Cashmere Valley Bank

2016 Annual Report

"The little Bank with the big circle of friends"

Member FDIC

Performance Results	**2016**	**2015**	**2014**	**2013**	**2012**
Return on average equity	10.70%	11.24%	11.79%	11.52%	11.45%
Return on average assets	1.24%	1.25%	1.21%	1.14%	1.12%
Equity to assets	11.41%	11.24%	10.73%	9.81%	9.85%
Earnings per share - Basic	$4.29	$4.12	$3.90	$3.52	$3.30
Dividends per share	$0.98	$0.90	$0.79	$0.76	$0.76
Book value per share	$40.50	$38.08	$35.02	$31.13	$30.17
Market value per share	$47.25	$38.42	$35.25	$29.50	$27.40
Net overhead to average assets	1.28%	1.20%	1.14%	1.00%	0.99%
Average earning assets to average total assets	96.30%	97.01%	96.41%	96.66%	96.60%
Allowance for credit losses to total loans at December 31	1.28%	1.49%	1.60%	1.58%	1.81%
Yield and Cost of Funds					
Yield on investments	2.65%	2.58%	2.73%	1.93%	1.87%
Yield on loans	4.13%	4.27%	4.53%	4.98%	5.76%
Cost of funds	0.36%	0.39%	0.53%	0.67%	0.89%
Net interest margin	3.25%	3.28%	3.27%	3.03%	3.06%
Selected Items ***(in thousands)***					
Total cash and cash equivalents	$125,444	$81,315	$54,205	$64,645	$83,262
Total investments	$424,800	$417,566	$482,104	$472,377	$490,863
Total loans	$864,924	$847,547	$753,810	$711,805	$631,543
Total assets	$1,454,239	$1,381,663	$1,324,604	$1,283,278	$1,238,687
Total deposits	$1,269,026	$1,203,816	$1,159,306	$1,137,897	$1,096,885
Total equity	$165,879	$155,343	$142,069	$125,917	$121,969

To the Shareholders and Friends of the Bank

We completed our 84th year in business and are happy to report net income increased by 4.53% to $17.5 million, or $4.29 per share.

Capital levels also continue to improve, increasing to 11.41% from 11.24% in the prior year. We augmented capital while also paying dividends to our shareholders totaling $3.7 million. We continue to provide our shareholders with top-tier returns, with return on equity totaling 10.70% and return on assets totaling 1.24%. These performance ratios reflect Cashmere Valley Bank's position as a high performing bank relative to our peers.

Credit quality continues to improve from an already strong position. Our non-performing loans are .02% of assets at year end, with past due loans on a monthly basis frequently reporting below .25% of total loans. These are levels of credit quality that surpass anything I have seen in my career. As a consequence we lowered our allowance for credit losses at year end, another first in my career, to 1.28% of total loans.

We continue to enjoy a very loyal and growing customer base that contributes to our core funding. Said another way, the overwhelming majority of our funding comes from retail households and business who deposit their money and perform the majority of their financial transactions with us. This loyalty is reflected in growth in deposits this year by 5.41%, exceeding most of our peers.

While we continue to provide excellent returns to our shareholders, we have done this while also reducing risk resulting from the Great Recession. With this report I am happy to share that your bank has what we believe to be a low-risk profile. As such, we now have the capital in place to take on additional risk in the coming years in order to improve returns moving forward. Rest assured that our appetite for risk will remain cautious, as it has in the past.

Our commitment and opportunities for growth are clear and we continue to look to new markets for expansion. We currently have a modest presence in Yakima County and may soon look there for additional market expansion. We have a talented group of employees who are uniquely focused on customer service and are anxious to "export" our way of doing business to new markets. We often hear our customers say "your bank is different and we really like it". Stay tuned for more on our expansion efforts in the near future.

Finally, we have a new administration in Washington D.C. that is leaning toward regulatory relief for community banks like us. We speculate that these changes may reduce unnecessary burdens, allow for improved customer service and thereby provide an environment for improved earnings. It remains to be seen, however, if changes in the political winds will manifest themselves into actions.

As always, don't hesitate to contact me at 509-782-2092 if you have any questions about the bank. Thank you again for your support of "the little bank with the big circle of friends".

Sincerely,

Greg Oakes,
President and CEO

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Spokane, WA 99201-0611

Independent Auditor's Report

Management & Audit Committee
Cashmere Valley Bank Cashmere,
Washington

We have audited the accompanying consolidated financial statements of Cashmere Valley Bank, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of income and comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the 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 auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. 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 Cashmere Valley Bank as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

BDO USA, LLP

Spokane, Washington
March 22, 2017

Consolidated Balance Sheets

December 31, 2016 and 2015 *(Dollars in Thousands, Except Share Amounts)*

	2016	2015
Assets		
Cash and Cash Equivalents:		
Cash and due from banks	$19,516	$18,521
Interest-bearing deposits at other financial institutions	95,337	57,146
Federal funds sold	10,591	5,648
Total Cash and Cash Equivalents	125,444	81,315
Securities available for sale at fair value	421,261	414,560
Securities held to maturity (fair value of $1,533 and $1,066)	1,551	1,069
Federal Home Loan Bank (FHLB) stock, at cost	1,757	1,699
Pacific Coast Banker's Bancshares (PCBB) stock, at cost	238	238
Loans held for sale	397	540
Loans and leases	864,924	847,547
Allowance for credit losses	(11,037)	(12,589)
Net loans and leases	853,887	834,958
Premises and equipment, net	14,250	13,393
Accrued interest receivable	4,504	4,394
Foreclosed real estate	66	343
Bank owned life insurance	14,118	13,627
Goodwill	6,820	6,820
Intangibles	4	10
Mortgage servicing rights	1,723	1,768
Other assets	8,219	6,929
Total assets	**$1,454,239**	**$1,381,663**
Liabilities		
Deposits:		
Demand	$199,633	$181,853
Savings and interest-bearing demand	830,310	782,474
Time	239,083	239,489
Total deposits	1,269,026	1,203,816
Accrued interest payable	445	407
Short-term borrowings	11,467	12,201
Long-term borrowings	2,404	2,671
Other liabilities	5,018	7,225
Total liabilities	**1,288,360**	**1,226,320**
Commitments and Contingencies (see Note 11)		
Shareholders' Equity		
Common stock (no par value); authorized 10,000,000 shares;		
Issued and outstanding: 2016 – 4,095,966; 2015 – 4,079,179	--	--
Additional Paid in Capital	1,962	1,472
Retained earnings	161,939	148,425
Accumulated other comprehensive income	1,978	5,446
Total shareholders' equity	**165,879**	**155,343**
Total liabilities and shareholders' equity	**$1,454,239**	**$1,381,663**

See notes to consolidated financial statements.

Consolidated Statements of Income and Comprehensive Income

Years Ended December 31, 2016 and 2015 *(Dollars in Thousands, Except Per Share Amounts)*	2016	2015
Interest Income:		
Loans and leases	$33,282	$32,557
Federal Funds sold and deposits at other financial institutions	191	91
Securities available for sale:		
Taxable	5,605	6,038
Tax-exempt	4,738	4,153
Securities held to maturity - tax-exempt	36	20
Total interest income	43,852	42,859
Interest Expense:		
Deposits	4,296	4,390
Short-term borrowings	28	33
Long-term borrowings	151	167
Total interest expense	4,475	4,590
Net interest income	**39,377**	**38,269**
(Recovery)/Provision for Credit Losses	(735)	1,200
Net interest income after provision for credit losses	**40,112**	**37,069**
Non-Interest Income:		
Service charges on deposit accounts	1,127	1,029
Mortgage banking operations	2,360	2,182
Net (loss)/gain on sales of securities available for sale	(1,925)	212
Brokerage commissions	518	684
Insurance commissions and fees	1,833	1,708
Net interchange income	1,716	1,634
BOLI cash value	492	460
Other	1,538	1,659
Total non-interest income	7,659	9,568
Non-Interest Expense:		
Salaries and employee benefits	14,011	13,265
Occupancy and equipment	4,155	4,252
Audits and examinations	431	440
State and local business and occupation taxes	615	428
FDIC Insurance & WA State Assessments	828	696
Legal and professional fees	439	555
Net (gain)/loss on foreclosed real estate	(26)	616
Check losses and charge-offs	252	305
Low Income Housing Fund Losses	341	470
Data Processing	775	762
Product Delivery	1,231	1,321
Other	2,642	2,588
Total non-interest expense	25,694	25,698
Income before income taxes	**22,077**	**20,939**
Income Taxes	4,553	4,175
Net Income	**$17,524**	**$16,764**
Change in the fair value of securities available for sale, net of tax	(3,468)	(492)
Comprehensive Income	**$14,056**	**$16,272**
Earnings per share – Basic	$4.29	$4.12
Earnings per share – Diluted	$4.27	$4.10

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

Years Ended December 31, 2016 and 2015 *(Dollars in Thousands, Except Share Information)*

	Shares of Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance, December 31, 2014	**4,056,604**	**$812**	**$135,319**	**$5,938**	**$142,069**
Net income	--	--	16,764	--	16,764
Other comprehensive income, net of tax:					
Change in fair value of securities available for sale	--	--	--	(492)	(492)
Disqualifying Disposition Tax Benefit	--	3	--	--	3
Cash dividends paid ($0.90 per share)	--	--	(3,658)	--	(3,658)
Stock based compensation expense	--	106	--	--	106
Options exercised	20,225	551	--	--	551
Restricted Stock Grant	2,350	--	--	--	--
Balance, December 31, 2015	**4,079,179**	**$1,472**	**$148,425**	**$5,446**	**$155,343**
Net income	--	--	17,524	--	17,524
Other comprehensive income, net of tax:					
Change in fair value of securities available for sale	--	--	--	(3,468)	(3,468)
Disqualifying Disposition Tax Benefit	--	10	--	--	10
Cash dividends paid ($0.48 per share—January, $0.50 per share—July)	--	--	(4,004)	--	(4,004)
Stock based compensation expense	--	128	--	--	128
Options exercised	12,977	352	--	--	352
Restricted Stock Grant	3,960	--	--	--	--
Shares Repurchased	(150)	--	(6)	--	(6)
Balance, December 31, 2016	**4,095,966**	**$1,962**	**$161,939**	**$1,978**	**$165,879**

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years Ended December 31, 2016 and 2015 *(Dollars in Thousands)*

	2016	2015
Cash Flows from Operating Activities		
Net income	$17,524	$16,764
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	1,755	1,676
Provision for credit losses	(735)	1,200
Investment amortization – net	7,602	8,058
Deferred income tax	643	(279)
(Decrease)/increase in Federal income tax payable	(1,344)	225
Stock based compensation expense	128	106
Tax benefits from share-based payment arrangements	(10)	(3)
Increase/(decrease) in deferred compensation	398	(223)
Originations of loans held for sale	72,988	60,038
Proceeds from sales of loans held for sale	(71,322)	(59,143)
Net loss/(gain) on sale of securities, loans, property and equipment	478	(1,488)
(Gain)/loss on sale and impairment of foreclosed real estate	(26)	616
Increase in surrender value of Bank Owned Life Insurance	(491)	(461)
Change in:		
Accrued interest receivable	(110)	80
Accrued interest payable	38	(123)
Other – net	(224)	838
Net cash provided by operating activities	**27,292**	**27,881**
Cash Flows from Investing Activities		
Activity in securities available for sale:		
Sales	69,444	37,528
Maturities, prepayments, and calls	73,003	76,348
Purchases	(166,367)	(59,368)
Activity in securities held to maturity:		
Maturities, prepayments, and calls	20	19
Purchases	(497)	--
Divided on FHLB stock	(4)	--
Proceeds from redemption of FHLB stock	841	1,158
Loans and leases originated in excess of principal collected	(19,242)	(95,064)
Investment in Low Income Housing Fund	--	(163)
Additions to premises and equipment	(2,273)	(3,186)
Proceeds from sale of office property and equipment	--	34
Proceeds from sale of other real estate owned	1,351	1,332
Net cash used in investing activities	**(43,724)**	**(41,362)**
Cash Flows from Financing Activities		
Net increase in deposits	65,210	44,510
Net (decrease) in short-term borrowings	(734)	(565)
Repayments of long-term borrowings	(267)	(250)
Tax benefits from share-based payment arrangements	10	3
Cash dividends paid	(4,004)	(3,658)
Exercise of stock options	352	551
Repurchase of common stock	(6)	--
Net cash provided by financing activities	**60,561**	**40,591**
Net change in cash and due from banks	**44,129**	**27,110**
Cash and Due from Banks		
Beginning of year	81,315	54,205
End of year	**$125,444**	**$81,315**

See notes to consolidated financial statements

Note 1 - Summary of Significant Accounting Policies

Principles of Consolidation

Cashmere Valley Bank (the Company) was established in 1932. The consolidated financial statements of the Company include the accounts of the Company and the Bank's wholly owned subsidiary, Mitchell, Reed and Schmitten, Inc. (MRS), an insurance agency. All significant intercompany transactions and balances have been eliminated.

Nature of Operations

The Company is a Washington State chartered bank established in 1932 and operates ten branches in North Central Washington. The Company's lending and other banking activities are carried out in and around Chelan, Douglas, Kittitas, and Yakima counties and to a lesser degree, other areas of Western Washington. The Company provides loan and deposit services to customers, who are predominately small and middle-market businesses and middle income individuals. MRS is based in Wenatchee, Washington and brokers personal and commercial lines of insurance, including property, casualty, life and health insurance.

Consolidated Financial Statement Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and practices within the banking industry. GAAP defines a public company as one whose securities trade in a public market, including in over-the-counter markets. As the Company's stock trades in certain over-the-counter markets, certain disclosures are required to meet public company requirements. The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, as of the date of the consolidated balance sheet, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate primarily to the determination of the allowance for credit losses and valuations of securities, goodwill, and mortgage servicing rights. Certain prior year amounts have been reclassified to conform to 2016 presentation, with no change to total shareholders' equity or net income reported.

Cash and Cash Equivalents

The Company considers federal funds sold, cash and amounts due from banks, and interest-bearing deposits at other financial institutions to be Cash and Cash Equivalents, and are reported as such on the consolidated balance sheets and statement of cash flows. Cash flows from loans, deposits, and short-term borrowings are reported net. Additional cash flow information was as follows (dollars in thousands):

	2016	**2015**
Cash paid for interest	$5,331	$5,527
Cash paid for income taxes	4,944	4,127
Significant non-cash transactions:		
Foreclosed real estate acquired in settlement of loans	$(122)	$--
Fair value adjustment of securities available for sale, net of tax	3,468	492
Securities purchased, not settled	--	1,222

Stock Based Compensation

The Company has a stock-based compensation plans which are more fully described in Note 13. Under the plans, certain key employees have been awarded restricted stock grants and options to purchase common stock. Under the accounting guidance for stock compensation, compensation expense recognized includes the cost of stock-based awards associated with restricted stock grants and non-qualified stock options which are recognized as compensation expense over the vesting period on a straight line basis. The Company recognized stock-based compensation expense totaling $128,358 and 105,616 in 2016 and 2015, respectively.

Securities Available for Sale

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

The Company evaluates the portfolio for impairment each quarter. In estimating other-than-temporary losses, the Company considers the following factors: (1) the length of time and the extent to which the market value has been less than cost; (2) the financial condition and near-term prospect of the issuer; (3) the intent and ability of the Company to retain its investment in a security for a period of time sufficient to allow for any anticipated recovery in market value; (4) whether it is more likely than not that the Company will be required to sell the securities before recovery; and (5) general market conditions which reflect prospects for the economy as a whole, including interest rates and sector credit spreads. If a loss is deemed to be other-than-temporary, the Company then calculates a credit loss charge against earnings by subtracting the estimated present value of estimated future cash flows on the security from its amortized cost. The other-than-temporary impairment less the credit loss charge against earnings is a component of other comprehensive income.

Securities Held to Maturity

Debt securities which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for amortization of premiums and accretion of discounts, which are recognized in interest income over the period to maturity.

Federal Home Loan Bank Stock

The Company, as a member of the Federal Home Loan Bank (FHLB) system, is required to maintain an investment in capital stock of the FHLB based on the sum of the two following calculations (calculated at least annually as of the preceding December 31):

- The Membership Stock Purchase Requirement: based on a percentage of assets as shown in table below:

	Current Requirement	Minimum Investment	Maximum Investment
Percent of Total Assets	0.12%	0.10%	0.25%
Membership Stock Cap	$10 million	$1 million	$30 million
Membership Stock Floor	$10,000	$10,000	$30,000

- The Activity Based Stock Purchase Requirement: based on a percentage of the book value held and records of the transactions shown in the table below:

Transaction	Current Requirement	Minimum Requirement	Maximum Requirement
Outstanding Advances	4.00%	2.00%	5.00%
Outstanding Acquired Member Assets	4.00%	0.00%	5.00%
Standby Letters of Credit	0.00%	0.00%	0.175%
Advance Commitments	0.00%	0.00%	0.35%
Acquired Member Asset Commitments	0.00%	0.00%	0.60%

The recorded amount of FHLB stock equals its fair value because the shares can only be redeemed by the FHLB at the $100 per share par value.

The Company views its investment in the FHLB stock as a long-term investment. Accordingly, when evaluating for impairment, the value is determined based on the ultimate recovery of the par value rather than recognizing temporary declines in value. The determination of whether a decline affects the ultimate recovery is influenced by criteria such as: (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount and length of time a decline has persisted; (2) impact of legislative and regulatory changes on the FHLB; and (3) the liquidity position of the FHLB. Management has determined there is no impairment on its FHLB stock as of December 31, 2016.

Loans Held for Sale

Loans originated for sale in the secondary market, which is our principal market, or as whole loan sales are classified as loans held for sale. Management has elected the fair value option for all single family loans held for sale (originated with the intent to be held for sale) and records these loans at fair value. The fair value of loans held for sale is generally based on observable market prices from other loans in the secondary market that have similar collateral, credit, and interest rate characteristics. If quoted market prices are not readily available, the Company may consider other observable market data such as dealer quotes for similar loans or forward sale commitments. In certain cases, the fair value may be based on a discounted cash flow model. Gains and losses from changes in fair value on loans held for sale are recognized in net gain on mortgage loan origination and sale activities within noninterest income. Direct loan origination costs and fees for single family loans originated as held for sale are recognized in earnings. The change in fair value of loans held for sale is primarily driven by changes in interest rates subsequent to loan funding and changes in the fair value of related servicing asset, resulting in revaluation adjustments to the recorded fair value. The use of the fair value option allows the change in the fair value of loans to more effectively offset the change in the fair value of derivative instruments that are used as economic hedges to loans held for sale.

Loans Held for Investment

Loans held for investment are reported at the principal amount outstanding, net of cumulative charge-offs, interest applied to principal (for loans accounted for using the cost recovery method), unamortized net deferred loan origination fees and costs and unamortized premiums or discounts on purchased loans. Deferred fees and costs and premiums and discounts are amortized over the contractual terms of the underlying loans using the constant effective yield (the interest method). Interest on loans is accrued and recognized as interest income at the contractual rate of interest. A determination is made as of the loan commitment date as to whether a loan will be held for sale or held for investment. This determination is based primarily on the type of loan or loan program and its related profitability characteristics.

When a loan is designated as held for investment, the intent is to hold these loans for the foreseeable future or until maturity or pay-off. If subsequent changes occur, the Company may change its intent to hold these loans. Once a determination has been made to sell such loans, they are immediately transferred to loans held for sale and carried at the lower of cost or fair value.

Direct financing leases are carried at the aggregate of lease payments plus estimated residual value of the leased property, less unearned income. Interest income from direct financing leases is recognized over the term of the lease to achieve a constant periodic rate of return on the outstanding investment.

From time to time, the Company will originate loans to facilitate the sale of other real estate owned without a sufficient down payment from the borrower. Such loans are accounted for using the installment method and any gain on sale is deferred.

Nonaccrual Loans

Loans are placed on nonaccrual status when the full and timely collection of principal and interest is doubtful, generally when the loan becomes 90 days or more past due for principal or interest payment or if part of the principal balance has been charged off.

All payments received on nonaccrual loans are accounted for using the cost recovery method. Under the cost recovery method, all cash collected is applied to first reduce the principal balance. A loan may be returned to accrual status if all delinquent principal and interest payments are brought current and the collectability of the remaining principal and interest payments in accordance with the loan agreement is reasonably assured. Loans that are well-secured and in the process of collection are maintained on accrual status, even if they are 90 days or more past due.

Impaired Loans

A loan is considered impaired when it is probable that all contractual principal and interest payments due will not be collected in accordance with the terms of the loan agreement. Factors considered by management in determining whether a loan is impaired include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due.

Troubled Debt Restructurings

A loan is accounted for and reported as a troubled debt restructuring (“TDR”) when, for economic or legal reasons, we grant a concession to a borrower experiencing financial difficulty that we would not otherwise consider. A restructuring that results in only an insignificant delay in payment is not considered a concession. A delay may be considered insignificant if the payments subject to the delay are insignificant relative to the unpaid principal or collateral value and the contractual amount due, or the delay in timing of the restructured payment period is insignificant relative to the frequency of payments, the debt's original contractual maturity or original expected duration.

TDRs are designated as impaired because interest and principal payments will not be received in accordance with original contract terms. TDRs that are performing and on accrual status as of the date of the modification remain on accrual status. TDRs that are nonperforming as of the date of modification generally remain as nonaccrual until the prospect of future payments in accordance with the modified loan agreement is reasonably assured, generally demonstrated when the borrower maintains compliance with the restructured terms for a predetermined period, normally at least six months. TDRs with temporary below-market concessions remain designated as a TDR and impaired regardless of the accrual or performance status until the loan is paid off. However, if the TDR loan has been modified in a subsequent restructure with market terms and the borrower is not currently experiencing financial difficulty, then the loan may be de-designated as a TDR.

Allowance for Credit Losses

The allowance for credit losses is maintained at a level sufficient to provide for probable credit losses based on evaluating known and inherent risks in the loan and lease portfolio. The allowance is provided based upon management’s continuing analysis of the pertinent factors underlying the quality of the loan and lease portfolio. These factors include changes in the size and composition of the loan and lease portfolio, delinquency levels, actual loan loss experience, current economic conditions, and detailed analysis of individual loans for which full collectability may not be assured. The detailed analysis includes techniques to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. The allowance consists of specific, general, and unallocated components. For such loans that are classified as impaired, a specific allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover the risk of loss due to general economic uncertainties that could affect the loan portfolio and management’s estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. The appropriateness of the allowance for credit losses is estimated based upon these factors and trends identified by management at the time consolidated financial statements are prepared.

When available information confirms that specific loans or portions thereof are uncollectible, identified amounts are charged against the allowance for credit losses. The existence of some or all of the following criteria will generally confirm that a loss has been incurred: the loan is significantly delinquent and the borrower has not demonstrated the ability or intent to bring the loan current; the Company has no recourse to the borrower, or if it does, the borrower has insufficient assets to pay the debt; the estimated fair value of the loan collateral is significantly below the current loan balance, and there is little or no near-term prospect for improvement.

A provision for credit losses is charged against income and added to the allowance for credit losses based on regular assessments of the loan and lease portfolio. The allowance for credit losses is allocated to certain loan and lease categories based on the relative risk characteristics, asset classifications and actual loss experience of the loan and lease portfolio.

While management has allocated the allowance for credit losses to various loan and lease portfolio segments, the allowance is general in nature and is available for the loan and lease portfolio in its entirety.

The ultimate recovery of all loans and leases is susceptible to future market factors beyond the Company's control. These factors may result in losses or recoveries differing significantly from those provided in the consolidated financial statements. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for credit losses and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation, which is computed on the straight-line method over the estimated useful lives of the assets, which range from 35 to 40 years for buildings and 3 to 15 years for furniture, fixtures, and equipment. These assets are reviewed for impairment under FASB ASC 360 *Property, Plant, and Equipment* when events indicate that the carrying amount may not be recoverable. Gains or losses on dispositions are reflected in earnings.

Foreclosed Real Estate

Real estate properties acquired through, or in lieu of, foreclosure are to be sold and are initially recorded at the fair value of the properties, less estimated costs of disposal, which becomes the new cost basis. Any write-down to fair value at the time of transfer to foreclosed real estate is charged to the allowance for credit losses. Properties are evaluated regularly to ensure that the recorded amounts are supported by their current fair values. Any subsequent reductions in carrying values and revenue and expense from the operations of properties are recognized in the consolidated statement of income.

Mortgage Servicing Rights

We initially record all mortgage servicing rights ("MSRs") at fair value. For subsequent measurement of MSRs, accounting standards permit the election of either fair value or the lower of amortized cost or fair value. Management has elected to account for single family MSRs at lower of amortized cost or fair value during the life of the MSR, with changes in fair value recorded through current period earnings. Fair value adjustments encompass market-driven valuation changes as well as modeled amortization involving the run-off of value that occurs due to the passage of time as individual loans are paid by borrowers.

MSRs are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Subsequent fair value measurements of single family MSRs, which are not traded in an active market with readily observable market prices, are determined by considering the present value of estimated future net servicing cash flows. Changes in the fair value of single family MSRs result from changes in (1) model inputs and assumptions and (2) modeled amortization, representing the collection and realization of expected cash flows and curtailments over time. The significant model inputs used to measure the fair value of single family MSRs include assumptions regarding market interest rates, projected prepayment speeds, discount rates, estimated costs of servicing and other income and additional expenses associated with the collection of delinquent loans. Impairment is recognized through a valuation allowance to the extent that fair value is less than the recorded value. If the Company later determines that all or a portion of the impairment no longer exists, a reduction of the allowance will be recorded as an increase to income.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan and are recorded as income when earned. The amortization of MSRs is netted against loan servicing fee income.

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.

Income Taxes

Deferred tax assets and liabilities result from differences between the consolidated financial statement carrying amounts and the tax basis of assets and liabilities, and are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. The deferred tax provision represents the difference between the net deferred tax asset/liability at the beginning and end of the year. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The determination of the realization of the deferred tax assets is highly subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence. The calculation of the Company's tax provision for federal income taxes is complex and requires the use of estimates and significant judgments in arriving at the amount of tax benefits to be recognized in the financial statements for a given tax position. It is possible that the tax benefits realized upon the ultimate resolution of a tax position may result in tax benefits that are significantly different from those estimated.

Bank-Owned Life Insurance (BOLI)

Bank-owned life insurance policies are recorded at their cash surrender value or the amount that can be realized upon surrender of the policy. Income from BOLI is recognized when it is earned.

Goodwill

Goodwill represents costs in excess of net assets acquired and is evaluated at least annually for impairment, in accordance with finalized FASB ASC 350 *Intangibles - Goodwill and Other*. The Company tested goodwill for impairment as of December 31, 2016 using the Step 0 method to evaluate impairment and concluded that the fair value of the goodwill is greater than the carrying value, noting no impairment of recorded goodwill. No events have occurred since December 31, 2016 that would require re-evaluation.

Intangible Assets

Intangible assets include non-competition and licensing agreements, and customer contracts and lists. The non-competition and licensing agreements are amortized by the straight-line method over four to five years, while the customer contracts and lists are being amortized by the straight-line method over three to four years. In 2016 and 2015, no circumstances existed that would indicate these assets were potentially impaired. If such circumstances had existed, the assets would have been tested for impairment in accordance with FASB ASC 350, *Intangibles – Goodwill and Other*.

Insurance Revenue

Insurance revenue consists of commissions and fees from the sales of insurance policies and related insurance services. Insurance commission income is recognized as of the effective date of the insurance policy, net of adjustments, including policy cancellations. Such adjustments are recorded when the amount can be reasonably estimated, which is generally in the period in which they occur. Contingent performance-based commissions from insurance companies are recognized when received and no contingencies remain.

Derivative Financial Instruments

The Company enters into interest rate swaps to convert fixed-rate long-term loans to floating rate loans. Management individually evaluates and converts fixed-rate loans to floating-rate loans depending on the size, maturity, and planned amortization of each loan. The interest-rate swap instruments are recognized as derivatives on the balance sheet at their fair value. On the date the derivative contract is entered into, the Company designates the derivative as a hedge of fair value of a recognized asset or liability ("fair value" hedge). Changes in the fair value of a derivative that is highly effective, and that is designated and qualifies as a fair value hedge, along with the loss or gain on the hedged asset or liability that is attributable to the hedged risk, are recorded in current period earnings.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedged transactions. This process includes linking all derivatives that are designated as fair value hedges to specific assets and liabilities on the balance sheet and statement of cash flows. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively, as discussed below.

The Company discontinues hedge accounting prospectively when: (1) it is determined that the derivative is no longer effective in offsetting changes in the fair value of a hedged item; (2) the derivative expires or is sold, terminated, or exercised; or (3) management determines that designation of the derivative as a hedge instrument is no longer appropriate.

When hedge accounting is discontinued because it is determined that the derivative no longer qualifies as an effective fair value hedge, the derivative will continue to be carried on the balance sheet at its fair value with changes in its fair value recognized in current period earnings, and the hedged asset or liability will no longer be adjusted for changes in fair value.

Fair Value

The Company measures or monitors many of its assets and liabilities on a fair value basis. Fair value is used on a recurring basis for certain assets and liabilities in which fair value is the primary basis of accounting. Examples of these include derivative instruments and available for sale securities. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes. Examples of these non-recurring uses of fair value include certain loans held for sale accounted for on a lower of cost or market basis, impaired loans, foreclosed real estate, mortgage servicing rights, goodwill and long-lived assets.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. Fair value estimates are based on quoted market prices, if available. If quoted market prices are not available, fair value estimates are based on quoted market prices of similar assets or liabilities or the present value of expected future cash flows and other valuation techniques. These valuations are significantly affected by discount rates, cash flow assumptions, and risk and other assumptions used. Therefore, fair value estimates may not be substantiated by comparison to independent markets and are not intended to reflect the proceeds that may be realizable in an immediate settlement of the instruments.

Fair value is determined at one point in time and is not representative of future value. Fair value amounts also do not reflect the total value of a going concern organization. Management does not have the intention to dispose of a significant portion of its assets and liabilities and therefore, the unrealized gains or losses should not be interpreted as a forecast of future earnings and cash flows.

In support of these representations, FASB ASC 820, *Fair Value Measurements and Disclosures*, establishes fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy is as follows:

> Level 1 inputs are observable inputs, based upon the quoted prices for identical instruments in active markets that are accessible as of the measurement date, and are to be used whenever available.
>
> Level 2 inputs are other types of observable inputs, such as quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are inactive; or other inputs that are observable or can be derived from or supported by observable market data. Level 2 inputs are to be used whenever Level 1 inputs are not available.
>
> Level 3 inputs are significantly unobservable and are supported by little or no market activity. These Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair values requires significant management judgment or estimation. Level 3 inputs are to only be used when Level 1 and Level 2 inputs are unavailable.

When determining the fair value measurements for assets and liabilities, the Company considers the principal or most advantageous market in which it would transact, and considers assumptions that market participants would use when pricing the asset or liability. When possible, the Company looks to active and observable markets to price identical assets or liabilities. When identical assets or liabilities are not traded in active markets, the Company looks to market observable data for similar assets and liabilities.

Recent Accounting Pronouncements

In January 2017, Financial Accounting Standards Board ("'FASB") issued Accounting Standards Update ("ASU") No. 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,* or ASU 2017-04, which eliminates Step 2 from the goodwill impairment test. ASU 2017-04 also eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. Adoption of ASU 2017-04 is required for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019 with early adoption being permitted for annual or interim goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect the adoption of ASU 2017-04 to have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations Clarifying the Definition of a Business (Topic 805),* for determining whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The new standard is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017 with early adoption permitted for transactions that occurred before the issuance date or effective date of the standard if the transactions were not reported in financial statements that have been issued or made available for issuance. The standard must be applied prospectively. Upon adoption, the standard will impact how we assess acquisitions (or disposals) of assets or businesses. The Company does not expect the adoption of ASU 2017-01 to have a material impact on its consolidated financial statements.

On November 17, 2016, the FASB issued ASU No. 2016-18, *"Statement of Cash Flows (Topic 230): Restricted Cash: a Consensus of the FASB Emerging Issues Task Force."* This ASU requires a company's cash flow statement to explain the changes during a reporting period of the totals for cash, cash equivalents, restricted cash, and restricted cash equivalents. Additionally, amounts for restricted cash and restricted cash equivalents are to be included with cash and cash equivalents if the cash flow statement includes a reconciliation of the total cash balances for a reporting period. This ASU is effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017, with early application permitted. The Company does not anticipate that this guidance will have a material impact on its consolidated financial statements.

On August 26, 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows, Classification of Certain Cash Receipts and Cash Payments (Topic 230)*. The amendments in this ASU were issued to reduce diversity in how certain cash receipts and payments are presented and classified in the statement of cash flows in eight specific areas. The amendments in this ASU are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years and should be applied using a retrospective transition method to each period presented. Early application was permitted upon issuance of the ASU. The Company is currently evaluating the impact of this ASU and the Company does not expect this ASU to have a material impact on the Company's consolidated financial statements.

On June 16, 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses (Topic 326)*. The amendments in this ASU were issued to provide financial statement users with more decision-useful information about the current expected credit losses (CECL) on financial instruments that are not accounted for at fair value through net income, including loans held for investment, held-to-maturity debt securities, trade and other receivables, net investment in leases and other commitments to extend credit held by a reporting entity at each reporting date. The amendments to this ASU require that financial assets measured at amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The amendments in this ASU eliminate the requirement that losses be recognized only when incurred, and instead require that an entity recognize its current estimate of all expected credit losses. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the financial assets.

For purchased financial assets with a more-than-insignificant amount of credit deterioration since origination ("PCD assets") that are measured at amortized cost, the initial allowance for credit losses is added to the purchase price rather than being reported as a credit loss expense. Subsequent changes in the allowance for credit losses on PCD assets are recognized through the statement of income as a credit loss expense.

Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses rather than as a direct write-down to the security.

The amendments to this ASU are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The amendments in this ASU should be applied on a modified-retrospective transition approach that would require a cumulative-effect adjustment to the opening retained earnings in the statement of financial condition as of the date of adoption. A prospective transition approach is required for debt securities for which an other-than-temporary impairment had been recognized before the effective date. The Company is currently evaluating the impact of this ASU and the Company expects this ASU to have a material impact on the Company's consolidated financial statements.

On March 30, 2016, the FASB issued ASU 2016-09, *Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting*. The FASB issued this ASU as part of its initiative to reduce complexity in accounting standards. This new accounting standard simplifies several areas of accounting for share-based payment transactions, including tax provision, classification in the cash-flow statement, forfeitures, and statutory tax withholding requirements. The amendments in this ASU are effective for annual periods beginning after December 15, 2016, including interim periods within those annual periods. Early application was permitted upon issuance of the ASU. The Company determined to early adopt the provisions of ASU 2016-09 during the second quarter of 2016 and determined the new standard did not have a material impact on the Company's Consolidated Financial Statements.

On February 25, 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The amendments in this ASU require lessees to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. This ASU simplifies the accounting for sale and leaseback transactions. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application was permitted upon issuance of the ASU. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently evaluating the provisions of this guidance to determine the potential impact the new standard will have on the Company's consolidated financial statements.

On September 25, 2015, the FASB issued ASU 2015-16, *Simplifying the Accounting for Measurement-Period Adjustments (Topic 805)*. The ASU was issued to simplify the accounting for measurement period adjustments for business combinations. The amendments in the ASU require that the acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amount is determined. The acquirer is required to also record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. In addition, an entity is required to present separately on the face of the income statement or disclose in the notes to the financial statements the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. For public business entities, the amendments in this ASU were effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The Company adopted this guidance during the first quarter of 2016 and applied it prospectively to adjustments to provisional amounts.

On April 7, 2015, the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. The ASU was issued to simplify the presentation of debt issuance costs. This guidance requires that debt issuance costs related to a recognized debt liability be presented on the statement of financial condition as a direct deduction from the carrying amount of that debt liability, consistent with the presentation of debt discounts. This guidance became effective for the Company for the interim and annual periods beginning after December 15, 2015, and early adoption was permitted for financial statements that had not been previously issued. The guidance is required to be applied on a retrospective basis to each individual period presented on the statement of financial condition. The Company adopted this guidance during the first quarter of 2016 and determined there was no material impact on the Company's consolidated financial statements.

On April 15, 2015, the FASB issued ASU 2015-05, *Customer's Accounting for Fees Paid in Cloud Computing Arrangement*. The ASU was issued to clarify a customer's accounting for fees paid in a cloud computing arrangement. The amendments provide guidance to customers in determining whether a cloud computing arrangement includes a software license that should be accounted for as internal-use software. If the arrangement does not contain a software license, it would be accounted for as a service contract. This guidance became effective for the Company for the interim and annual periods beginning after December 15, 2015; early adoption was permitted. The Company could elect to adopt the amendments either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. The

Company adopted this guidance during the first quarter of 2016 and determined there was no material impact on the Company's consolidated financial statements.

In February 2015, the FASB issued ASU 2015-02, *Consolidation*. The ASU provides an additional requirement for a limited partnership or similar entity to qualify as a voting interest entity, amending the criteria for consolidating such an entity and eliminating the deferral provided under previous guidance for investment companies. In addition, the new guidance amends the criteria for evaluating fees paid to a decision maker or service provider as a variable interest and amends the criteria for evaluating the effect of fee arrangements and related parties on a VIE primary beneficiary determination. This guidance was effective for interim and annual reporting periods beginning after December 15, 2015. The Company adopted this guidance during the first quarter of 2016 and determined there was no material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU clarifies the principles for recognizing revenue from contracts with customers. On August 12, 2015, the FASB issued ASU 2015-14 to defer the effective date of ASU 2014-09. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. On March 17, 2016, the FASB issued Accounting Standards Update 2016-08 to clarify the implementation guidance on principal versus agent considerations. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements

Note 2 - Restricted Assets

Federal Reserve Board regulations require that the Company maintain certain minimum reserve balances on hand or on deposit with the Federal Reserve Bank, based on a percentage of deposits. The required minimum reserve balances at December 31, 2016 and 2015 were $1,590,000 and $1,365,000, respectively. Due to sufficient balances maintained on premises, no balances were required to be on deposit with the Federal Reserve Bank for the years ended December 31, 2016 and 2015.

Note 3 - Securities

Securities have been classified according to management's intent. The amortized cost of securities and their approximate fair value are as follows (dollars in thousands):

Securities Available for Sale	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2016				
Money market funds	$21	$--	$--	$21
State and municipal securities	160,483	4,599	(407)	164,675
Collateralized mortgage obligations	208,044	1,500	(2,057)	207,487
Mortgaged-backed securities	49,299	277	(498)	49,078
Total	$417,847	$6,376	$(2,962)	$421,261
December 31, 2015				
Money market funds	$21	$--	$--	$21
State and municipal securities	152,866	7,523	(133)	160,256
U.S. Government agencies	6,791	120	(1)	6,910
Collateralized mortgage obligations	190,154	2,011	(932)	191,233
Mortgaged-backed securities	55,743	856	(459)	56,140
Total	$405,575	$10,510	$(1,525)	$414,560

Securities Held to Maturity	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2016				
State and municipal securities	$43	$--	$--	$43
Tax exempt municipals	503	--	(15)	488
Mortgaged-backed securities	1,005	--	(3)	1,002
Total	$1,551	$--	$(18)	$1,533
December 31, 2015				
State and municipal securities	$46	$--	$--	$46
Mortgaged-backed securities	1,023	--	(3)	1,020
Total	$1,069	$--	$(3)	$1,066

On a regular basis, the Company evaluates these securities for other-than-temporary impairment (“OTTI”). During 2016 and 2015 there was no OTTI recorded in earnings. The unrealized losses on securities are primarily due to elevated yield/rate spreads at December 31, 2016 and 2015 as compared to yield/rate relationships prevailing at the time specific securities were purchased.

At December 31, 2016, there were eleven investments securities in an unrealized loss portion. The following shows the unrealized gross losses and fair value of securities in the available for sale portfolio at December 31, 2016 and 2015, by length of time that individual securities in each category have been in a continuous loss position (dollars in thousands):

	Less Than 12 Months		More Than 12 Months		Total	
	Unrealized Gross Loss	Fair Value	Unrealized Gross Loss	Fair Value	Unrealized Gross Loss	Fair Value
December 31, 2016						
U.S. Government agency securities, including mortgage backed securities	$(394)	$29,811	$(104)	$6,077	$(498)	$35,888
State and municipal securities	(407)	25,901	--	--	(407)	25,901
Collateralized mortgage obligations	(1,885)	108,836	(172)	11,821	(2,057)	120,657
Total	**$(2,686)**	**$164,548**	**$(276)**	**$17,898**	**$(2,962)**	**$182,446**

	Less Than 12 Months		More Than 12 Months		Total	
	Unrealized Gross Loss	Fair Value	Unrealized Gross Loss	Fair Value	Unrealized Gross Loss	Fair Value
December 31, 2015						
U.S. Government agency securities, including mortgage backed securities	$(135)	$27,875	$(325)	$19,810	$(460)	$47,685
State and municipal securities	(96)	10,202	(37)	2,763	(133)	12,965
Collateralized mortgage obligations	(674)	72,611	(258)	18,305	(932)	90,916
Total	**$(905)**	**$110,688**	**$(620)**	**$40,878**	**$(1,525)**	**$151,566**

The contractual maturities of securities held to maturity and available for sale at December 31, 2016, are shown below (dollars in thousands):

	Held to Maturity		Available for Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$--	$--	$2,472	$2,506
Due from one year to five years	--	--	103,506	105,824
Due from five years to ten years	503	488	123,106	123,650
Due after ten years	43	43	139,464	140,203
Mortgage backed securities	1,005	1,002	49,299	49,078
Total	**$1,551**	**$1,533**	**$417,847**	**$421,261**

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations, with or without call or prepayment penalties.

Securities carried at approximately $173.8 million and $184.4 million at December 31, 2016 and 2015, respectively, were pledged to secure public deposits, repurchase agreements, demand notes issued to U.S. Treasury, and other purposes required or permitted by law.

Sales of securities available for sale were as follows (dollars in thousands):

	2016	2015
Proceeds from sales	$69,444	$37,528
Gross realized gains included in earnings	581	401
Gross realized losses included in earnings	(2,506)	(189)

No held to maturity securities were sold in 2016 or 2015.

Note 4 - Loans and Leases

Loans and leases at December 31 consist of the following (dollars in thousands):

	2016	2015
Commercial and agricultural	$59,528	$65,293
Real estate:		
Residential 1-4 family	138,993	138,907
Commercial	315,515	289,494
Construction	47,597	76,339
Farmland	10,362	10,828
Municipal	104,750	98,124
Consumer	19,121	18,200
Dealer contracts	160,960	141,951
Leases	1,153	1,009
Credit card	5,684	6,072
Plus deferred loan costs, less deferred loan fees	1,261	1,330
Total loans and leases	$864,924	$847,547

In the ordinary course of business, the Company has transactions with directors, principal officers, their immediate families, and affiliated companies in which they are principal shareholders (commonly referred to as related parties), all of which have been, in the opinion of management, on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with outside parties. Total loans outstanding at December 31, 2016 and 2015 to key officers and directors were $23,468,000 and $23,867,000, respectively. During 2016 and 2015 loan advances totaled $1,679,000 and $5,373,000, respectively and principal payments totaled $2,078,000 and $3,908,000, respectively.

The following tables detail activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2016 and 2015 (dollars in thousands). Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

		Real Estate					
2016	**Commercial and Agricultural**	**Residential 1-4 Family**	**Commercial, Construction, and Farmland**	**Municipal**	**Consumer and Other**	**Unallocated**	**Total**
Beginning Balance	$1,027	$1,194	$7,285	$101	$2,417	$565	$12,589
Provision for loan losses	284	72	(1,009)	10	445	(536)	(734)
Charge-offs	(864)	(200)	(135)	--	(546)	--	(1,745)
Recoveries	448	44	175	--	260	--	927
Net Charge-offs	(416)	(156)	40	--	(286)	--	(818)
Ending balance	$895	$1,110	$6,316	$111	$2,576	$29	$11,037
Period-end amount allocated to:							
Loans individually evaluated for impairment	$4	$155	$64	$--	$4	$--	$227
Loans collectively evaluated for impairment	891	955	6,252	111	2,572	29	10,810
Ending balance	$895	$1,110	$6,316	$111	$2,576	$29	$11,037

		Real Estate					
2015	**Commercial and Agricultural**	**Residential 1-4 Family**	**Commercial, Construction, and Farmland**	**Municipal**	**Consumer and Other**	**Unallocated**	**Total**
Beginning balance	$1,185	$1,392	$6,407	$63	$2,013	$1,031	$12,091
Provision for loan losses	(2)	(359)	1,421	38	568	(466)	1,200
Charge-offs	(280)	(73)	(569)	--	(405)	--	(1,327)
Recoveries	124	234	26	--	241	--	625
Net Charge-offs	(156)	161	(543)	--	(164)	--	(702)
Ending balance	$1,027	$1,194	$7,285	$101	$2,417	$565	$12,589
Period-end amount allocated to:							
Loans individually evaluated for impairment	$4	$182	$142	$--	$7	$--	$335
Loans collectively evaluated for impairment	1,023	1,012	7,143	101	2,410	565	12,254
Ending balance	$1,027	$1,194	$7,285	$101	$2,417	$565	$12,589

The Company had a previously recorded $295,000 reserve for possible losses on unfunded commitments as of December 31, 2015. An over accrual of $60,000 reserve was reversed in 2016, for a total reserve for possible losses on unfunded commitments of $235,000 as of December 31, 2016. The Company's recorded investment in loans as of December 31, 2016 and 2015 related to each balance in the allowance for loan losses by portfolio segment and disaggregated on the basis of the Company's impairment methodology was as follows (dollars in thousands):

	Commercial and Agricultural	Real Estate: Residential 1-4 Family	Real Estate: Commercial, Construction, and Farmland	Municipal	Consumer and Other	Total
2016						
Loans individually evaluated for impairment	$1,353	$4,683	$4,451	$--	$--	$10,487
Loans collectively evaluated for impairment	58,175	134,310	369,023	104,750	188,179	854,437
Ending balance	$59,528	$138,993	$373,474	$104,750	$188,179	$864,924
2015						
Loans individually evaluated for impairment	$1,428	$3,063	$4,125	$--	$210	$8,826
Loans collectively evaluated for impairment	65,651	135,844	372,536	98,124	166,566	838,721
Ending balance	$67,079	$138,907	$376,661	$98,124	$166,776	$847,547

Non-Accrual Loans:

	2016	2015
Commercial and Agricultural	$--	$59
Residential 1-4 family real estate	--	297
Commercial, construction, and farmland real estate	117	176
Municipal	--	--
Consumer and other	49	112
Total	$166	$644

A summary of loans by age, segregated by class of loans, as of December 31, 2016 and 2015 was as follows (dollars in thousands):

	Loans 30-89 Days Past Due	Loans 90 or more Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or more Days Past Due
2016						
Commercial and Agricultural	$470	$--	$470	$59,058	$59,528	$--
Residential 1-4 family real estate	918	--	918	138,075	138,993	--
Commercial, construction, and farmland real estate	360	--	360	373,114	373,474	--
Municipal	--	--	--	104,750	104,750	--
Consumer and other	739	--	739	187,440	188,179	--
Total	$2,487	$--	$2,487	862,437	$864,924	$--
2015						
Commercial and Agricultural	$299	$34	$333	$66,746	$67,079	$--
Residential 1-4 family real estate	934	297	1,231	137,676	138,907	--
Commercial, construction, and farmland real estate	409	42	451	376,210	376,661	--
Municipal	--	--	--	98,124	98,124	--
Consumer and other	622	6	628	166,148	166,776	--
Total	$2,264	$379	$2,643	$844,904	$847,547	$--

The following table provides information with respect to impaired loans as of the years ended December 31, 2016 and 2015 (dollars in thousands):

2016	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
Commercial and agricultural	$1,353	$1,301	$52	$1,353	$3	$1,449
Residential 1-4 family real estate	5,080	2,451	2,629	5,080	155	3,628
Commercial, construction, and farmland real estate	4,350	2,045	2,248	4,293	64	4,368
Municipal	--	--	--	--	--	--
Consumer and other	188	--	188	188	4	200
Total	$10,971	$5,797	$5,117	$10,914	$226	$9,645
2015						
Commercial and agricultural	$1,428	$1,363	$65	$1,428	$4	$1,238
Residential 1-4 family real estate	3,070	2,420	643	3,063	182	2,740
Commercial, construction, and farmland real estate	4,146	1,268	2,857	4,125	142	5,138
Municipal	--	--	--	--	--	--
Consumer and other	210	4	206	210	7	217
Total	$8,854	$5,055	$3,771	$8,826	$335	$9,333

At December 31, 2016, there were no commitments to lend additional funds to borrowers whose loans have been impaired. Loans over 90 days past due still accruing interest totaled $0 and $0 at December 31, 2016 and 2015, respectively.

Interest income recognized on a cash basis on impaired loans was $451,000 and $514,000 in 2016 and 2015, respectively.

The Company assigns risk rating classifications to its loans. These risk ratings are divided into the following groups:

Pass – asset is considered of sufficient quality to preclude a Special Mention or an adverse rating. Pass assets generally are well protected by the current net worth and paying capacity of the obligor or by the value of the asset or underlying collateral.

Special Mention – asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Company's credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

Substandard – asset is inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. Assets so classified have well-defined weaknesses. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful – asset has the weaknesses of those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Credit quality indicators for the Company's loan portfolio as of December 31, 2016 and 2015 grouped according to internally assigned risk ratings and payment activity (dollars in thousands):

	Commercial and Agricultural	Real Estate: Residential 1-4 Family	Real Estate: Commercial, Construction, and Farmland	Municipal	Consumer and Other	Total
2016						
Pass	$55,787	$128,983	$351,655	$104,750	$184,777	$825,952
Watch	475	2,297	1,455	--	1,931	6,158
Substandard	3,266	7,713	20,364	--	1,465	32,808
Doubtful	--	--	--	--	6	6
Total	$59,528	$138,993	$373,474	$104,750	$188,179	$864,924
Restructured	$--	$2,208	$2,891	$--	$--	$5,099
Non-accrual	--	--	117	--	49	166
Nonperforming	--	2,208	3,008	--	49	5,265
Performing	59,528	136,785	370,466	104,750	188,130	859,659
Total	$59,528	$138,993	$373,474	$104,750	$188,179	$864,924

	Commercial and Agricultural	Real Estate: Residential 1-4 Family	Real Estate: Commercial, Construction, and Farmland	Municipal	Consumer and Other	Total
2015						
Pass	$62,572	$130,937	$352,066	$98,124	$165,736	$809,435
Watch	689	739	2,518	--	1,434	5,380
Substandard	2,032	7,231	22,077	--	1,392	32,732
Doubtful	--	--	--	--	--	--
Total	$65,293	$138,907	$376,661	$98,124	$168,562	$847,547
Restructured	$1,488	$2,715	$4,023	$--	$261	$8,487
Non-accrual	59	297	176	--	112	644
Nonperforming	1,547	3,012	4,199	--	373	9,131
Performing	63,746	135,895	372,462	98,124	168,189	838,416
Total	$65,293	$138,907	$376,661	$98,124	$168,562`	$847,547

The following table presents by class troubled debt restructurings (TDRs) recorded during the years ended December 31, 2016 and 2015 (dollars in thousands, except number of contracts):

2016	Number of Contracts	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial and Agricultural	1	$11	$11
Residential 1-4 family real estate	8	2,531	2,572
Commercial, construction, and farmland real estate	13	1,924	1,867
Municipal	--	--	--
Consumer and other	--	--	--
Total*	22	$4,466	$4,450

*Amounts exclude specific loan loss reserves

2015	**Number of Contracts**	**Pre-Modification Recorded Investment**	**Post-Modification Recorded Investment**
Commercial and Agricultural	4	$1,440	$1,440
Residential 1-4 family real estate	6	1,984	1,990
Commercial, construction, and farmland real estate	6	2,402	2,407
Municipal	--	--	--
Consumer and other	--	--	--
Total*	16	$5,826	$5,837

*Amounts exclude specific loan loss reserves

The majority of TDRs are determined to be impaired prior to being restructured. As such, they are individually evaluated for impairment, unless they are considered homogeneous loans in which case they are collectively evaluated for impairment. As of December 31, 2016 Cashmere Valley Bank had $172,000 in specific reserves on TDRs which were restructured during the year ended December 31, 2016. No loans were removed from TDR status during the year ended December 31, 2016. The primary type of concession granted in all TDRs during the year ended December 31, 2016 was maturity extensions. There were no TDRs that were restructured and subsequently defaulted during the years ended December 31, 2016 and 2015.

Note 5 - Premises and Equipment

Components of premises and equipment at December 31 are as follows (dollars in thousands):

	2016	**2015**
Land	$3,725	$3,725
Buildings and improvements	15,073	14,835
Furniture	5,044	4,476
Equipment	2,529	2,340
Assets in process	815	146
Total cost	27,186	25,522
Less accumulated depreciation	(12,936)	(12,129)
Total premises and equipment	$14,250	$13,393

There were no material commitments for capital expenditures for 2016 or 2015.

Depreciation expense was $1,245,000 and $1,084,000 in 2016 and 2015, respectively.

Note 6 – Mortgage Servicing Rights

Mortgage servicing rights (MSR) are evaluated periodically for possible impairment based on the difference between the carrying amount and current fair value of the MSR by risk stratification. If a temporary impairment exists, a valuation allowance is established for any excess of amortized cost over the current fair value through a charge to income. A direct write-down is performed when the recoverability of a recorded valuation allowance is determined to be remote. Unlike a valuation allowance, a direct write-down permanently reduces the carrying value of the MSR and the valuation allowance, precluding subsequent reversals.

Mortgage loans serviced for others are not included on the accompanying consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others were $392,195,000 and $392,737,000 at December 31, 2016 and 2015, respectively. Custodial escrow balances maintained in connection with the foregoing loan servicing were approximately $2,070,000 and $1,962,000 at December 31, 2016 and 2015, respectively. The weighted average amortization period of the Company's servicing rights was 6.8 years and 6.4 years in 2016 and 2015.

The following summarizes the activity in mortgage servicing rights for the years ended December 31 (dollars in thousands):

	2016	2015
Balance, beginning of year	$1,768	$1,816
Originations	282	306
Amortization	(327)	(354)
Adjustment valuation	--	--
Balance, end of year	$1,723	$1,768

The estimated fair value of the Company's mortgage servicing rights portfolio was $3,892,000 and $3,709,000 at December 31, 2016 and 2015, respectively. Fair value of mortgage servicing rights is based on market prices for comparable mortgage servicing contracts when available. In periods of market inactivity, fair value is determined using a discounted cash flow analysis, utilizing observable market data with unobservable adjustments. The analysis takes into consideration existing conditions in the secondary servicing markets, such as prices from recently executed servicing transactions and market discount rates. The adjustments made to observable data include adjustments for delinquency and loss rates, as well as prepayment speeds and assumptions.

Note 7 - Deposits

The composition of deposits is as follows (dollars in thousands):

	Deposits		Interest Expense	
	2016	2015	2016	2015
Demand deposits, non-interest-bearing	$199,633	$181,853	$--	$--
NOW accounts	230,352	222,796	245	200
Money market and savings accounts	599,958	559,678	1,270	1,226
Time certificates $250,000 and over	37,109	35,629	465	423
Other time certificates	201,974	203,860	2,316	2,541
Total	$1,269,026	$1,203,816	$4,296	$4,390

Certificates of deposit at December 31, 2016, are scheduled to mature as follows (dollars in thousands):

	Under $250,000	Over $250,000
0 to 90 days	$25,895	$6,006
91 to 365 days	59,526	7,790
1 year to 3 years	87,356	17,595
Over 3 years	29,197	5,718
Total	$201,974	$37,109

Total deposits at December 31, 2016 and 2015 by key officers and directors were $6,790,316 and $5,761,176, respectively.

Cashier check deposits of $3.1 million and $4 million are included in total demand deposits for 2016 and 2015, respectively.

Total demand deposit overdrafts that have been reclassified to loans were $57,000 and $146,000 at December 31, 2016 and 2015, respectively.

The Company is a State of Washington Public Depository. All such public depositaries are required to be members of Washington State's Public Deposit Protection Commission (PDPC). As such, when there is a loss of public funds at a member institution, those funds are in most instances insured to some extent by the federal government. To the degree a public deposit is not insured by the federal government, the PDPC will assess a claim first against the institution responsible for the loss and then against the pool of collateral held by other PDPC member institutions. Each institution is then responsible to pay its portion of the cost in proportion to the share of public funds held by that institution. The Company held $28,490,000 and $29,508,000 of public deposits as of December 31, 2016 and 2015, respectively.

Note 8 - Short-Term Borrowings

Securities sold under agreements to repurchase and line of credit advances from the Federal Home Loan Bank Des Moines (FHLB) represent short-term borrowings. Securities sold under agreements to repurchase are secured by specific securities which, in all cases, the Bank maintains control. The securities underlying agreements to repurchase entered into by the Bank are for the same securities originally sold, with a one-day maturity.

The following is a summary of such short-term borrowings for the years ended December 31 (dollars in thousands):

	2016	**2015**
Average balance during the year	$11,472	$11,915
Average interest rate during the year	0.25%	0.27%
Maximum month-end balance during the year	$13,372	$15,614
Balance at December 31:		
Securities under agreements to repurchase	$11,467	$12,201
Weighted-average interest rate at year-end	0.25%	0.25%
Carrying Value of Underlying Securities	$30,727	$29,220
Market Value of Underlying Securities	$30,720	$29,220

Note 9 - Long-Term Borrowings

Long-term borrowings at December 31, 2016 and 2015 represent amounts due to the FHLB totaling $2,404,000 and $2,671,000, respectively, and bear fixed interest rates ranging from 5.42% to 6.23%. All funds borrowed from the FHLB are secured by a blanket pledge of 15% of the Company's assets. The schedule of maturities for the long-term FHLB borrowings for future years ending December 31 is as follows (dollars in thousands):

2017	$285
2018	304
2019	324
2020	346
Thereafter	1,145
	$2,404

Note 10 - Income Taxes

Income taxes are comprised of the following for the years ended December 31 (dollars in thousands):

	2016	**2015**
Current	$3,886	$4,427
Deferred (income) expense	643	(279)
State income taxes	24	27
Total income taxes	$4,553	$4,175

The following is a reconciliation of the statutory income tax rate to the effective income tax rate for the years ended December 31 (dollars in thousands):

	2016		2015	
	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income
Income tax at statutory rates	$7,722	35.0%	$7,328	35.0%
Increase resulting from:				
State income tax	24	0.1%	27	0.1%
Decrease resulting from:				
Tax-exempt income	(2,602)	(11.8%)	(2,300)	(11.0%)
Other	(591)	(2.7%)	(880)	(4.2%)
Total income tax expense	$4,553	20.6%	$4,175	20.0%

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities at December 31 are as follows (dollars in thousands):

	2016	2015
Deferred Tax Assets		
Allowance for credit losses	$3,863	$4,406
Deferred compensation	784	647
Other	675	833
Total deferred tax assets	5,322	5,886
Deferred Tax Liabilities		
Accumulated depreciation	$2,243	$1,954
Deferred income	733	769
Unrealized gain on securities available for sale	1,065	2,933
Mortgage servicing rights	600	616
FHLB dividends	230	388
Total deferred tax liabilities	4,871	6,660
Net deferred tax assets (liabilities)	$451	$(774)

Note 11 - Commitments and Contingencies

Credit

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

The Company'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 amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of the Company's commitments at December 31 is as follows (dollars in thousands):

	2016	2015
Commitments to extend credit:		
Credit card lines	$36,475	$40,280
Commercial real estate, construction and development	18,483	17,226
Other	89,374	90,849
Total commitments to extend credit	$144,332	$148,355
Standby letters of credit	$193	$215

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company's experience has been that between approximately 10% and 25% of loan commitments are drawn upon by customers. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the party. Associated with the unfunded commitment, the Company has established a loss reserve in the amount of $235,000 and $295,000 as of December 31, 2016 and 2015, respectively.

Standby Letters of Credit

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. When the Company deems collateral necessary to secure the commitment, the collateral is required and varies as specified above.

Legal

Because of the nature of its activities, the Company is subject to various pending and threatened legal actions which arise in the ordinary course of business. In the opinion of management, liabilities arising from these claims, if any, will not have a material effect on the financial position of the Company.

Borrowing Facilities

The Company has agreements with commercial banks for lines of credit totaling $44,000,000, none of which was used at December 31, 2016, and a credit line with the Federal Home Loan Bank of Des Moines totaling 35% of assets which approximates $508,984,000 of which $2,404,000 was utilized at December 31, 2016. The Company entered into a Blanket Pledge Agreement with the Federal Home Loan Bank to secure this credit line (see Note 8).

Investments

The Company entered into a subscription agreement to purchase four units at $500,000 per unit for an interest in Homestead Equity Fund A-Washington Limited Partnership; an Oregon limited partnership (HEFA-WA) for which funding has been completed. HEFA-WA has been formed to invest in partnerships or limited liability companies, which will acquire, construct, rehabilitate, operate, and dispose of low-income housing developments which are located in Washington State. The housing developments will be eligible for the federal low-income housing tax credit and, in some cases, the historic rehabilitation tax credit available under the Internal Revenue Code of 1986, as amended. The Company accounts for the investment under the equity method in accordance with ASC 323 *Investments – Equity Method and Joint Ventures*, and a pass-through loss of $46,000 and $120,000 was recorded during 2016 and 2015, respectively. At December 31, 2016 and 2015, the Company's partnership equity was $134,000 and $180,000, respectively, and is included in other assets.

The Company entered into a subscription agreement to purchase one unit at $1,000,000 for an interest in Homestead Western Communities Fund (HWCF). HWCF has been formed to invest in partnerships or limited liability companies, which will acquire, construct, rehabilitate, operate, and dispose of low-income housing developments which are located in the state of Oregon, Washington, Idaho, and California. The housing developments will be eligible for the federal low-income housing tax credit and, in some cases, the historic rehabilitation tax credit available under the Internal Revenue Code of 1986, as amended. The Company accounts for the investment under the equity method in accordance with ASC 323, "*Investments –*

Equity Method and Joint Ventures," and a pass-through loss of $64,000 and $76,000 was recorded during 2016 and 2015, respectively. At December 31, 2016 and 2015, the Company's partnership equity was $120,000 and $183,000 respectively.

The Company entered into a subscription agreement to purchase five units at $1,000,000 per unit for an interest in Homestead Equity Fund X (HEF-X). HEF-X has been formed to invest in partnerships or limited liability companies, which will acquire, construct, rehabilitate, operate, and dispose of low-income housing developments primarily located in the state of Oregon, Washington, Idaho, and California. The housing developments will be eligible for the federal low-income housing tax credit and, in some cases, the historic rehabilitation tax credit available under the Internal Revenue Code of 1986, as amended. The Company accounts for the investment under the equity method in accordance with ASC 323, "*Investments – Equity Method and Joint Ventures"* and a pass-through loss of $225,000 and $274,000 was recorded during 2016 and 2015, respectively. At December 31, 2016 and 2015, the Company's partnership equity was $4,053,000 and $4,259,000 respectively.

The Company's remaining contractual contribution for Homestead Equity Fund X (HEF-X) of $167,000 is expected to be paid as follows (dollars in thousands):

2017	$21
2018	21
2019	22
2020	22
Thereafter	81
	$167

Employment Agreements

The Company has entered into employment contracts with certain key employees, which provide for contingent payments subject to future events. These agreements are discussed in Note 13.

Derivatives

For the years ended December 31, 2016 and 2015, the fair value of the hedged investments of $371,000 and $606,000 respectively, are recorded in securities available for sale and the related swap liability is recorded in other liabilities at $371,000 and 649,000, respectively. In 2011, the Company pledged a $2 million certificate of deposit due from the counterparty of the hedging instruments as collateral for the swap liability. The notional amounts of the interest rate swaps were $6,831,169 and $7,264,901 at December 31, 2016 and 2015, respectively. The Company recognized no loss in 2016 and 2015 which represents the ineffective portion of all fair value hedges. All components of each derivative's gain or loss are included in the assessment of hedge effectiveness, unless otherwise noted.

Note 12 – Significant Concentration of Credit Risk

Most of the Company's business activity is with customers located in the state of Washington. Investments in state and municipal securities involve government entities primarily within the state. At December 31, 2016, 7.30% of total loans outstanding were for construction related projects. Of those, 1.97% of total loans outstanding were residential developed lot loans to consumers.

Loans are generally limited, by state banking regulations, to 20% of the Company's capital to any one borrower, excluding accumulated other comprehensive income. At year end 2016 the banks legal lending limits was $33,639,000. Standby letters of credit were granted primarily to commercial borrowers. The Company, as a matter of practice, generally does not extend credit to any single borrower or group of related borrowers in excess of $18,500,000. At December 31, 2016, one borrowing relationship was in excess of this limit at $23,836,892.

Note 13 - Employee Compensation Plans

Stock Option Plan

The Company has a stock option plan under which certain key employees have been granted options to purchase shares of common stock. Under the plan, the Company may grant options of its common stock to certain key employees, of which $323,034 were available for grant at December 31, 2016. Options have an exercise price equal to the fair market value of the stock as of the date of grant. All options granted since 1994 are 40% vested on the date of grant, with 20% vesting on each of the three subsequent anniversaries of the grant date and have a maximum contractual term of ten years. The Black-Scholes model requires the use of assumptions noted in the following table. The dividend yield is based on the Company's actual and expected dividends paid to shareholders. The Company uses historical data to estimate the option exercise and forfeitures to estimate the expected life, which represents the period of time the options are expected to be outstanding. Expected stock price volatility is based on the Company's historical stock price, adjusted for dividends. The risk-free interest rate is based on the U.S. Treasury yield curve rate in effect at grant date with average equivalent term.

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

	2016	2015
Dividend yield	--	--
Expected life	7 years	--
Risk-free interest rate	1.46%	--
Expected volatility	18.63%	--

5,000 shares were granted in 2016. The weighted average fair value of options granted at grant date 2016 was $10.46.

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

A summary of the status of the Company's stock option plan as of December 31 2016, and changes during the years ending on those dates, is presented below:

2016	**Shares**	**Weighted Average Exercise Price**	**Weighted Average Fair Value At Grant**	**Intrinsic Value (Dollars in Thousands)**
Outstanding at beginning of year	61,090	$28.54	$1.16	$598
Granted	5,000	44.00	10.46	16
Exercised	12,977	27.14	4.46	261
Forfeited	--	--	--	--
Expired	7,463	27.28	4.49	149
Outstanding at end of year	45,650	$30.91	$6.18	$746
Vested and expected to vest	45,066	$27.14	$6.41	$736
Options exercisable at year-end	42,350	$29.96	$6.83	$732

The following information summarizes information about stock options outstanding and exercisable at December 31, 2016:

Options Outstanding				Options Exercisable		
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
$ 15.00 – 17.49	1,750	4.04	$16.00	1,750	4.05	$16.00
$ 17.50 – 26.49	9,500	4.92	$22.37	9,500	4.92	$22.37
$ 26.50 – 31.49	5,000	5.87	$26.75	5,000	5.87	$26.75
$ 31.50 – 35.00	29,400	4.30	$35.27	26,100	3.63	$34.28
	45,650	4.59	$30.91	42,350	4.20	$29.96

The total intrinsic value of the options exercised during 2016 and 2015 was $260,944 and $225,626, respectively. Weighted average remaining contractual life of options vested and expected to vest is 4.78 years. Total proceeds from options exercised in 2016 and 2015 were $352,219 and $551,418 respectively. As a result of disqualifying dispositions of options exercised, the Company recorded a tax benefit of $6,928 and $2,545 in 2016 and 2015, respectively.

At December 31, 2016, unrecognized compensation expense related to unvested options totaled $34,109 and is expected to be recognized over a weighted average period of thirty-six months. During 2016 2,300 options vested which had a weighted average fair value at grant date of $10.28, and during 2015 3,100 options vested with a fair value grant of $4.39.

Restricted Stock Plan

The Company granted 3,960 and 2,350 shares of restricted stock in 2016 and 2015 respectively. The restricted stock has a weighted-average grant date fair value of $40.51 and $36.50 per share for 2016 and 2015, respectively. All the restricted stock vests between 2014 and 2019. Restricted stock is generally scheduled to vest over a 3 year period, with the unearned compensation related to restricted stock amortized to expense on a straight-line basis. Unrecognized compensation cost related to non-vested restricted stock totaled $160,669 and $45,979, respectively. Total expense recognized by the Company for restricted stock for the year ended December 31, 2016 and 2015 was $101,431 and $52,121, respectively.

Profit-Sharing Plans

The Company has a 401(k) employee benefit plan for those employees who meet eligibility requirements set forth in the plan. Eligible employees may contribute up to 100% of their compensation, subject to certain IRS limits. The Company provides a discretionary match of 100% of the first 4% contributed by participants. Additionally, matching contributions may be made by the Company pursuant to a prescribed formula based on the Company's achievement of certain performance goals. The Company contributed $402,000 and $392,000 in 2016 and 2015, respectively.

Incentive compensation is awarded to certain employees based on the financial performance of the Company. Cash bonuses were awarded pursuant to a formula targeted on the Company achieving certain performance goals for the years ended in 2015 and 2014, with the amounts awarded in 2016 and 2015. Amounts awarded under the plan for 2016 and 2015 were $396,369 and $392,586, respectively.

Deferred Compensation Plan

The Company entered into deferred compensation arrangements with key employees. The agreements provide for employee and Company matching contributions equal to the amount that would have been contributed under the Company's 401(k) plan, had the employees not been otherwise excluded from the plan. At December 31, 2016 and 2015, the Company had a recorded liability in the amount of $2,241,000 and $1,848,000, respectively. The Company contributed $110,000 and $96,000 in 2016 and 2015, respectively, of which $110,000 and $96,000, respectively, represented plan earnings in accordance with the deferred compensation agreements.

The Company entered into employment contracts with certain key employees which provided for future compensation subject to the occurrence of future events. Compensation expense recognized related to such agreements totaled $0 for 2016 and $20,000 for 2015, and is reflected in salaries and employee benefits in these financial statements.

Insurance

The Company provides certain health care, disability, and life insurance benefits for current employees. The cost of health care benefits for employees is recognized as expense when paid. Life insurance benefits for employees are provided through an insurance company whose premiums are based on the benefits paid during the year. The Company recognizes the cost of providing such benefits by expensing the monthly insurance premiums. For 2016 and 2015, the cost of providing health care, disability, and life insurance benefits was $1,289,000 and $1,375,000, respectively.

Note 14 - Regulatory Matters

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

Quantitative measures established by regulation to ensure capital adequacy require the Company maintain minimum amounts and ratios (set forth in the table below) of Tier 1 capital (as defined in the regulations) to total average assets (as defined), and minimum ratios of Tier 1 and total capital (as defined) to risk-weighted assets (as defined).

In July 2013, the Board of Governors of the Federal Reserve System and the FDIC approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks ("Basel III"). Under the final rules, which became effective for the Bank on January 1, 2015 and are subject to a phase-in period through January 1, 2019, minimum requirements increased for both the quantity and the quality of capital held by the Bank. The rules include a new Common Equity Tier 1 capital to risk-weighted assets ratio ("CET1" ratio) of 4.5% and a capital conservation buffer of 2.5% above the regulatory minimum risk-based capital requirements, which when fully phased-in, effectively results in a minimum CET1 ratio of 7.0%. Basel III also (i) raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% (which, with the capital conservation buffer, effectively results in a minimum Tier 1 capital to risk-weighted assets ratio of 8.5% when fully phased-in), (ii) effectively results in a minimum total capital to risk-weighted assets ratio of 10.5% (with the capital conservation buffer fully phased-in), and (iii) requires a minimum leverage ratio of 4.0%. Basel III also makes changes to risk weights for certain assets and off-balance-sheet exposures.

As of December 31, 2015, the most recent notification from the Company's regulator categorized the Company as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Company must maintain minimum total risk-based, Tier 1 risk-based, Common Equity Tier 1, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Company's actual capital amounts and ratios are also presented in the following table (dollars in thousands).
Management believes as of December 31, 2016, that the Company meets all capital requirements to which it is subject.

December 31, 2016	Actual		Regulatory minimum to be "adequately capitalized"		Basel III minimum adequacy with capital conservation buffer		Regulatory minimum to be "well capitalized"	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
Tier 1 leverage (to average assets)	$157,078	10.92%	$57,549	4.00%	N/A	N/A	$71,936	5.00%
CET 1 capital (to risk weighted assets)	157,078	17.66%	40,015	4.50%	45,573	5.13%	57,799	6.50%
Tier 1 capital (to risk weighted assets)	157,078	17.66%	53,353	6.00%	58,911	6.63%	71,138	8.00%
Total capital (to risk weighted assets)	168,195	18.91%	71,138	8.00%	76,695	8.63%	88,922	10.00%

December 31, 2015	Actual		Regulatory minimum to be "adequately capitalized"		Basel III minimum adequacy with capital conservation buffer		Regulatory minimum to be "well capitalized"	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
Tier 1 leverage (to average assets)	$143,073	10.69%	$53,547	4.00%	N/A	N/A	$66,934	5.00%
CET 1 capital (to risk weighted assets)	143,073	16.02%	40,180	4.50%	N/A	N/A	58,038	6.50%
Tier 1 capital (to risk weighted assets)	143,073	16.02%	53,574	6.00%	N/A	N/A	71,432	8.00%
Total capital (to risk weighted assets)	154,255	17.28%	71,432	8.00%	N/A	N/A	89,290	10.00%

Restrictions on Retained Earnings

The Company is restricted from paying dividends in an amount that would decrease regulatory capital below the minimum amounts shown above.

Note 15 - Fair Value

The Company is required to disclose the estimated fair value of financial instruments, both assets and liabilities on and off the balance sheet, for which it is practicable to estimate fair value. These fair value estimates are made at December 31, 2016 based on relevant market information and information about the financial instruments. Fair value estimates are intended to represent the price an asset could be sold at or the price a liability could be settled for. However, given there is no active market or observable market transactions for many of the Company's financial instruments, the Company has made estimates of many of these fair values which are subjective in nature, involve uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimated values.

Fair Value of Financial Instruments

The carrying amounts and estimated fair value of the Company's financial instruments as of December 31, 2016 and December 31, 2015 are as follows (dollars in thousands):

		2016		2015	
	Level	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets					
Cash and cash equivalents	1	$125,444	$125,444	$81,315	$81,315
Securities available for sale	2	421,261	421,261	414,560	414,560
Securities held to maturity	2	1,551	1,533	1,069	1,066
FHLB and PCBB stock	2	1,995	1,995	1,937	1,937
Loans Held for Sale	2	397	402	540	539
Loans and leases, net	3	853,887	854,448	834,958	841,980
Mortgage servicing rights	3	1,723	3,892	1,768	3,709
Accrued interest receivable	2	4,504	4,504	4,394	4,394
Bank Owned Life Insurance	2	14,118	14,118	13,627	13,627
Financial Liabilities					
Deposits	3	$1,269,026	$1,086,435	$1,203,816	$1,048,073
Borrowings	3	13,871	14,199	14,872	15,317
Interest Rate Swaps	3	371	371	649	649
Accrued interest payable	2	445	445	407	407

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company's financial instruments will change when interest rate levels change and that change may either be favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities, and attempts to minimize interest rate risk by adjusting terms of new loans and deposits, and by investing in securities with terms that mitigate the Company's overall interest rate risk.

The following methods and assumptions were used by the Company in estimating the fair value of financial instruments:

Cash and Due from Banks, Fed Funds Sold and Interest Bearing Deposits at Other Financial Institutions

Cash and Due from Banks, Fed Funds Sold, and Interest Bearing Deposits at Other Financial Institutions are valued at their carrying amounts, which are reasonable estimates of fair value due to the relatively short period to maturity of the instruments.

Securities Available for Sale and Held to Maturity

Securities totaling $422,812,000 are reported at fair value utilizing Level 2 inputs. The fair values are based on quoted market prices of similar instruments and dealer quotes or determined utilizing a present-value income model that utilized observable market-based inputs, as described in Footnote 1. The fair values were obtained from an independent pricing service and internally validated. 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 bond's terms and conditions, among other things.

Federal Home Loan Bank and Pacific Coast Banker's Bancshares Stock

The carrying value of Federal Home Loan Bank and Pacific Coast Banker's Bancshares stock approximates fair value because the shares can only be redeemed by the FHLB and PCBB, respectively, at par value.

Loans Held for Sale

The fair value of loans held for sale is based on observable current market prices. If quoted market prices are not available, fair value is based on quoted market prices of similar instruments.

Mortgage Servicing Rights

The fair value of mortgage servicing rights is estimated using a discounted cash flow model to arrive at the net present value of expected earnings from the servicing of the loans. Model inputs include prepayment speeds, market interest rates, contractual interest rates on the loans being serviced, the amount of other fee income generated, and other factors. The fair value of mortgage servicing rights is impacted by any changes in these inputs.

Bank Owned Life Insurance

The carrying amount approximates the estimated fair value of these instruments. Fair values of insurance policies owned are based on the insurance contracts' cash surrender values.

Loans and Leases

Fair values of variable rate loans and leases that reprice frequently and have no significant change in credit risk are based on the carrying values. Fair value of fixed rate loans and leases is estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair value of impaired loans and leases is estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Deposit Liabilities

The fair value of deposits with no stated maturity date is included at the amount payable on demand. The fair value of fixed rate certificates of deposit is estimated using a discounted cash flow calculated based on interest rates currently being offered on similar certificates.

Short-Term Borrowings

The carrying amounts of demand notes issued to U.S. Treasury and repurchase agreements approximate their fair value due to the relatively short period to maturity of the instruments.

Long-Term Borrowings

Fair value of the Company's long-term borrowings is estimated using discounted cash flow analyses based on the Company's current incremental borrowing rate for similar types of borrowing arrangements.

Accrued Interest

Carrying amounts of accrued interest approximate fair value due to their short settlement periods.

Interest Rate Swap Derivatives

The fair values of interest rate swap derivatives are estimated by an independent third party using a discounted cash flow method based on current incremental rates for similar types of arrangements. For purposes of potential valuation adjustments to its derivative positions, the company evaluates the credit risk of its counterparties as well as that of the company. Accordingly, the company has considered factors such as the likelihood of default by the Company and its counterparties, its net exposures, and remaining contractual life, among other things, in determining if any fair value adjustments related to credit risk are required. Counterparty exposure is evaluated by considering the amounts of collateral securing the position. The Company reviews its counterparty exposure on a regular basis, and when necessary, appropriate business actions would be taken to adjust the exposures. The Company also uses this approach to estimate its own credit risk on derivative liability positions. To date, the Company has not realized any significant losses due to a counterparty's inability to pay any net uncollateralized position. The change in value of derivative assets and derivative liabilities attributable to credit risk was not significant during the reported periods.

Off-Balance Sheet Instruments

The fair value of commitments to extend credit and standby letters of credit was estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the customers. Since the majority of the Company's off-balance sheet instruments consist of non-fee producing, variable-rate commitments, the Company has determined they do not have a distinguishable fair value.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents information about the Company's assets measured at fair value on a recurring basis as of December 31, 2016 and 2015, respectively, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value (dollars in thousands):

		Fair Measurements Using		
December 31, 2016	**Assets/(Liabilities) Total**	**Level 1**	**Level 2**	**Level 3**
State and municipal securities	$164,675	$--	$164,675	$--
Collateralized mortgage obligations	207,487		207,487	--
Mortgage-backed securities	49,078	--	49,078	--
Money market mutual funds	21	--	21	--
Securities Available for Sale	$421,261		$421,261	
Interest Rate Swap Derivatives	(371)	--	(371)	--
December 31, 2015				
State and municipal securities	$160,256	$--	$160,256	$--
U.S Government agencies	6,910	--	6,910	--
Collateralized mortgage obligations	191,233	--	191,233	--
Mortgage-backed securities	56,140	--	56,140	--
Money market mutual funds	21	--	21	--
Securities Available for Sale	$414,560	$--	$414,560	$--
Interest Rate Swap Derivatives	(649)	--	(649)	--

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Impaired Loans: In accordance with GAAP, loans are measured for impairment using one of three methods: 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 valuations which are 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 locale. 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. The Company has categorized all its loans impaired during the calendar year utilizing fair value metrics as level 3.

OREO: The Company's OREO is measured 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 like assets in reaching a conclusion as to fair value. Since many recent real estate sales could be termed "distressed sales", and since preponderance have been short-sale or foreclosure related, this has directly impacted appraisal valuation estimates. 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. The Company has categorized its OREO as Level 3.

The table below presents the Company's other real estate owned ("OREO"). At December 31, 2016 and 2015, there were no loans measured at fair value on a nonrecurring basis where the measurement occurred during the respective year. Amounts are aggregated by the level in the fair value hierarchy within which those measurements fall (dollars in thousands):

		Fair Value Measurement Using			
December 31, 2016	**Total**	**Level 1**	**Level 2**	**Level 3**	**(Gains)/Losses During The Year**
Other Real Estate Owned	$66	$--	$--	$66	$(26)
December 31, 2015					
Other Real Estate Owned	$343	$--	$--	$343	$616

Certain impaired loans are reported at the fair value of the underlying collateral less costs to sell if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on observable market data and Level 3 inputs based on customized discounting criteria. For additional information on how the Company determines the allowance for credit losses, see Note 1 – *Summary of Significant Accounting Policies*. There were no loans measured for impairment in 2016 or 2015 using current market values.

Qualitative factors in Level 3:

The following table presents additional qualitative information about assets and liabilities measured at fair value on a non-recurring basis and for which the company has utilized Level 3 inputs to determine fair value, as of December 31, 2016:

Asset	**Valuation Technique**	**Unobservable Input**
OREO	Income, market and comparable sales	External appraised values; probability weighting of broker price opinions; management assumptions regarding market trends or other relevant factors; selling and commission costs ranging from 7% to 11%

Note 16 - Comprehensive Income

Net unrealized gains and losses include, net of tax, $3,468,000 unrealized losses and $492,000 of unrealized losses arising during 2016 and 2015, respectively (dollars in thousands):

	Before Tax Amount	Tax Benefit (Expense)	Net of Tax Amount
Year Ended December 31, 2016			
Unrealized holding losses arising during the year	$(7,261)	$2,542	$(4,719)
Reclassification adjustment for gains realized in net income	1,925	(674)	1,251
Net unrealized losses	$(5,336)	$1,868	$(3,468)
Year Ended December 31, 2015			
Unrealized holding gains arising during the year	$(545)	$191	$(354)
Reclassification adjustment for gains realized in net income	(212)	74	(138)
Net unrealized losses	$(757)	$265	$(492)

Note 17 – Shareholders Equity and Earnings per Common Share

Earnings per Common Share

The following table presents a reconciliation of the number of shares used in the calculation of basic and diluted earnings per common share (dollars in thousands, except share and per share amounts):

	2016	2015
Distributed earnings allocated to common stock	$4,004	$3,657
Undistributed earnings allocated to common stock	13,520	13,107
Net earnings allocated to common stock	$17,524	$16,764
Weighted-average shares outstanding - Basic	4,088,566	4,068,483
Dilutive effect of securities outstanding	15,986	17,518
Weighted-average shares outstanding - Diluted	4,104,552	4,086,001
Earnings Per Share – Basic	$4.29	$4.12
Earnings Per Share – Diluted	$4.27	$4.10
“Out of the money” stock options	--	--

Stock Repurchase Plans

From time to time, the Company’s board of directors has authorized stock repurchase plans. In general, stock repurchase plans allow the Company to proactively manage its capital position and return excess capital to shareholders. Shares purchased under such plans also provide the Company with shares of common stock necessary to satisfy obligations related to stock compensation awards. Under the most recent plan, there were 150 shares repurchased in 2016 and there were no shares repurchased in 2015.

Note 18 – Subsequent Events

The Company performed an evaluation of subsequent events through March 22, 2017, the date these financial statements were available to be issued.

On January 17, 2017, the Company's Board of Directors approved a dividend of $0.53 per share, payable on February 6, 2017, to shareholders of record as of January 27, 2017.

Directors and Officers

Board of Directors
Brian Nelson, Chairman
Lyman Boyd, Vice Chairman
Judy Conner, CPA
Bill Dronen
Greg Oakes
John Doyle
Keith Wiggins

Administrative Officers
Greg Oakes, President & CEO
David Hooston, Exec. Vice President & CFO
Connie Fritz, Exec. Vice President & CROO
Steve Vradenburg, Exec. Vice President & CLO
Sue Ozburn, Exec. Vice President & CIO

Mitchell, Reed & Schmitten Insurance Board of Directors
Greg Oakes, Chairman
Lori Reed
Lyman Boyd
Jim Gibbons
Laura Mounter
Brent Schmitten

Finance
DeAnne Williams, Vice President & Controller

Internal Audit
Dennis Combs, Examiner

Credit Administration
Ann Rankin, Credit Operations Supervisor

Compliance
Deidra Anderson, AVP & Compliance Officer

Retail Operations and Personnel
Annie Horey, AVP & Human Resource Director
Jeff Burton, Retail Operations Officer

Financial Services Group
Art Hansen, Senior Vice President

Contract Purchasing and Equipment Leasing
Chuck Moser, AVP & Loan Officer
Chris Ewer, AVP & Equipment Leasing Manager

Electronic Banking and Card Services
Sharon Low, AVP & Manager
Nicole Ivarsen, Card Service Plan Manager

Municipal Banking
Ron Olsen, Senior Vice President & Manager
James Tinker, AVP & Loan Officer

Statewide Banking
Alex Cruz, Vice President

Cashmere Branch
Alex Cruz, Vice President & Manager
Jana Flores, Retail Operations Officer

Maple Street Branch
Steve Lee, Senior Vice President & Manager
Christy Tomlinson, AVP & Retail Operations Officer
Mike Kintner, Vice President & Commercial Lender

Leavenworth Branch
Darrin Rylaarsdam, Senior Vice President & Manager
Shawna Alexander, AVP & Retail Operations Officer
Gary Waunch, Loan Officer

East Wenatchee Branch
Ann Harris, AVP & Retail Operations Officer

Chelan Street Branch
Jenny Pulver, AVP & Manager

Easy Street Branch
Claudia De Robles, Vice President & Manager
Elizabeth Mejia, Retail Operations Officer

Ellensburg Branch
Pam Wilson, Vice President & Manager
Miriam Nation, Retail Operations Officer

Cle Elum Branch
Dale Loveland, Senior Vice President & Manager
Caren Reed, Retail Operations Officer

Lake Chelan Branch
Russ Jones, Vice President & Manager
Jan Fryer, Retail Operations Officer

Yakima Branch
Taylor Stormo, Vice President & Manager
Brittanie Vaughn, Retail Operations Officer

Cashmere Valley Mortgage
Shirley Reyes, Vice President & Manager
Kyle Lewis, AVP & Assistant Manager

Mitchell Reed & Schmitten Insurance
Brent Schmitten, President & COO

Cashmere Valley Wealth Management
Timothy Meyers, Division Director

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Credit Cards 509-664-5455
ATM/Debit Cards 509-664-5453

Dealer Financing
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Cashmere Valley Bank

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WEALTH MANAGEMENT

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INSURANCE, INC.