mortgage loan sales and servicing fees	498,384	408,720
Investment sales commissions	197,101	239,656
Merchant card services	273,405	234,543
Registered Investment Advisory (RIA) income	413,583	216,074
Increase in cash surrender value of bank-owned life insurance	230,162	193,712
Other income	88,336	60,764
	4,744,746	4,805,706
NONINTEREST EXPENSE		
Salaries and benefits	7,275,847	6,178,316
Outside services	1,391,051	1,192,997
Occupancy	1,214,412	1,138,242
Trust department expenses	1,349,691	1,317,616
Loan and collection expense	446,656	349,485
Advertising	275,984	254,607
Card services	106,984	151,660
Other real estate owned expenses	264,693	145,576
Deferred compensation expense	190,508	141,550
Supplies	95,622	126,996
Postage and freight	98,814	105,198
Federal Deposit Insurance Corporation assessment	44,795	74,536
Other expenses	845,534	693,819
	13,600,591	11,870,598
INCOME BEFORE PROVISION FOR INCOME TAXES	$ 4,664,633	$ 3,401,531
PROVISION FOR INCOME TAXES	1,146,760	796,036
NET INCOME	$ 3,517,873	$ 2,605,495
OTHER COMPREHENSIVE INCOME (LOSS)		
Unrealized (loss) gain on available-for-sale debt securities, (net of tax of ($441,556) in 2019, $160,211 in 2018)	1,193,731	(433,210)
COMPREHENSIVE INCOME	$ 4,711,604	$ 2,172,285
BASIC EARNINGS PER SHARE	$ 0.50	$ 0.37
DILUTED EARNINGS PER SHARE	$ 0.50	$ 0.37

The accompanying notes are an integral part of the consolidated financial statements

Oregon Pacific Bancorp and Subsidiary

Consolidated Statements of Changes in Stockholders' Equity

Years Ended December 31, 2019 and 2018

	Common Stock		Undivided	Accumulated Other Comprehensive	Total Stockholders'
	Shares	Amount	Profits	Income (Loss)	Equity
Balances - December 31, 2017	6,948,584	20,590,011	10,003,987	(199,006)	30,394,992
Net income	-	-	2,605,495	-	2,605,495
Adoption of ASU 2018-02	-	-	36,649	(36,649)	-
Other comprehensive loss - net	-	-	-	(433,210)	(433,210)
Stock-based compensation	24,000	43,567	-	-	43,567
Balances - December 31, 2018	6,972,584	$ 20,633,578	$ 12,646,131	$ (668,865)	$ 32,610,844
Net income	-	-	3,517,873	-	3,517,873
Other comprehensive income - net	-	-	-	1,193,731	1,193,731
Stock-based compensation	2,500	29,130	-	-	29,130
Balances - December 31, 2019	6,975,084	$ 20,662,708	$ 16,164,004	$ 524,866	$ 37,351,578

The accompanying notes are an integral part of the consolidated financial statements

Oregon Pacific Bancorp and Subsidiary
Consolidated Statements of Cash Flows
Years Ended December 31, 2019 and 2018

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 3,517,873	$ 2,605,495
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	235,392	553,586
Depreciation and amortization	904,190	970,894
Deferred income taxes	244,277	50,381
Write-down of other real estate owned	-	99,277
Stock-based compensation expense	29,130	43,567
Loss on sales of premises, equipment, and other real estate owned	251,669	47,384
Change in cash surrender value of bank-owned life insurance	(230,162)	(193,712)
Change in deferred loan fees	(2,377)	(18,007)
Change in accrued interest receivable and other assets	(17,346)	(187,414)
Change in accrued interest payable and other liabilities	193,874	119,805
Net cash from operating activities	5,126,520	4,091,256
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities and calls of available-for-sale debt securities	1,524,515	2,822,091
Purchases of available-for-sale debt securities	(1,017,813)	(2,238,533)
Purchases of restricted equity securities	(59,200)	(254,450)
Net (increase) decrease in interest-bearing deposits in banks	(7,971,170)	15,409,543
Net increase in loans	(46,603,029)	(59,445,202)
Purchases of premises and equipment	(817,148)	(1,143,454)
Proceeds from sales of premises, equipment, and other real estate owned	971,854	64,477
Purchase of bank-owned life insurance	-	(3,664,000)
Net cash used in investing activities	(53,971,991)	(48,449,528)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	48,311,916	48,924,066
Proceeds from Federal Home Loan Bank borrowings	20,000	10,000
Repayments of Federal Home Loan Bank borrowings	(20,000)	(3,010,000)
Net cash from financing activities	48,311,916	45,924,066
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(533,555)	1,565,794
Cash and cash equivalents - beginning of year	5,515,759	3,949,965
CASH AND CASH EQUIVALENTS - End of Year	$ 4,982,204	$ 5,515,759
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for		
Interest	$ 1,323,350	$ 795,666
Income taxes - net	$ 1,005,000	$ 885,000
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES		
Unrealized gain (loss) on available-for-sale debt securities - net	$ 1,193,731	$ (433,210)
Right-of-use assets obtained in exchange for operating lease liabilities	$ 1,409,412	$ -

The accompanying notes are an integral part of the consolidated financial statements

Note 1 - Basis of Presentation, Description of Business, and Summary of Significant Accounting Policies

Basis of presentation

The accompanying consolidated financial statements include the accounts of Oregon Pacific Bancorp ("Bancorp"), a bank holding company; its wholly-owned subsidiary, Oregon Pacific Banking Company dba Oregon Pacific Bank ("the Bank"); and the Bank's wholly-owned subsidiary, Oregon Pacific Wealth Management, LLC ("OPWM") (collectively, "the Company"). All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company has also established a subsidiary grantor trust in connection with the issuance of trust preferred securities (see Note 8). In accordance with accounting principles generally accepted in the United States of America ("U.S.") ("GAAP"), the accounts and transactions of this trust are not included in the accompanying consolidated financial statements.

Description of business

The Bank is an Oregon state-chartered institution with headquarters in Florence, Oregon. The Bank provides banking products and services from its full-service branches in Florence, Eugene, Coos Bay, and Roseburg, and its Trust and Wealth Management office in Medford. The Bank also offers trust services in Florence, Coos Bay, Medford, and Eugene. Specializing in offering comprehensive financial services to local families and business owners, the Bank services customers in Lane, Douglas, Coos, Jackson, and Josephine Counties. These financial services include full service banking for both individual and business customers which includes checking, savings, money market, and time deposit accounts. In terms of technology, internet banking, online billpay, and mobile banking services are available. The Bank also offers a variety of lending services including commercial, consumer, and credit cards. The Bank's merchant services department handles payment processing solutions for business clients. Wealth management and investment services are also available, allowing the Bank to offer non-deposit products such as estate planning and trust administration. OPWM provides retirement planning services and is a State of Oregon Registered Investment Advisor.

Method of accounting

The Company prepares its consolidated financial statements in conformity with GAAP and prevailing practices within the banking industry. The Company utilizes the accrual method of accounting which recognizes income and gains when earned and expenses and losses when incurred. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities, as of the date of the consolidated balance sheet, and the reported amounts of income, gains, expenses, and losses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to material change in the near term relate to the allowance for loan losses.

Subsequent events

Management has evaluated, for potential recognition or disclosure in the consolidated financial statements, subsequent events that have occurred through March 10, 2020, which is the date that the consolidated financial statements were available to be issued.

Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand and amounts due from banks (including cash items in process of collection).

Interest-bearing deposits in banks

Interest-bearing deposits in banks include time certificates of deposit from other banks and federal funds sold. Generally, federal funds are sold for one-day periods.

Investments in debt securities

Investments in debt securities that management has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at cost, adjusted for amortization of premiums and accretion of discounts that are recognized in interest income using the interest method over the period to maturity.

Investments in debt securities that are purchased and held principally for the purpose of selling them in the near term are classified as trading securities and are reported at fair value, with unrealized gains and losses included in noninterest income.

Investments in debt securities that are not classified as either held-to-maturity securities or trading securities are classified as available-for-sale securities and are reported at fair value, with unrealized gains and losses, net of the related deferred income tax effect, excluded from earnings and reported as other comprehensive income or loss. All of the Company's investments in debt securities held during 2019 and 2018 were classified as available-for-sale.

Management determines the appropriate classification of debt securities at the time of purchase. Realized gains and losses on the sales of investments in debt securities are determined using the specific-identification method. See Note 12 for a description of the Company's methodologies for determining the fair value of investments in debt securities.

In estimating other-than-temporary impairment ("OTTI") losses, management considers, among other things, (1) the length of time and the extent to which the fair value has been less than amortized cost, (2) the financial condition and near term prospects of the issuer, (3) the impact of changes in market interest rates, and (4) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery of fair value. For individual debt securities which the Company does not intend to sell, and for which it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, the OTTI losses would be evaluated and (1) the portion related to credit losses would be included in earnings as realized losses, and (2) the portion related to market or other factors would be recognized in other comprehensive income or loss. Credit loss is recorded if the present value of expected cash flows is less than the amortized cost. For individual debt securities which the Company intends to sell or for which it more likely than not will not recover all of its amortized cost, the OTTI is recognized in earnings equal to the entire difference between the security's cost basis and its fair value at the consolidated balance sheet date.

For individual debt securities for which credit loss has been recognized in earnings, interest accruals and amortization of premiums and accretion of discounts are suspended when the credit loss is recognized. Interest received after accruals have been suspended is recognized on a cash basis.

During the years ended December 31, 2019 and 2018, the Company did not recognize any OTTI on its investments in debt securities.

Restricted equity securities

As of December 31, 2019, restricted equity securities consisted of $371,300 of Federal Home Loan Bank ("FHLB") of Des Moines stock and $707,800 of Federal Reserve Bank ("FRB") stock. As of December 31, 2018, restricted equity securities consisted of $313,400 of FHLB of Des Moines stock and $706,500 of FRB stock.

As a member of the FHLB system, the Bank is required to maintain a minimum investment in FHLB stock based on specific percentages of its outstanding mortgages, total assets, or FHLB advances. As of December 31, 2019 and 2018, the Bank met its minimum required investment. The Bank may request redemption at par value of any FHLB stock in excess of the minimum required investment; however, stock redemptions are at the discretion of the FHLB.

The Bank’s investment in FHLB stock (which has limited marketability) is carried at cost, which approximates fair value. The Bank evaluates its FHLB stock for impairment as needed. The Bank's determination of whether this investment is impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared with the capital stock amount and the length of time any decline has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB. Based on its evaluation, the Bank determined that there was no impairment of its FHLB stock as of December 31, 2019 and 2018.

The Bank's investment in FRB stock is carried at par value (which represents the Bank's cost), which approximates fair value. The Bank accounts for its investment in FRB stock in accordance with GAAP as described above for FHLB stock. Management believes that there is no impairment of the carrying value of FRB stock as of December 31, 2019 and 2018.

Loans

Loans are stated at the amount of unpaid principal, reduced by the allowance for loan losses and deferred loan fees.

Interest income on all loans is accrued as earned on the simple interest method based on daily balances of the principal amount outstanding. The accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to make payments as they become due. When accrual of interest is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due.

The Bank charges fees for originating loans. These fees, net of certain loan origination costs, are deferred and generally amortized to interest income over the term of the related loan. If the loan is repaid prior to maturity, the remaining unamortized net deferred loan origination fee is recognized in interest income at the time of repayment.

Allowance for loan losses

The allowance for loan losses represents management's recognition of the assumed risks of extending credit. The allowance is established to absorb management's best estimate of known and inherent losses in the loan portfolio as of the consolidated balance sheet date. The allowance requires complex subjective judgments as a result of the need to make estimates about matters that are uncertain. The allowance is maintained at a level currently considered adequate to provide for potential loan losses based on management's assessment of the various factors affecting the portfolio.

The allowance is based on estimates, and ultimate losses may vary from the current estimates. These estimates are reviewed periodically, and, as adjustments become necessary, they are reported in earnings in the periods in which they become known. Therefore, the Bank cannot provide assurance that, in any particular period, the Bank will not have significant losses in relation to the amount reserved. The allowance is increased by provisions charged to income and reduced by loans charged-off, net of recoveries. Loan losses are charged against the reserve when management deems a loan balance to be uncollectible.

The following describes the Bank’s methodology for assessing the appropriate level of the allowance for loan losses. For this purpose, loans and related commitments to loan are analyzed – and allowances categorized – into the pooled allowance, specifically identified allowances for impaired loans, and the unallocated allowance.

The pooled portion of the allowance is established by considering historical and industry loss data for the different loan segments in the portfolio. This loss data is then adjusted, as appropriate, based on management's continuing evaluation of qualitative factors that are not directly measured by – or may not yet be reflected in – historical loss data. Such qualitative factors include, but are not limited to, changes in lending policies and procedures, experience of lending management personnel, the quality of the Bank's loan review system, changes and trends in the nature of the loan portfolio, the volume and severity of troubled loans, concentrations, current economic conditions and outlook, the estimated value of collateral for collateral-dependent loans, and external factors such as regulatory requirements. The resulting loss factors are then applied to the outstanding loan balances based on a risk rating system.

Impaired loans are either specifically reserved for in the allowance for loan losses or reflected as a partial charge-off of the loan balance. The Bank considers loans to be impaired when management believes that it is probable that either principal and/or interest amounts due will not be collected according to the contractual terms. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, the estimated fair value of the loan's underlying collateral, or the value of a related guaranty. A significant portion of the Bank's loans are either (1) collateralized by real estate, whereby the Bank primarily measures impairment based on the estimated fair value of the underlying collateral, net of selling costs, or (2) are supported by underlying cash flows, whereby impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate. Accordingly, changes in such estimated collateral values or future cash flows could result in actual losses which differ from those estimated at the date of the consolidated balance sheet. The valuation of real estate collateral is subjective in nature and may be adjusted in future periods because of changes in economic conditions. Management considers third-party appraisals, as well as independent fair market value assessments from realtors or other persons involved in selling real estate, in determining the estimated fair value of particular properties. In addition, as certain of these third-party appraisals and independent fair market value assessments are only updated periodically, changes in the values of specific properties may have occurred subsequent to the most recent appraisals. Accordingly, the amounts of any such potential changes and any related adjustments are generally recorded at the time such information is received. Smaller balance homogeneous loans (typically certain consumer loans) are collectively evaluated for impairment. Generally, the Bank evaluates a loan for impairment when it is placed on non-accrual status.

The unallocated portion of the allowance is based upon management's evaluation of various factors that are not directly measured in the determination of the pooled and specific allowances. Such factors include uncertainties in economic conditions, the imprecision of appraisals used in estimating collateral values, uncertainties in identifying triggering events that directly correlate to subsequent loss rates, risk factors that have not yet manifested themselves in historical loss factors, and historical loss experience data that may not precisely correspond to the current portfolio. The unallocated allowance may also be affected by review by the bank regulatory authorities who may require increases or decreases to the unallocated allowance based on their evaluation of the information available to them at the time of their examinations. Accordingly, the unallocated allowance helps to minimize the risk related to the margin of imprecision inherent in the estimation of pooled and specific allowances. Due to the subjectivity involved in the determination of the unallocated portion of the allowance for loan losses, the relationship of the unallocated component to the total allowance for loan losses may fluctuate from period to period.

A provision for loan losses is charged against income and is added to the allowance for loan losses based on quarterly comprehensive analyses of the loan portfolio. The allowance for loan losses is allocated to certain loan categories based on the relative risk characteristics, asset classifications, and actual loss experience of the loan portfolio. While management has allocated the allowance for loan losses to various loan portfolio segments, the allowance is general in nature and is available for the loan portfolio in its entirety.

The ultimate 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 in the accompanying consolidated financial statements.

Troubled debt restructurings

A loan is classified as a troubled debt restructuring ("TDR") when a borrower is experiencing financial difficulties and the Bank grants a concession to the borrower in the restructuring that the Bank would not otherwise consider. These concessions may include – but are not limited to – certain interest rate reductions; principal forgiveness; deferral of interest payments; certain extensions of maturity dates; a reduction of accrued interest; and other actions intended to minimize potential losses to the Bank. A TDR loan is considered to be impaired and is individually evaluated for impairment. A TDR loan can be classified as either accrual or non-accrual.

Allowance for unfunded loan commitments

The Bank maintains a separate allowance for estimated losses related to unfunded loan commitments. Management estimates the amount of probable losses related to unfunded loan commitments by applying the estimated loss factors used in the allowance for loan loss methodology to the expected amount of commitments that will actually require funding. The allowance for unfunded loan commitments totaled $44,888 as of both December 31, 2019 and 2018. In accordance with industry practice and regulatory guidance, the allowance for estimated losses related to unfunded loan commitments is included in accrued interest payable and other liabilities in the accompanying consolidated balance sheets. Increases (decreases) in the allowance for unfunded loan commitments are recorded in noninterest expense in the accompanying consolidated statements of comprehensive income.

Premises and equipment

Premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation is computed principally by the straight-line method over the estimated useful lives of the assets, which range from two to 30 years. Leasehold improvements are amortized over the lesser of the terms of the related leases or their estimated useful lives. Capital improvements or equipment purchases greater than $1,000 are capitalized, while maintenance and repairs are charged to expense. Gains or losses on dispositions are reflected in earnings as incurred.

Impairment of long-lived assets

The Bank accounts for long-lived assets, including intangibles other than goodwill, at amortized cost. Management reviews long-lived assets for possible impairment whenever events or circumstances indicate that the carrying amount of such assets may not be recoverable. If there is an indication of impairment, management would prepare an estimate of future cash flows (undiscounted and without interest charges) expected to result from the use of the asset and its eventual disposition. If these estimated cash flows were less than the carrying amount of the asset, an impairment loss would be recognized to write down the asset to its estimated fair value.

Bank-owned life insurance ("BOLI")

The Bank has purchased single premium BOLI policies on certain executives and other employees. The policies are recorded at their cash surrender values (net of surrender charges). Changes in cash surrender values are included in noninterest income in the accompanying consolidated statements of comprehensive income.

OREO

OREO, acquired through foreclosure or deeds in lieu of foreclosure, is carried at the lower of cost or estimated net realizable value. When the property is acquired, any excess of the loan balance over the estimated net realizable value is charged to the allowance for loan losses. Holding costs, subsequent write-downs to net realizable value, if any, or any disposition gains or losses are included in noninterest income and expense. Costs relating to the development and improvement of the properties are capitalized. The valuation of OREO is subjective in nature and may be adjusted in the future because of changes in economic conditions. The valuation of OREO is also subject to review by bank regulatory authorities who may require increases or decreases to carrying amounts based on their evaluation of the information available to them at the time of their examination of the Bank. Management considers third-party appraisals, as well as independent fair market value assessments from realtors or other persons involved in selling OREO, in determining the fair value of particular properties. In addition, as certain of these third-party appraisals and independent fair market value assessments are only updated periodically, changes in the values of specific properties may have occurred subsequent to the most recent appraisals. Accordingly, the amounts of any such potential changes and any related adjustments are generally recorded at the time such information is received.

As of December 31, 2019, the Bank held no OREO properties and as of December 31, 2018, the Bank held OREO totaling $1,223,523 which consisted of a foreclosed residential real estate property recorded as a result of obtaining physical possession of the property.

Loan servicing rights

The carrying value of loan servicing rights is the original estimated value of the originated loan servicing rights or the cost of purchased loan servicing rights, net of subsequent amortization, write-offs due to prepayments, or other write-downs or valuation allowances due to impairment. The originated loan servicing rights are measured by allocating the carrying value of loans between the assets sold and interest retained, based upon the relative estimated fair values at the date of sale. The loan servicing rights are amortized in proportion to, and over the period of, estimated net servicing income.

Management determines the estimated fair value of loan servicing rights through its review and assessment of current industry data. Accordingly, changes in management's evaluation of such data could significantly affect the estimated fair values of the loan servicing rights. GAAP requires the Bank to record an impairment loss in the event that the estimated fair value of loan servicing rights falls below the Bank’s carrying value. To mitigate this risk, management amortizes loan servicing rights over their expected lives and fully amortizes loan servicing rights that are specifically associated with any serviced loans that are paid-off.

The Bank does not employ specific hedges to mitigate fair value changes that may occur due to market fluctuations. There can be no assurance regarding the possible impairment of loan servicing rights in future periods. The net book value of loan servicing rights as of December 31, 2019 and 2018 ($89,055 and $108,210, respectively) is included in accrued interest receivable and other assets in the accompanying consolidated balance sheets.

Transfers of financial assets

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

Preferred stock

The Company's preferred stock is issuable with the par value, dividend, voting, and other features determined by the Company's Board of Directors (the Board) or by action of the stockholders of the Company. As of December 31, 2019 and 2018, there were no shares of preferred stock outstanding.

Stock-based compensation

The Company has stock-based compensation plans, which are described more fully in Note 13. The Company recognizes as compensation expense all stock-based awards made to employees and Board members. The compensation cost is measured based upon the grant-date fair value of the related stock-based awards and is recognized over the service period of the stock-based awards, which is generally the same as the vesting period.

Advertising

Advertising costs are generally charged to expense during the year in which they are incurred.

Income taxes

The provision for income taxes is based on income and expenses as reported for consolidated financial statement purposes using the "asset and liability method" for accounting for deferred taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

Income tax positions that meet the "more-likely-than-not" recognition threshold are measured at the largest amount of income tax benefit that is more than 50 percent likely to be realized upon settlement with the applicable taxing authority. The portion of the benefits associated with income tax positions taken that exceeds the amount measured as described above would be reflected as a liability for unrecognized income tax benefits in the accompanying consolidated balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized income tax benefits would be classified as additional income taxes in the consolidated statements of comprehensive income. The Company has evaluated its income tax positions as of December 31, 2019 and 2018. Based on this evaluation, the Company has determined that it does not have any uncertain income tax positions for which an unrecognized income tax liability should be recorded.

The Company files a federal income tax return in the U.S. and a state income tax return in Oregon.

Trust assets

The Bank operates a full-service trust department and, through an arrangement with a registered securities broker-dealer, an investment and brokerage service department. Assets of the Bank's trust and investment and brokerage service departments, other than cash on deposit at the Bank, are not included in the accompanying consolidated financial statements, because they are not assets of the Bank. Assets (unaudited) totaling approximately $301 million and $243 million, were held in trust and/or managed by the investment and brokerage service department as of December 31, 2019 and 2018, respectively.

Reclassifications

Certain reclassifications have been made to prior year balances to conform to the current year presentation.

New authoritative accounting guidance

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, *Leases*, which created FASB Accounting Standards Codification (ASC) Topic 842 (ASC 842) and is intended to increase transparency and comparability among organizations by requiring the recognition of lease assets and lease liabilities on the balance sheet and disclosure of key information about leasing arrangements. The principal change required by ASC 842 relates to lessee accounting, and is that for operating leases, a lessee is required to (1) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position, (2) recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term generally on a straight-line basis, and (3) classify all cash payments within operating activities in the statement of cash flows. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term. ASC 842 also changes disclosure requirements related to leasing activities and requires certain qualitative disclosures along with specific quantitative disclosures. ASC 842 also provides an optional transition method for adoption, under which an entity initially applies ASC 842 at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Consequently, an entity's reporting for the comparative periods presented in the financial statements in which it adopts ASC 842 will continue to be in accordance with previous GAAP. The Company adopted the provisions of ASC 842 effective January 1, 2019 utilizing the optional transition method and will not restate comparative periods. The Company also elected the package of practical expedients permitted under ASC 842's transition guidance, which allows the Company to carryforward its historical lease classifications and its assessment as to whether a contract is or contains a lease. The Company also elected to not recognize lease assets and lease liabilities for leases with an initial term of 12 months or less. See Note 10 for additional discussion..

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses*. ASU 2016-13 replaces the existing incurred losses methodology for estimating allowances with a current expected credit losses methodology with respect to most financial assets measured at amortized cost and certain other instruments, including trade and other receivables, loans, held-to-maturity investment securities, and off-balance sheet commitments. In addition, ASU 2016-13 requires credit losses relating to available-for-sale debt securities to be recorded through an allowance for credit losses rather than a reduction of the carrying amount. ASU 2016-13 also changes the accounting for purchased credit-impaired debt securities and loans. ASU 2016-13 retains many of the disclosure requirements in current GAAP and expands certain disclosure requirements. ASU 2016-13 was originally effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years; however, in November 2019 the FASB issued ASU 2019-10 delaying the effective date for non-SEC public business entities to fiscal years beginning after December 15, 2022. Upon adoption, the Company expects a change in the processes and procedures to calculate the allowance for loan losses, including changes in the assumptions and estimates to consider expected credit losses over the life of the loan versus the current methodology which utilizes the incurred loss model. The Company is reviewing the requirements of ASU 2016-13 and has begun developing and implementing processes and procedures to ensure it is fully compliant with the amendments at the adoption date. At this time, the Company anticipates the allowance for loan losses will increase as a result of the implementation of ASU 2016-13; however, until its evaluation is complete, the magnitude of the increase will be unknown.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement*. ASU 2018-13 was issued to improve the effectiveness of disclosures surrounding fair value measurements. ASU 2018-13 removes numerous disclosures from ASC Topic 820 including: transfers between level 1 and 2 of the fair value hierarchy, the policy for timing of transfers between levels, and the valuation process for level 3 fair value measurements. ASU 2018-13 also modified and added disclosure requirements in regard to changes in unrealized gains and losses included in other comprehensive income, as well as the range and weighted average of unobservable inputs for level 3 fair value measurements. ASU 2018-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. The adoption of ASU 2018-13 is not expected to have a material impact on the Company's future consolidated financial statements.

In August 2018, the FASB issued ASU 2018-15, *Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract*. ASU 2018-15 reduces complexity for the accounting for costs of implementing a cloud computing service arrangement. ASU 2018-15 aligns the requirements for capitalization of implementation costs incurred in a hosting arrangement that is a service contract with those incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). ASU 2018-15 requires an entity in a hosting arrangement that is a service contract to follow the guidance in ASC Subtopic 350-40 to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense. Costs to develop or obtain internal use software that cannot be capitalized under ASC Subtopic 350-40, such as training costs and certain data conversion costs, also cannot be capitalized for a hosting arrangement that is a service contract. The capitalized costs will be amortized over the life of the service contract. The amendments in ASU 2018-15 should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. ASU 2018-15 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. The adoption of ASU 2018-15 is not expected to have a material impact on the Company's future consolidated financial statements.

Note 2 - Investment Securities

Available-for-sale debt securities as of December 31, 2019 and 2018 consisted of the following:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses Less than 12 Months	Gross Unrealized Losses More than 12 Months	Fair Value
2019					
Unrealized Loss Position					
U.S. Treasury and agencies	$ 1,003,884	$ -	$ (894)	$ -	$ 1,002,990
Obligations of state and political subdivisions	-	-	-	-	-
Mortgage-backed securities	973,405	-	-	(32,191)	941,214
Corporate notes	2,006,621	-	-	(1,861)	2,004,760
	3,983,910	-	(894)	(34,052)	3,948,964
Unrealized Gain Position					
U.S. Treasury and agencies	-	-	-	-	-
Obligations of state and political subdivisions	15,696,810	617,910	-	-	16,314,720
Mortgage-backed securities	7,201,525	136,069	-	-	7,337,594
Corporate notes	-	-	-	-	-
	22,898,335	753,979	-	-	23,652,314
	$ 26,882,245	$ 753,979	$ (894)	$ (34,052)	$ 27,601,278
2018					
Unrealized Loss Position					
U.S. Treasury and agencies	$ 1,008,070	$ -	$ -	$ (23,440)	$ 984,630
Obligations of state and political subdivisions	11,832,874	-	(74,570)	(587,700)	11,170,604
Mortgage-backed securities	7,617,758	-	(154,998)	(79,496)	7,383,264
Corporate notes	2,015,160	-	-	(42,030)	1,973,130
	22,473,862	-	(229,568)	(732,666)	21,511,628
Unrealized Gain Position					
U.S. Treasury and agencies	-	-	-	-	-
Obligations of state and political subdivisions	4,302,640	43,771	-	-	4,346,411
Mortgage-backed securities	946,060	2,209	-	-	948,269
Corporate notes	-	-	-	-	-
	5,248,700	45,980	-	-	5,294,680
	$ 27,722,562	$ 45,980	$ (229,568)	$ (732,666)	$ 26,806,308

As of December 31, 2019 and 2018, the Bank held 36 investment securities, of which 11 were in unrealized loss positions, and 36 investment securities, of which 30 were in unrealized loss positions, respectively. Management has evaluated these securities and has determined that the declines in value are temporary and are related to changes in market interest rates since purchase. The declines in value are not related to any company or industry-specific events. With respect to unrealized losses on the above investment securities as of December 31, 2019, management does not have the intent to sell any of the investment securities and believes that it is more likely than not that the Bank will not have to sell any such securities before a recovery of cost. Accordingly, no impairment adjustments for these investment securities have been recorded as of December 31, 2019 or 2018.

The amortized cost and estimated fair value of investment securities as of December 31, 2019, by contractual maturity, 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 in one year or less	$ 2,004,184	$ 2,002,770
Due after one year through five years	2,108,665	2,124,056
Due after five years through ten years	6,919,032	7,137,837
Thereafter	15,850,364	16,336,615
	$ 26,882,245	$ 27,601,278

As of December 31, 2019 and 2018, investment securities with an amortized cost of $7,268,278 and $6,623,516 and estimated fair values of $7,400,779 and $6,363,279, respectively, were pledged to secure deposits of public funds and for other purposes as required or permitted by law.

Note 3 - Loans and Allowance for Loan Losses

Loans as of December 31, 2019 and 2018 consisted of the following:

	2019	2018
Commercial real estate	$ 211,438,019	$ 162,546,276
Commercial	59,520,634	60,545,466
Residential real estate	24,624,153	26,325,973
Consumer	3,564,265	2,949,400
Total loans	299,147,071	252,367,115
Less allowance for loan losses	(3,592,139)	(3,179,820)
Less deferred loan fees	(300,312)	(302,689)
Loans - net	$ 295,254,620	$ 248,884,606

A substantial portion of the Bank's loans are collateralized by real estate in the geographic areas it serves and, accordingly, the ultimate collectability of a substantial portion of the Bank's loan portfolio is susceptible to changes in the local economic conditions in such markets.

In the normal course of business, the Bank participates portions of loans to third parties in order to extend the Bank's lending capability or to mitigate risk. As of December 31, 2019 and 2018, the portion of these loans participated to third parties (which are not included in the accompanying consolidated financial statements) totaled $13,072,164 and $19,507,739, respectively. The Bank also purchases portions of loans from third parties. As of December 31, 2019 and 2018, the Bank had $14,502,288 and $11,300,721, respectively, of loans which were purchased from third parties (which are included in the accompanying consolidated financial statements).

As of December 31, 2019, loans totaling $131,585,433 were pledged to secure borrowings from the FHLB and FRB.

The Bank has lending policies, practices, and procedures in place that are designed to generate loan income within an acceptable level of risk. The Board reviews and approves the Bank’s loan policies on an annual basis or when changes and/or additions are recommended to the Board by management. A reporting and review process is provided by management to the Board with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies, and non-performing and potential problem loans. Diversification within the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Loans are underwritten after evaluating and understanding the borrower's loan request. Underwriting standards are designed to promote relationship banking by understanding a borrower's entire banking need. The Bank examines current and projected cash flows to determine the ability of the borrower to repay its obligation as agreed upon and, secondarily, evaluates the underlying collateral provided by the borrower.

The Bank obtains an independent third-party review of its loan portfolio on a regular basis for quality and accuracy in underwriting loans. Results of these reviews are presented to management and the Board. The loan review process complements and reinforces the ongoing risk identification and assessment decisions made by the Bank's lenders and credit personnel, as well as the Bank's policies and procedures.

Commercial real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate, and the collateral securing these loans may fluctuate in value. Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans is generally largely dependent on the successful operations of the real property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy than other loan types.

Commercial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as forecasted and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Residential real estate loans are generally secured by first or second mortgage liens and are exposed to the risk that the collateral securing these loans may fluctuate in value due to economic or individual performance factors.

Consumer loans are loans made to purchase personal property such as automobiles, boats, and recreational vehicles. The terms and rates are established periodically by management. Consumer loans tend to be relatively small and the amounts are spread across many individual borrowers, thereby minimizing the risk of significant loss to the Bank.

Changes in the allowance for loan losses, by portfolio segment, and the recorded investment in loans, by portfolio segment and impairment method, as of and for the years ended December 31, 2019 and 2018 were as follows:

2019	**Commercial Real Estate**	**Commercial**	**Residential Real Estate**	**Consumer**	**Total**
Allowance for loan losses					
Beginning balance	$ 1,981,256	$ 799,467	$ 379,666	$ 19,431	$ 3,179,820
Charge-offs		-	-	(4,223)	(4,223)
Recoveries	172,062	-	3,088	6,000	181,150
Provision (credit)	450,698	(172,362)	(56,166)	13,222	235,392
Ending balance	$ 2,604,016	$ 627,105	$ 326,588	$ 34,430	$ 3,592,139
Ending balance individually evaluated for impairment	$ -	$ -	$ 3,024	$ -	$ 3,024
Ending balance collectively evaluated for impairment	$ 2,604,016	$ 627,105	$ 323,564	$ 34,430	$ 3,589,115
Loans					
Ending balance individually evaluated for impairment	$ 2,031,631	$ 457,138	$ 527,381	$ -	$ 3,016,150
Ending balance collectively evaluated for impairment	$ 209,406,388	$ 59,063,496	$ 24,096,772	$ 3,564,265	$ 296,130,921
Ending balance	$ 211,438,019	$ 59,520,634	$ 24,624,153	$ 3,564,265	$ 299,147,071
2018					
Allowance for loan losses					
Beginning balance	$ 1,621,962	$ 451,884	$ 545,210	$ 21,637	$ 2,640,693
Charge-offs	-	(46,723)	-	(3,659)	(50,382)
Recoveries	6,000	26,746	3,177	-	35,923
Provision (credit)	353,294	367,560	(168,721)	1,453	553,586
Ending balance	$ 1,981,256	$ 799,467	$ 379,666	$ 19,431	$ 3,179,820
Ending balance individually evaluated for impairment	$ -	$ 861	$ 1,146	$ -	$ 2,007
Ending balance collectively evaluated for impairment	$ 1,981,256	$ 798,606	$ 378,520	$ 19,431	$ 3,177,813
Loans					
Ending balance individually evaluated for impairment	$ 1,580,026	$ 364,550	$ 643,940	$ 34,556	$ 2,623,072
Ending balance collectively evaluated for impairment	$ 160,966,250	$ 60,180,916	$ 25,682,033	$ 2,914,844	$ 249,744,043
Ending balance	$ 162,546,276	$ 60,545,466	$ 26,325,973	$ 2,949,400	$ 252,367,115

Information related to impaired loans as of and for the years ended December 31, 2019 and 2018 by class of loans was as follows:

	As of December 31			For the Year Ended December 31	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
2019					
With an allowance recorded					
Commercial real estate	$ -	$ -	$ -	$ -	$ -
Commercial	-	-	-	12,850	-
Residential real estate	216,318	216,318	3,024	268,694	14,259
Consumer	-	-	-	-	-
Subtotal	216,318	216,318	3,024	281,544	14,259
With no related allowance recorded					
Commercial real estate	2,031,631	2,031,631	-	2,027,370	108,649
Commercial	457,138	457,138	-	463,913	9,828
Residential real estate	311,063	311,063	-	369,600	17,287
Consumer	-	-	-	-	-
Subtotal	2,799,832	2,799,832	-	2,860,883	135,764
Total					
Commercial real estate	2,031,631	2,031,631	-	2,027,370	108,649
Commercial	457,138	457,138	-	476,763	9,828
Residential real estate	527,381	527,381	3,024	638,294	31,546
Consumer	-	-	-	-	-
Total	$ 3,016,150	$ 3,016,150	$ 3,024	$ 3,142,427	$ 150,023
2018					
With an allowance recorded					
Commercial real estate	$ -	$ -	$ -	$ -	$ -
Commercial	79,831	79,831	861	86,543	5,899
Residential real estate	374,066	374,066	1,146	178,759	19,679
Consumer	-	-	-	444	-
Subtotal	453,897	453,897	2,007	265,746	25,578
With no related allowance recorded					
Commercial real estate	1,580,026	1,580,026	-	1,466,339	110,202
Commercial	284,719	284,719	-	190,774	2,577
Residential real estate	269,874	269,874	-	478,104	18,839
Consumer	34,556	34,556	-	35,427	2,237
Subtotal	2,169,175	2,169,175	-	2,170,644	133,855
Total					
Commercial real estate	1,580,026	1,580,026	-	1,466,339	110,202
Commercial	364,550	364,550	861	277,317	8,476
Residential real estate	643,940	643,940	1,146	656,863	38,518
Consumer	34,556	34,556	-	35,871	2,237
Total	$ 2,623,072	$ 2,623,072	$ 2,007	$ 2,436,390	$ 159,433

The cash basis interest income on impaired loans was not materially different than the interest recognized on impaired loans as shown in the tables above.

Past due loans are loans for which principal and interest were not paid timely according to the contractual payment terms. The following tables present, by portfolio segment, the recorded investment in loans by aging category, non-accrual status, and in total, as of December 31, 2019 and 2018:

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days and Accruing	Non-accrual	Total Past Due	Current	Total Loans
2019							
Commercial real estate	$ -	$ -	$ -	$ 1,001,600	$ 1,001,600	$ 210,436,419	$ 211,438,019
Commercial	-	-	-	457,138	457,138	59,063,496	59,520,634
Residential real estate	149,735	279,874	-	155,131	584,740	24,039,413	24,624,153
Consumer	684	-	-	-	684	3,563,581	3,564,265
Total	$ 150,419	$ 279,874	$ -	$ 1,613,869	$ 2,044,162	$ 297,102,909	$ 299,147,071
2018							
Commercial real estate	$ -	$ 404,416	$ -	$ 641,176	$ 1,045,592	$ 161,500,684	$ 162,546,276
Commercial	158,243	-	-	364,650	522,893	60,022,573	60,545,466
Residential real estate	274,207	-	66,261	258,788	599,256	25,726,717	26,325,973
Consumer	3,592	-	-	34,556	38,148	2,911,252	2,949,400
Total	$ 436,042	$ 404,416	$ 66,261	$ 1,299,170	$ 2,205,889	$ 250,161,226	$ 252,367,115

Had the non-accrual loans in the above tables performed according to their original contractual terms, additional interest income of $70,913 and $62,824 would have been recognized in 2019 and 2018, respectively.

The Bank utilizes an internal asset classification system as a means of reporting problem and potential problem loans. Loan risk ratings are updated whenever information comes to management's attention that indicates that a loan's risk has changed. The following is a detailed description of these credit risk ratings:

Pass (Ratings 1 – 6) - These loans range from minimal to acceptable credit risk.

Watch (Rating 7) – These loans have a lower than average, but still acceptable, credit risk and are performing as agreed.

Special Mention (Rating 8) - These loans have potential weaknesses that, if not checked or corrected, may inadequately protect the Bank's position at some future date. Loans in this category warrant more than usual management attention but do not justify a Substandard classification.

Substandard (Rating 9) - Substandard loans have well-defined weaknesses that jeopardize the ability of the borrower to repay in full. These loans are inadequately protected by either the sound net worth and payment capacity of the borrower or the value of pledged collateral. These are loans with a distinct possibility of loss. Loans moving toward foreclosure and/or legal action due to credit quality deterioration are rated 9 or higher by the Bank.

Doubtful (Rating 10) - Doubtful loans have an extremely high probability of loss. These loans have all the critical weaknesses found in a Substandard loan; however, the weaknesses are elevated to the point that, based upon current information, collection or liquidation in full is improbable.

Loss (Rating 11) – Loans classified as Loss are considered uncollectible and are charged off.

The following tables present, by class of loans, the recorded investment in loans by internally assigned risk rating as of December 31, 2019 and 2018:

2019	Pass	Watch/ Special Mention	Substandard	Doubtful	Total Loans
Commercial real estate	$ 203,904,471	$ 3,273,428	$ 4,260,120	$ -	$ 211,438,019
Commercial	55,915,358	1,241,496	2,363,780	-	59,520,634
Residential real estate	23,720,770	684,695	218,688	-	24,624,153
Consumer	3,546,643	16,030	1,592	-	3,564,265
Total	$ 287,087,242	$ 5,215,649	$ 6,844,180	$ -	$ 299,147,071
2018					
Commercial real estate	$ 156,428,056	$ 4,338,643	$ 1,779,577	$ -	$ 162,546,276
Commercial	57,982,674	2,108,507	454,285	-	60,545,466
Residential real estate	25,463,641	537,287	325,045	-	26,325,973
Consumer	2,896,564	18,280	34,556	-	2,949,400
Total	$ 242,770,935	$ 7,002,717	$ 2,593,463	$ -	$ 252,367,115

Troubled debt restructurings

Loans classified as TDRs aggregated $1,316,314 and $1,332,478 as of December 31, 2019 and 2018, respectively. All loans classified as TDRs were accruing interest as of December 31, 2019 and 2018, respectively.

Loan modifications made by the Bank which result in TDRs generally include rate modifications (a modification of the interest rate), term modifications (a modification of the maturity date, timing of payments, and/or frequency of payments), payment modifications (a modification of the payment amount), or combination modifications (any other type of modification, including the use of multiple types of modifications).

There were no new TDRs during the years ended December 31, 2019 and 2018.

The Bank's operations, like those of other financial institutions operating in the Bank's market, are significantly influenced by various economic conditions including local economies, the strength of the real estate market, and the fiscal and regulatory policies of the federal and state governments and the regulatory authorities that govern financial institutions. Any downturn in the real estate markets could materially and adversely affect the Bank's business, because a significant portion of the Bank's loans are secured by real estate. The Bank's ability to recover on defaulted loans by selling the real estate collateral would then be diminished and the Bank would be more likely to suffer losses on defaulted loans. Consequently, the Bank's results of operations and financial condition are dependent upon the general trends in the economy, and, in particular, the residential and commercial real estate markets. If there is a decline in real estate values, the collateral for the Bank's loans would provide less security. Real estate values could be affected by, among other things, a worsening of economic conditions, an increase in foreclosures, a decline in home sale volumes, and an increase in interest rates. Furthermore, the Bank may experience an increase in the number of borrowers who become delinquent, file for protection under bankruptcy laws, or default on their loans or other obligations to the Bank given a sustained weakness or a weakening in business and economic conditions generally or specifically in the principal markets in which the Bank does business. An increase in the number of delinquencies, bankruptcies, or defaults could result in a higher level of nonperforming assets, net charge-offs, and provision for loan losses.

Note 4 - Loan Servicing Rights

Loans serviced by the Bank for the Federal Home Loan Mortgage Corporation ("FHLMC") and U.S. Department of Agriculture are not included in the accompanying consolidated balance sheets. The unpaid principal balance of such serviced loans as of December 31, 2019 and 2018 was $19,183,006 and $23,669,740, respectively.

Transactions in the Bank's loan servicing rights for the years ended December 31, 2019 and 2018 were as follows:

	2019	2018
Balance, beginning of year	$ 108,210	$ 132,238
Additions	-	-
Amortization	(19,155)	(24,028)
Balance, end of year	$ 89,055	$ 108,210

Note 5 - Premises and Equipment

Premises and equipment consisted of the following as of December 31, 2019 and 2018:

	2019	2018
Land	$ 1,787,984	$ 1,787,984
Building and improvements	7,221,192	7,100,498
Construction in progress	95,690	669,018
Furniture and equipment	4,246,045	3,701,085
Leasehold improvements	894,332	169,510
Total premises and equipment	14,245,243	13,428,095
Less accumulated depreciation and amortization	(7,203,523)	(6,650,921)
Premises and equipment, net	$ 7,041,720	$ 6,777,174

Depreciation expense for the years ended December 31, 2019 and 2018 was $552,602 and $584,982, respectively.

Note 6 - Time Deposits

Time deposits that meet or exceed the Federal Deposit Insurance Corporation ("FDIC") insurance limit of $250,000 aggregated $1,964,257 and $2,466,105 as of December 31, 2019 and 2018, respectively.

As of December 31, 2019, the scheduled annual maturities of time deposits were as follows:

2020	$ 12,656,467
2021	2,441,106
2022	756,684
2023	1,097,814
2024	1,649,631
	$ 18,601,702

Note 7 - Short-Term Borrowings and FHLB Borrowings

As of December 31, 2019, the Bank has available lines of credit of $3,000,000 with U.S. Bank and $2,000,000 with Pacific Coast Bankers' Bank. The Bank had no amounts outstanding on such lines of credit. As of December 31, 2019, the Bank also has an available line of credit with the FRB discount window totaling $3,862,754 subject to certain collateral requirements (primarily the amount of certain pledged loans).

The Bank is a member of and has entered into credit arrangements with the FHLB. The Bank participates in the FHLB's Cash Management Advance (CMA) program and also has fixed and adjustable rate promissory notes with the FHLB. Borrowings under the credit arrangements are collateralized by mortgage loans or other pledged instruments. Borrowings available to the Bank under all FHLB credit arrangements are limited to the lesser of 45% of the Bank's total assets or collateral availability. The CMA program advances are due on demand, or if no demand is made, in one year. As of December 31, 2019 and 2018, the Bank had no outstanding borrowings under the CMA program.

The Bank had no FHLB term borrowing notes outstanding as of December 31, 2019 and 2018.

FHLB advances are collateralized by certain qualifying loans in the amount of $125,487,757 and $80,462,309 as of December 31, 2019 and 2018, respectively. As of December 31, 2019 and 2018, the Banky had borrowing capacity available at the FHLB of $88,476,420 and $57,914,743, respectively.

Note 8 – Subordinated Debentures (Trust Preferred Securities)

Oregon Pacific Statutory Trust I (the Trust) is a wholly-owned Connecticut statutory business trust subsidiary which issued $4,000,000 of guaranteed undivided beneficial interests in Bancorp's floating rate Junior Subordinated Deferrable Interest Debentures (the "Trust Preferred Securities" or "TPS") and $124,000 of common securities. The common securities were purchased by Bancorp and represent a 3% minority interest in the Trust. The Company's investment in common securities is included in accrued interest receivable and other assets in the accompanying consolidated balance sheets.

The proceeds from the issuance of the common securities and the TPS were used by the Trust to purchase $4,124,000 of subordinated deferrable interest debentures ("the Debentures") of Bancorp. The Debentures, which represent the sole asset of the Trust, possess the same terms as the TPS and accrue interest at the three-month London Interbank Offered Rate ("LIBOR") plus 2.85% per year which changes quarterly. The rate ranged between 4.75% and 5.64% during 2019 and between 4.45% and 5.64% during 2018. The accrued interest on the Debentures is paid to the Trust by Bancorp, and the Trust in turn distributes the interest income as dividends on the TPS. As of December 31, 2019 and 2018, the accrued interest to be paid to the Trust is $8,773 and $5,968, respectively. Management believes that, as of December 31, 2019 and 2018, the Debentures meet applicable regulatory guidelines to qualify as tier 1 capital/common equity tier 1 capital.

In conjunction with the issuance of the TPS, Bancorp entered into contractual arrangements which, taken collectively, fully and unconditionally guarantee payment of (1) accrued and unpaid distributions required to be paid on the TPS, (2) the redemption price with respect to any TPS called for redemption by the Trust, and (3) payments due upon a voluntary or involuntary dissolution, winding up, or liquidation of the Trust. The TPS are mandatorily redeemable upon maturity of the Debentures on December 17, 2033, or upon earlier redemption as provided in the indenture. Bancorp has the right to redeem the Debentures purchased by the Trust in whole or in part, on or after December 17, 2008. As specified in the indenture, if the Debentures are redeemed prior to maturity, the redemption price will be the principal amount and any accrued but unpaid interest. For the years ended December 31, 2019 and 2018, Bancorp's interest expense related to the TPS was $217,287 and $201,503, respectively.

Note 9 - Income Taxes

The provision for income taxes in 2019 and 2018 was as follows:

	2019	2018
Current expense:		
Federal	$ 637,609	$ 523,259
State	264,874	222,396
	902,483	745,655
Deferred expense:		
Federal	175,459	38,021
State	68,818	12,360
	244,277	50,381
Income taxes	$ 1,146,760	$ 796,036

The provision for income taxes results in effective tax rates which are different than the federal income tax statutory rate. The nature of the differences in 2019 and 2018 were as follows:

	2019	2018
Federal income taxes at statutory rate	$ 979,573	$ 714,322
State income taxes	280,065	204,228
Effect of nontaxable income	(144,899)	(139,915)
Other	32,021	17,401
Provision for income taxes	$ 1,146,760	$ 796,036

The components of the net deferred tax assets and liabilities as of December 31, 2019 and 2018 were as follows:

	2019	2018
Deferred tax assets:		
Allowance for loan losses and unfunded loan commitments	$ 529,538	$ 434,750
Deferred compensation	545,855	528,168
Interest income on nonaccrual loans	19,150	16,965
OREO basis	-	96,905
Unrealized losses on available-for-sale debt securities	-	247,389
Other	36,930	7,855
	1,131,473	1,332,032
Deferred tax liabilities:		
Accumulated depreciation and amortization	(356,575)	(60,616)
Loan servicing rights	(26,590)	(24,340)
FHLB stock dividends	(19,487)	(26,589)
Unrealized gains on available-for-sale investment securities - net	(194,167)	-
	(596,819)	(111,545)
Net deferred tax assets	$ 534,654	$ 1,220,487

The Company has determined that it is not required to establish a valuation allowance for the net deferred tax assets as of December 31, 2019 and 2018, as management believes it is more likely than not that the net deferred tax assets will be realized principally through future taxable income and future reversals of existing taxable temporary differences.

Note 10 - Commitments and Contingencies

Financial instruments with off-balance sheet risk

In the normal course of business, the Bank is a party to financial instruments with off-balance sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These financial instruments involve elements of credit and interest rate risk similar to the amounts recognized in the accompanying consolidated balance sheets. The contract or notional amounts of these financial instruments reflect the extent of the Bank's involvement in particular classes of financial instruments.

As of December 31, 2019 and 2018, the Bank had no commitments to extend credit at below-market interest rates and held no significant derivative 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 standby letters of credit is represented by the contractual or notional amount of those instruments. The Bank uses the same credit policies in underwriting and offering commitments and conditional obligations as it does for on-balance sheet instruments.

A commitment to extend credit is an agreement to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of fees. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. While most commercial letters of credit are not utilized, a significant portion of such utilization is on an immediate payment basis.

The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include cash, accounts receivable, premises and equipment, and income producing commercial properties.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third-party, the Bank would be required to fund the commitment. The maximum potential amount of future payments the Bank could be required to make is represented by the contractual amount of the commitment. 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.

A summary of the Bank's off-balance sheet financial instruments as of December 31, 2019 and 2018 is as follows:

	2019	2018
Commitments to extend credit	$ 49,598,315	$ 43,318,968
Commercial and standby letters of credit	315,361	2,959,657
Total off-balance sheet financial instruments	$ 49,913,676	$ 46,278,625

Additionally, the Bank previously sold real estate loans to the FHLMC. The FHLMC has the right to reject a loan that it has previously purchased and require the Bank to repurchase the loan in the event of certain misstatements or omissions of facts in the loan application. During the years ended December 31, 2019 and 2018, there were no loans that required repurchase by the Bank from the FHLMC. The Bank has not realized significant losses related to these repurchases, and management believes that any liabilities that may result from such recourse provisions are not significant to the accompanying consolidated financial statements.

In December 2018 the Bank executed an early termination option on its existing Eugene lease to relocate to a larger branch location. Through the Bank's commercial leasing agent, a subtenant was identified. Instead of entering into a subtenant lease agreement, the landlord agreed to lease to the tenant directly. In order for the landlord to agree to the terms of the replacement lease, the Bank has agreed to remain a contingent guarantor on the replacement tenant's lease through September 2021. As of December 31, 2019, the total maximum potential amount of future payments under the leasing agreement was $114,746. The Bank has reviewed the financial condition of the replacement tenant and does not believe there is any significant risk that the Bank will be required to make any payments under this guaranty. Accordingly, the Bank has not recorded any liability related to this guaranty as of December 31, 2019.

Operating lease commitments

The Bank leases certain branch premises under noncancelable operating lease agreements. The Bank does not have any operating leases with an initial term of 12 months or less.

The lease agreements contain various provisions for increases in rental rates, based either on changes in the published Consumer Price Index or a predetermined escalation schedule. The lease agreements do not contain any material residual value guarantees or restrictive covenants. Certain operating leases provide the Bank with the option to extend the lease term one or more times following expiration of the initial term. Lease extensions are not reasonably certain, and the Bank generally does not recognize payments occurring during option periods in the calculation of its operating lease right-of-use assets and operating lease liabilities.

The Company adopted the requirements of ASC 842 effective January 1, 2019, which required the Company to record in the consolidated balance sheet an operating lease right-of-use asset and an operating lease liability for leases with an initial term of more than 12 months for leases that existed as of January 1, 2019. The periods prior to the date of adoption are accounted for under superseded ASC 840; therefore, the following disclosures include only the period for which ASC 842 was effective.

The table below presents the lease right-of-use assets and lease liabilities, which are recorded in accrued interest receivable and other assets and accrued interest payable and other liabilities, respectively, in the accompanying consolidated balance sheet as of December 31, 2019:

Operating lease right-of-use assets	$	1,221,441
Operating lease liabilities	$	1,235,442
Operating lease weighted-average remaining lease term		6.51 years
Operating lease weighted-average discount rate		3.02%

Total operating lease costs were $241,584 and $255,747 for the years ended December 31, 2019 and 2018, respectively, and are included in occupancy expense in the accompanying consolidated statement of comprehensive income.

Operating cash flows paid for operating lease amounts included in the measurement of lease liabilities was $213,630 for the year ended December 31, 2019.

The following table reconciles the undiscounted cash flows for the periods presented related to the Company's operating lease liabilities as of December 31, 2019.

Year ending December 31,	
2020	218,359
2021	223,194
2022	228,137
2023	216,061
2024	135,153
Thereafter	349,590
Total minimum leaase payments	1,370,494
Less: amount of payments representing interest	135,052
Lease Liabilities	1,235,442

Litigation

In the ordinary course of business, the Bank becomes involved in various litigation arising from normal banking activities, including numerous matters related to loan collections and foreclosures. In the opinion of management, the ultimate disposition of these legal actions will not have a material effect on the Company's consolidated financial statements as of and for the year ended December 31, 2019.

Public deposits

The Bank is a participant in the Oregon Public Deposit Protection Program (the Program). The Program was established to provide additional protection for Oregon public funds in the event of a bank loss. Each Program participant is required to pledge securities or obtain a letter of credit for a defined percentage of its average of public funds held in excess of FDIC deposit insurance limits. This percentage is based on the Bank's capital adequacy and the discretion of the Office of the State Treasurer. In the event of an Oregon bank failure and to the extent sufficient collateral is unavailable to repay its public funds, any uninsured public deposits would be fully repaid by the other Program participants. As of December 31, 2019, the Bank had pledged securities aggregating $4,600,273 under the Program for its public deposits and there was no liability associated with the Bank's participation in the Program. The maximum future contingent liability is dependent upon the occurrence of an actual loss, the amount of such loss, the failure of collateral to cover such a loss, and the resulting share of loss to be assessed to the Company, all of which cannot presently be determined.

Note 11 - Concentrations of Credit Risk

Except for guaranteed loans purchased from the U.S. Department of Agriculture and Small Business Administration, all of the Bank's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area. Nearly all such customers are depositors of the Bank. Concentrations of credit by type of loan are set forth in Note 3. The distribution of commitments to extend credit approximates the distribution of loans outstanding. Commercial and standby letters of credit were granted primarily to commercial borrowers as of December 31, 2019. The Bank's loan policy does not allow the extension of credit to any single borrower or group of related borrowers in excess of the Bank's legal lending limit, which is generally 15% of aggregate common stock and the allowance for loan losses. Investments in state and municipal securities involve government entities throughout the U.S.

The Bank maintains balances in correspondent bank accounts, which at times may exceed federally insured limits. Management believes that its risk of loss associated with such balances is minimal due to the financial strength of the correspondent banks. The Bank has not experienced any losses in such accounts.

Note 12 - Fair Value

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. GAAP requires that valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs. GAAP also establishes a fair value hierarchy which prioritizes the valuation inputs into three broad levels. Based on the underlying inputs, each fair value measurement in its entirety is reported in one of three levels. These levels are:

Level 1: Fair value of the asset or liability is determined using unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: Fair value of the asset or liability is determined using inputs other than quoted prices that are observable for the applicable asset or liability, either directly or indirectly, such as quoted prices for similar (as opposed to identical) assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3: Fair value of the asset or liability is determined using unobservable inputs that are significant to the fair value measurement and reflect management's own assumptions regarding the applicable asset or liability.

Recurring fair value measurements

The fair values of the Company's available-for-sale debt securities as of December 31, 2019 and 2018 are estimated by an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the security's terms and conditions, among other factors. When market quotes are not readily accessible or available, alternative approaches are utilized, such as matrix or model pricing.

The Company's assets measured at fair value on a recurring basis as of December 31, 2019 and 2018 were as follows:

2019	Level 1	Level 2	Level 3
Available-for-sale debt securities			
U.S. Treasury and agencies	$ -	$ 1,002,990	$ -
Obligations of state and political subdivisions	-	16,314,720	-
Mortgage-backed securities	-	8,278,808	-
Corporate notes	-	2,004,760	-
Total available-for-sale debt securities	$ -	$ 27,601,278	$ -

2018	Level 1	Level 2	Level 3
Available-for-sale debt securities			
U.S. Treasury and agencies	$ -	$ 984,630	$ -
Obligations of state and political subdivisions	-	15,517,015	-
Mortgage-backed securities	-	8,331,533	-
Corporate notes	-	1,973,130	-
Total available-for-sale debt securities	$ -	$ 26,806,308	$ -

Non-recurring fair value measurements

Certain impaired loans are reported at estimated fair value on a non-recurring basis, including impaired loans measured at an observable market price (if available), the present value of expected future cash flows discounted at the loan's effective interest rate, or at the fair value of the loan's collateral (if collateral dependent). Estimated fair value of the loan's collateral is determined by appraisals or independent valuation which is then adjusted for the estimated costs related to liquidation of the collateral. Management's ongoing review of appraisal information may result in additional discounts or adjustments to valuation based upon more recent market sales activity or more current appraisal information derived from properties of similar type and/or location. A significant portion of the Bank's impaired loans are measured using the estimated fair market value of the collateral less the estimated costs to sell.

OREO is measured on a non-recurring basis at estimated fair value less estimated costs to sell. Fair value is generally determined based on third-party appraisals of fair value in an orderly sale. Historically, appraisals have considered comparable sales of similar assets in reaching a conclusion as to fair value. Estimated costs to sell OREO are based on standard market factors. The valuation of OREO is subject to significant external and internal judgment. Management periodically reviews OREO to determine whether the property continues to be carried at the lower of its recorded book value or estimated fair value, net of estimated costs to sell. Fair value adjustments on OREO are recognized within the statements of comprehensive income as a component of noninterest expense.

The Company's assets measured at fair value on a non-recurring basis as of December 31, 2019 and 2018 were as follows:

	Level 1	Level 2	Level 3
2019			
Impaired loans with specific valuation allowances	$ -	$ -	$ 213,294
OREO	-	-	-
Total assets measured at fair value	$ -	$ -	$ 213,294
2018			
Impaired loans with specific valuation allowances	$ -	$ -	$ 451,890
OREO	-	-	1,223,523
Total assets measured at fair value	$ -	$ -	$ 1,675,413

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis as of December 31, 2019 and 2018:

	Fair Value 2019	Fair Value 2018	Valuation Technique	Unobservable Input(s)	Range
Impaired loans	$ 213,294	$ 451,890	Market approach	Appraised value of collateral less selling costs	NA
OREO	$ -	$ 1,223,523	Market approach	Lower of appraised value or listing price less selling costs	NA

The Company did not change the methodology used to determine the recurring/non-recurring fair values for any financial instruments during the years ended December 31, 2019 and 2018. Accordingly, for any given class of financial instruments, the Company did not have any transfers among Level 1, Level 2, or Level 3 during these years.

Other fair value disclosures

GAAP requires disclosure of estimated fair values for certain financial instruments. Such estimates are subjective in nature, and significant judgment is required regarding the risk characteristics of various financial instruments at a discrete point in time. Therefore, such estimates could vary significantly if assumptions regarding uncertain factors were to change. In addition, as the Company normally intends to hold the majority of its financial instruments until maturity, it does not expect to realize many of the estimated amounts disclosed. The disclosures also do not include estimated fair value amounts for certain items which are not defined as financial instruments but which may have significant value. The Company does not believe that it would be practicable to estimate a fair value for these types of items as of December 31, 2019 and 2018. Because GAAP excludes certain items from fair value disclosure requirements, any aggregation of the fair value amounts presented would not represent the underlying value of the Company.

The estimated fair values of the Company's financial instruments as of December 31, 2019 and 2018 were as follows:

			Fair Value Measurements at Report Date Using		
	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
2019					
Financial assets:					
Cash and cash equivalents	$ 4,982,204	$ 4,982,204	$ 4,982,204	$ -	$ -
Interest-bearing deposits in banks	17,510,684	17,510,684	17,510,684	-	-
Available-for-sale debt securities	27,601,278	27,601,278	-	27,601,278	-
Restricted equity securities	1,079,100	1,079,100	1,079,100	-	-
Loans	295,254,620	285,232,704	-	-	285,232,704
Bank-owned life insurance	7,066,432	7,066,432	7,066,432	-	-
Accrued interest receivable	1,052,623	1,052,623	1,052,623	-	-
Loan servicing rights	89,055	89,055	-	-	89,055
Financial liabilities:					
Time certificate accounts	18,601,702	18,351,164	-	18,351,164	-
Accrued interest payable	35,839	35,839	35,839	-	-
Subordinated debentures	4,124,000	3,440,469	-	-	3,440,469
2018					
Financial assets:					
Cash and cash equivalents	$ 5,515,759	$ 5,515,759	$ 5,515,759	$ -	$ -
Interest-bearing deposits in banks	9,539,514	9,539,514	9,539,514	-	-
Available-for-sale debt securities	26,806,308	26,806,308	-	26,806,308	-
Restricted equity securities	1,019,900	1,019,900	1,019,900	-	-
Loans	248,884,606	239,563,934	-	-	239,563,934
Bank-owned life insurance	6,836,270	6,836,270	6,836,270	-	-
Accrued interest receivable	963,887	963,887	963,887	-	-
Loan servicing rights	108,210	108,210	-	-	108,210
Financial liabilities:					
Time certificate accounts	17,804,262	17,709,316	-	17,709,316	-
Accrued interest payable	21,843	21,843	21,843	-	-
Subordinated debentures	4,124,000	3,726,528	-	-	3,726,528

Note 13 - Stock-Based Compensation

The Company has a stock incentive plan (the 2012 Plan) which was approved by its stockholders during 2012. The 2012 Plan provides that 250,000 shares of Bancorp's common stock will be reserved for the granting of incentive stock options and non-statutory stock options to certain key employees, directors, or consultants. The exercise price of each incentive option cannot be less than the fair market value of the Company's common stock on the date of grant. In addition, the 2012 Plan allows the Board to grant stock appreciation rights and restricted stock awards as may be allowable by law. As of December 31, 2019, no options had been granted under the 2012 Plan.

The following table summarizes the restricted stock award activity under the 2012 Plan:

	2019		2018	
	Nonvested restricted shares outstanding	**Weighted average grant date fair value**	**Nonvested restricted shares outstanding**	**Weighted average grant date fair value**
Balance, beginning of period	26,000	$ 5.33	7,000	$ 4.66
Granted	2,500	$ 5.76	24,000	$ 5.45
Forfeited	-		-	
Vested	-	$ -	(5,000)	$ 4.99
Balance,end of period	28,500	$ 5.37	26,000	$ 5.33

The restricted stock awards generally cliff vest over a period of five years and are valued based on the grant-date fair value of the Company's common stock. During the years ended December 31, 2019 and 2018, the Company recognized stock-based compensation expense of $29,130 and $43,567, respectively.

As of December 31, 2019, there was $98,153 in unrecognized compensation costs related to nonvested restricted stock, which is expected to be recognized over a weighted average period of 3.21 years.

The unvested restricted stock shares are considered issued and outstanding. Holders of the shares have voting rights and would receive any declared dividends.

Note 14 - Benefit Plans

Effective January 1, 1998, the Bank adopted a Savings Incentive Match Plan (SIMPLE IRA) which covers substantially all employees once a minimum length of employment has been met. The Bank's contributions to the SIMPLE IRA totaled $143,981 during the year ended December 31, 2018.

On January 1, 2019, the Bank replaced the SIMPLE IRA with a 401(k) Plan which covers all employees once a minimum length of employment has been met. The Bank's contributions to the 401(k) Plan totaled $216,661 during the year ended December 31, 2019.

The Bank has also established a nonqualified deferred compensation plan for certain key management employees. Participants may elect to defer a portion of their compensation to the deferred compensation plan, subject to a minimum annual deferral of $5,000. In addition, the Bank may make discretionary employer contributions to the accounts of participants in the deferred compensation plan. Each participant's account is subject to a rate of return based on either the Bank's performance or on the return of another eligible investment option, as selected by each participant. For the years ended December 31, 2019 and 2018, the Bank recorded expenses of $190,508 and $141,550, respectively, related to the deferred compensation plan. The liability for benefits under the deferred compensation plan totaled $2,021,389 and $1,956,779 as of December 31, 2019 and 2018, respectively.

Upon enrollment in the deferred compensation plan, employees can elect the terms of their post-retirement distributions. Payout terms vary between one lump sum or monthly payments over a period of fifteen years.

Note 15 - Earnings Per Common Share and Common Equivalent Shares

The Company's basic earnings per common share is computed by dividing net income by the weighted-average number of common shares outstanding during the period. The Company's diluted earnings per common share is computed by dividing net income by the weighted-average number of common shares outstanding plus dilutive common shares related to stock options.

The numerators and denominators used in computing basic and diluted earnings per common share in 2019 and 2018 can be reconciled as follows:

	Net Income (Numerator)	Weighted Average Shares (Denominator)	Earnings Per Common Share
2019			
Basic and diluted earnings per common share	$ 3,517,873	6,973,920	$ 0.50
2018			
Basic and diluted earnings per common share	$ 2,605,495	6,964,036	$ 0.37

Note 16 - Transactions with Related Parties

Certain directors, executive officers, and principal stockholders of the Company (and the companies with which they are associated) are customers of, and have had banking transactions with, the Bank in the ordinary course of business. In addition, the Bank expects to have such transactions in the future. All loans and commitments to loan to such parties were made in compliance with applicable laws on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons. In the opinion of management, these transactions do not involve more than the normal risk of collectability or present any other unfavorable features.

An analysis of activity with respect to such loans in 2019 and 2018 is as follows:

	2019	2018
Loans outstanding, beginning of year	$ 3,967,811	$ 900,475
Additions	1,400,000	3,148,856
Repayments	(285,306)	(81,520)
Loans no longer classified as related party loans	(192,130)	-
Loans outstanding, end of year	$ 4,890,375	$ 3,967,811

Note 17 – Revenue from Contracts with Customers

Revenue in the scope of ASC 606 is measured based on the consideration specified in the contract with a customer and excludes amounts collected on behalf of third parties. The majority of the Bank's revenue is specifically excluded from the scope of ASC 606. For in-scope revenue, the following is a description of principal activities, separated by the timing of revenue recognition from which the Bank generates its revenue from contracts with customers.

Revenue earned at a point in time - Examples of revenue earned at a point in time are ATM transaction fees, wire transfer fees, overdraft fees, interchange fees and foreign exchange transaction fees, which are recorded in the service charges and fees category in the following table. Revenue is primarily based on the number and type of transactions and is generally derived from transactional information accumulated by the Bank's systems and is recognized immediately as the transactions occur or upon providing the service to complete the customer's transaction. The Bank is the principal in each of these contracts, with the exception of interchange fees, in which case the Bank is acting as the agent and records revenue net of expenses paid to the principal.

Revenue earned over time - The Bank earns revenue from contracts with customers in a variety of ways where the revenue is earned over a period of time - generally monthly. Examples of this type of revenue are deposit account maintenance fees and safe deposit box fees, which are recorded in the service charges and fees category in the following table. Other examples are trust fee income, RIA income, investment sales commissions, and merchant card services. Revenue is generally derived from transactional information accumulated by the Bank’s systems or those of third-parties and is recognized as the related transactions occur or services are rendered to the customer.

The Bank recognizes revenue from contracts with customers when it satisfies its performance obligations. The Bank’s performance obligations are typically satisfied as services are rendered, and the Bank’s contracts generally do not include multiple performance obligations. As a result, there are no contract balances as payments and services are rendered simultaneously. Payment is generally collected at the time services are rendered, monthly or quarterly. Unsatisfied performance obligations at the reporting date are not material to the Bank’s consolidated financial statements.

The Bank’s revenue from contracts with customers is recognized in noninterest income. The following table presents the Bank’s noninterest income for the years ended December 31, 2019 and 2018, segregated by revenue from contracts with customers and revenue from other sources:

	2019	2018
Revenue from contracts with customers		
Trust fee income	$ 2,141,040	$ 2,603,916
Service charges and fees	902,735	848,321
Investment sales commissions	197,101	239,656
Merchant card services	273,405	234,543
RIA income	413,583	216,074
Other income	35,556	37,575
	3,963,420	4,180,085
Revenue from other sources		
Mortgage loan sales and servicing fees	498,384	408,720
Increase in cash surrender value of BOLI	230,162	193,712
Other income	52,780	23,189
	781,326	625,621
Total noninterest income	$ 4,744,746	$ 4,805,706

Note 18 - Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by federal and state 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 Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's 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 tables) of tier 1 capital to average assets and common equity tier 1, tier 1, and total capital to risk-weighted assets (all as defined in the regulations). Management believes that, as of December 31, 2019 and 2018, the Bank met or exceeded all capital adequacy requirements to which it is subject.

To be categorized as "adequately capitalized" or "well-capitalized," the Bank must maintain minimum common equity tier 1, tier 1 leverage, tier 1 risk-based, and total risk-based capital ratios as set forth in the following tables. As of December 31, 2019, the most recent notification from the Bank's regulator categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes would change the Bank's regulatory capital categorization.

The Bank's actual and required capital amounts and ratios as of December 31, 2019 and 2018 are presented in the following table (dollars in thousands):

	Actual		Regulatory Minimum to be "Adequately Capitalized"		Regulatory Minimum to be "Well Capitalized" Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2019						
Tier 1 capital (to average assets)	$ 40,734	11.13%	$ 14,634	4.00%	$ 18,293	5.00%
Common equity tier 1 capital (to risk weighted assets)	40,734	13.80%	13,281	4.50%	19,183	6.50%
Tier 1 capital (to risk-weighted assets)	40,734	13.80%	17,708	6.00%	23,610	8.00%
Total capital (to risk-weighted assets)	44,371	15.03%	23,610	8.00%	29,513	10.00%
2018						
Tier 1 capital (to average assets)	$ 37,207	12.11%	$ 12,285	4.00%	$ 15,357	5.00%
Common equity tier 1 capital (to risk weighted assets)	37,207	15.05%	11,128	4.50%	16,074	6.50%
Tier 1 capital (to risk-weighted assets)	37,207	15.05%	14,837	6.00%	19,783	8.00%
Total capital (to risk-weighted assets)	40,300	16.30%	19,783	8.00%	24,729	10.00%

Bancorp is a bank holding company registered with the FRB. Bank holding companies are subject to capital adequacy requirements of the FRB under the Bank Holding Company Act of 1956, as amended, and the regulations of the FRB. For a bank holding company with less than $3.0 billion in assets, the capital guidelines apply on a bank only basis, and the FRB expects the holding company's subsidiary bank to be well capitalized under the prompt corrective action provisions. If the Company was subject to regulatory guidelines for bank holding companies with $3.0 billion or more in assets, as of December 31, 2019, Bancorp would have exceeded all regulatory capital requirements.

Oregon Pacific Bancorp

Oregon Pacific Bank

Forward-Looking Statement Safe Harbor

This release contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 ("PSLRA"). These statements can be identified by the fact that they do not relate strictly to historical or current facts. Forward-looking statements often use words such as "anticipates," "targets," "expects," "estimates," "intends," "plans," "goals," "believes" and other similar expressions or future or conditional verbs such as "will," "should," "would" and "could." The forward-looking statements made represent Oregon Pacific's current estimates, projections, expectations, plans or forecasts of its future results and revenues, including but not limited to statements about performance, loan or deposit growth, strategic focus, capital position, liquidity, credit quality and credit quality trends. These statements are not guarantees of future results or performance and involve certain risks, uncertainties and assumptions that are difficult to predict and are often beyond Oregon Pacific's control. Actual outcomes and results may differ materially from those expressed in, or implied by, any of these forward-looking statements. You should not place undue reliance on any forward-looking statement and should consider all of the following uncertainties and risks. Oregon Pacific Bancorp undertakes no obligation to publicly revise or update any forward-looking statement to reflect the impact of events or circumstances that arise after the date of this release. This statement is included for the express purpose of invoking the PSLRA's safe harbor provisions.

Oregon Pacific Bancorp, whose stock is publicly traded, is the holding company for Oregon Pacific Bank.
Our stock is listed on the OTCBB (Over-the-Counter Bulletin Board) with the ticker symbol ORPB.