

**SAVIBANK
(FORMERLY KNOWN AS
BUSINESS BANK)
BURLINGTON, WASHINGTON**

**AUDITED
FINANCIAL STATEMENTS**

DECEMBER 31, 2015 AND 2014

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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To the Board of Directors
of SaviBank
Burlington, Washington

We have audited the accompanying balance sheets of SaviBank (formerly known as Business Bank) as of December 31, 2015 and 2014, and the related statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Bank is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of SaviBank as of December 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Stovall, Grandey & Allen, LLP

STOVALL, GRANDEY & ALLEN, L.L.P.
Fort Worth, Texas
April 4, 2016

**SAVIBANK
(FORMERLY KNOWN AS BUSINESS BANK)
BALANCE SHEETS
DECEMBER 31, 2015 AND 2014**

	2015	2014
ASSETS		
Cash and due from banks - Note 2	\$ 2,079,925	\$ 1,777,212
Interest-bearing deposits with financial institutions	9,216,383	2,549,815
Cash and cash equivalents	11,296,308	4,327,027
Investment securities - Note 3	4,926,748	5,831,475
Federal Home Loan Bank stock, at cost - Note 2	348,500	1,011,900
Pacific Coast Bankers' Bank stock, at cost - Note 2	190,000	190,000
Loans receivable, net of allowance for loan losses and deferred loan fees - Note 4	115,199,152	105,291,085
Other real estate owned	1,920,656	1,641,938
Premises and equipment, net - Note 5	4,735,548	4,908,272
Accrued interest receivable	296,381	265,904
Other assets	685,340	222,289
Total Assets	\$ 139,598,633	\$ 123,689,890
LIABILITIES		
Deposits - Note 6	\$ 119,836,312	\$ 98,809,708
Federal Home Loan Bank borrowings - Note 9	5,000,000	12,000,000
Accrued interest payable	58,178	56,801
Accrued expenses and other liabilities	389,671	363,535
Total Liabilities	125,284,161	111,230,044
Commitments and contingencies - Notes 5, 9, 10, 11 and 12		
SHAREHOLDERS' EQUITY - Notes 13, 14 and 15		
Common stock, no par value; authorized: 20,000,000 shares Issued and outstanding: 11,630,161 and 10,728,961 shares at December 31, 2015 and 2014, respectively	28,757,066	27,652,763
Additional paid-in capital	218,069	177,274
Retained deficit	(14,634,164)	(15,336,651)
Accumulated other comprehensive loss	(26,499)	(33,540)
Total Shareholders' Equity	14,314,472	12,459,846
Total Liabilities and Shareholders' Equity	\$ 139,598,633	\$ 123,689,890

The accompanying notes are an integral part of these financial statements.

SAVIBANK
(FORMERLY KNOWN AS BUSINESS BANK)
STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

	<u>2015</u>	<u>2014</u>
Interest income		
Interest and fees on loans	\$ 5,690,663	\$ 5,081,820
Interest on investment securities	51,654	67,344
Interest on interest-bearing deposits with financial institutions	10,262	4,518
Total interest income	<u>5,752,579</u>	<u>5,153,682</u>
Interest expense		
On deposits	632,966	642,814
On borrowed funds	205,296	210,331
Total interest expense	<u>838,262</u>	<u>853,145</u>
Net interest income	4,914,317	4,300,537
Provision for loan losses - Note 4	282,948	-
Net interest income after provision for loan losses	<u>4,631,369</u>	<u>4,300,537</u>
Non-interest income		
Service charges on deposit accounts	244,366	203,327
Gain on sales of SBA loans (guaranteed portion)	1,014,030	455,797
Gain on sales of loans held-for-sale	107,691	251,365
Net loss on sales of other real estate owned	-	(18,412)
Rental income	75,151	97,388
Other	196,173	93,152
Total non-interest income	<u>1,637,411</u>	<u>1,082,617</u>
Non-interest expense		
Salaries and employee benefits	3,197,381	2,808,626
Occupancy and equipment	608,853	529,401
Data processing fees	232,851	204,674
Professional fees	138,644	263,546
FDIC assessment	160,500	268,370
OREO expense and writedowns	119,050	290,470
Unreimbursed loan expense	112,257	18,398
Directors and officers insurance	94,681	110,254
Director fees	107,677	112,144
Regulatory examination fees	73,162	56,000
NSF check and other losses	1,363	64,775
B & O taxes	72,738	48,133
Other expense	647,136	470,754
Total non-interest expense	<u>5,566,293</u>	<u>5,245,545</u>
Net Income	<u>\$ 702,487</u>	<u>\$ 137,609</u>

The accompanying notes are an integral part of these financial statements.

**SAVIBANK
(FORMERLY KNOWN AS BUSINESS BANK)
STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014**

	2015	2014
Net Income	\$ 702,487	\$ 137,609
Other Comprehensive Income		
Securities available-for-sale:		
Change in net unrealized loss during the year	7,041	5,214
Other comprehensive income	7,041	5,214
Comprehensive Income	\$ 709,528	\$ 142,823

The accompanying notes are an integral part of these financial statements.

SAVIBANK
(FORMERLY KNOWN AS BUSINESS BANK)
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

	<u>Shares of Common Stock</u>	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Retained Deficit</u>	<u>Accumulated Other Comprehensive Loss</u>	<u>Total</u>
Balance at January 1, 2014	5,828,961	\$ 22,504,663	\$ 149,737	\$ (15,474,260)	\$ (38,754)	\$ 7,141,386
Stock-based compensation, stock options			27,537			27,537
Sales of common stock, net of stock issuance costs	4,900,000	5,148,100				5,148,100
Comprehensive income for the year ended December 31, 2014				137,609	5,214	142,823
Balance at December 31, 2014	10,728,961	27,652,763	177,274	(15,336,651)	(33,540)	12,459,846
Stock-based compensation, stock options			40,795			40,795
Stock options exercised	200	350				350
Sales of common stock, net of stock issuance costs	896,000	1,103,953				1,103,953
Additional shares of common stock granted	5,000	-				-
Comprehensive income for the year ended December 31, 2015				702,487	7,041	709,528
Balance at December 31, 2015	<u>11,630,161</u>	<u>\$ 28,757,066</u>	<u>\$ 218,069</u>	<u>\$ (14,634,164)</u>	<u>\$ (26,499)</u>	<u>\$ 14,314,472</u>

The accompanying notes are an integral part of these financial statements.

SAVIBANK
(FORMERLY KNOWN AS BUSINESS BANK)
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 702,487	\$ 137,609
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization	269,541	221,897
Provision for loan losses	282,948	-
Writedowns on other real estate owned	-	206,736
Gain on sales of SBA loans	(1,014,030)	(455,797)
Gain on sales of loans held-for-sale	(107,691)	(251,365)
Net loss on sales of other real estate owned	-	18,412
Net amortization on investment securities	29,776	41,438
Stock-based compensation	40,795	27,537
Originations of loans held-for-sale	(7,634,855)	(15,471,297)
Proceeds from sales of loans held-for-sale	7,742,546	16,356,730
Increase in other assets	(489,700)	(19,911)
Increase in other liabilities	27,513	19,959
Total adjustments	(853,157)	694,339
Net Cash Provided (Used) by Operating Activities	(150,670)	831,948
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale investment securities	(520,313)	-
Principal payments on available-for-sale securities	1,402,303	1,066,720
Purchases of FHLB stock	(893,900)	(4,900)
Redemptions of FHLB stock	1,557,300	40,700
Net increase in loans receivable	(9,498,400)	(15,663,302)
Cash proceeds from sales of other real estate owned	42,696	64,442
Purchases of furniture and equipment	(100,642)	(574,767)
Net Cash Used by Investing Activities	(8,010,956)	(15,071,107)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	21,026,604	1,618,000
Proceeds from FHLB borrowings	-	6,000,000
Payments on FHLB borrowings	(7,000,000)	(10,000,000)
Proceeds from exercise of incentive stock options	350	-
Net proceeds from common stock issued	1,103,953	5,148,100
Net Cash Provided by Financing Activities	15,130,907	2,766,100
Net increase (decrease) in cash and cash equivalents	6,969,281	(11,473,059)
Cash and cash equivalents at beginning of year	4,327,027	15,800,086
Cash and cash equivalents at end of year	\$ 11,296,308	\$ 4,327,027
SUPPLEMENTAL SCHEDULE OF OPERATING AND INVESTING ACTIVITIES:		
Cash paid for interest	\$ 836,885	\$ 856,124
Other real estate owned, acquired through foreclosure	369,736	-
Transfer of other real estate owned to bank premises	-	269,430
Bank financed sales of other real estate owned	48,321	-

The accompanying notes are an integral part of these financial statements.

SAVIBANK
(FORMERLY KNOWN AS BUSINESS BANK)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2015 AND 2014

Note 1 Description of Business

SaviBank (formerly known as Business Bank) is a commercial bank chartered in the State of Washington. The Bank began operations April 11, 2005 and has three branch locations as of December 31, 2015: Burlington, Bellingham and Mt. Vernon, Washington. A loan production center was opened in Anacortes, Washington in May 2013 and in Oak Harbor in August 2014. The Bank provides loan and deposit services to customers who are predominantly small and middle-market businesses and individuals in and around Skagit, Island, and Whatcom counties. The Bank operates under a state bank charter and is subject to regulation by the State of Washington Department of Financial Institutions and the Federal Deposit Insurance Corporation (FDIC).

Note 2 Summary of Significant Accounting Policies

Financial Statement Presentation

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and practices within the banking industry.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral.

The Bank's loans are generally secured by specific items of collateral including real property, consumer assets and business assets. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on local economic conditions.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Bank to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

Cash and Cash Equivalents

Cash and due from banks consists of vault cash, cash items in the process of collection, and non-interest-bearing deposits with financial institutions. For purposes of the statements of cash flows, the Bank considers cash and cash equivalents to include cash, due from banks, interest-bearing deposits, investments with an original maturity of three months or less and federal funds sold.

SAVIBANK
(FORMERLY KNOWN AS BUSINESS BANK)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2015 AND 2014

Note 2 Summary of Significant Accounting Policies, continued

Restrictions on Cash and Due from Banks

SaviBank is required to maintain reserve funds in cash or on deposit with Pacific Coast Bankers' Bank. The required reserve at December 31, 2015 and 2014 was \$545,000 and \$250,000, respectively.

Investment Securities

The Bank accounts for investment securities according to authoritative guidance issued by the Financial Accounting Standards Board (FASB). Under the provisions of the FASB authoritative guidance, debt securities that management has the ability and intent to hold to maturity are classified as held-to-maturity and carried at amortized cost. The amortization of premiums and accretion of discounts are recognized in interest income using methods approximating the interest method over the period to maturity.

Debt securities not classified as held-to-maturity are classified as available-for-sale. Securities available-for-sale are carried at fair value with unrealized gains and losses reported in other comprehensive income. Realized gains (losses) on securities available-for-sale are included in other income, and when applicable, are reported as a reclassification adjustment, in other comprehensive income. Gains and losses on sales of securities are determined on the specific-identification method.

Declines in the fair value of individual held-to-maturity and available-for-sale securities below their amortized cost that are other than temporary result in writedowns of the individual securities to their fair value. The related writedowns are included in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Federal Home Loan Bank and Pacific Coast Bankers' Bank Stock

The Bank's investment in Federal Home Loan Bank (FHLB) stock is a restricted investment carried at cost (\$100 per share par value), which reasonably approximates its fair value. As a member of the FHLB system, the Bank is required to maintain a minimum level of investment in FHLB stock based on specific percentages of its outstanding FHLB advances. The Bank is required to purchase or redeem shares as the level of outstanding advances increase or decrease. This stock is classified as a restricted investment security, carried at cost and evaluated annually for impairment. No impairment loss was recorded in 2015 or 2014.

The Bank owns stock in Pacific Coast Bankers' Bank (PCBB). The investment in PCBB stock is a restricted investment carried at cost, which reasonably approximates its fair value. As a holder of PCBB stock, the Bank is allowed to borrow at a lower interest rate than a non-holder and to receive dividends.

Loans Held-for-Sale

Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by aggregate outstanding commitments from investors or current investor yield requirements. Net unrealized losses are recognized through a valuation allowance by charges to income.

SAVIBANK
(FORMERLY KNOWN AS BUSINESS BANK)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2015 AND 2014

Note 2 Summary of Significant Accounting Policies, continued

Loans Held-for-Sale, continued

Mortgage loans held-for-sale are generally sold with the mortgage servicing rights released by the Bank. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold.

Loans

Loans that management has the intent and ability to hold for the foreseeable future are stated at the principal amount outstanding, net of allowance for loan losses and deferred loan fees. Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income using the interest method. Interest on loans is calculated using the simple interest method based on the daily balance of principal amount outstanding and is credited to income when earned. Interest is accrued as earned unless management doubts the collectibility of interest or principal, at which time the loan is placed on nonaccrual status and accrued but unpaid interest is charged against income in that period. Any loan delinquent 90 days or more is placed on nonaccrual. Accrual of interest income is resumed when the borrower demonstrates the ability to make scheduled payments of both principal and interest.

Management considers loans impaired when it is probable the Bank will not be able to collect all amounts as scheduled under a loan agreement. Impaired loans are measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Changes in these values will be reflected in income and as adjustments to the allowance for possible loan losses.

The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due, unless the loan is well secured and in the process of collection. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received, or payment is considered certain.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level believed to be sufficient to absorb potential losses in the portfolio. The allowance for specific loan losses is provided on loans, which are considered impaired when full collectibility may not be assured. The allowance is established by a charge against operations in the period the loss is identified. General loan loss reserves are established to provide for inherent risks in the portfolio. The reserves are based on management's continuing evaluation of the pertinent factors underlying the credit quality of the loan portfolio, including changes in the size and composition of the loan portfolio, actual loan loss experience, and current and anticipated economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available. Additionally, loans are subject to examinations by state and federal regulators, who, based upon their judgment, may require the Bank to make additional provisions or adjustments to its allowance for loan losses. Past due status is determined based on contractual terms.

SAVIBANK
(FORMERLY KNOWN AS BUSINESS BANK)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2015 AND 2014

Note 2 Summary of Significant Accounting Policies, continued

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 Bank, (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 Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Reserve for Unfunded Commitments

The Bank has established a reserve for possible losses associated with commitments to lend funds under existing agreements. Management determines the adequacy of the reserve for unfunded commitments by evaluating the outstanding commitment levels, the expected conversion to loans, historical loss estimates and other relevant factors. This evaluation is inherently subjective and actual losses may vary from current estimates. Changes in the reserve are reported in earnings in the periods they become known. The reserve for unfunded commitments is included in accrued expenses and other liabilities in the accompanying balance sheets. At December 31, 2015 and 2014, the recorded liability was \$52,960 and \$37,699, respectively.

Premises and Equipment

Property, equipment and leasehold improvements are recorded at cost, net of accumulated depreciation and amortization. Gains and losses on dispositions are reflected in operations. Expenditures for improvements and major renewals are capitalized, and ordinary maintenance, repairs and small purchases are charged to operations as incurred.

Depreciation and Amortization

Property, equipment and leasehold improvements are depreciated or amortized over the estimated useful life of the related asset, which ranges from three to thirty-nine years. The Bank uses the straight-line method of recognizing depreciation and amortization expenses. Leasehold improvements are amortized over lease terms on a straight-line basis.

Other Real Estate Owned

Other real estate owned is foreclosed property held pending disposition and is initially recorded at fair value less estimated selling costs when acquired, establishing a new cost basis. At foreclosure, if the fair value of the real estate acquired less estimated selling costs is less than the Bank's recorded investment in the related loan, a writedown is recognized through a charge to the allowance for loan losses. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Valuations are periodically performed by management, and any subsequent writedowns are recorded as a charge to income, if necessary, to reduce the carrying value of the property to its fair value less estimated selling costs. Sales of other real estate owned are accounted for according to authoritative guidance issued by the FASB.

SAVIBANK
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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2015 AND 2014

Note 2 Summary of Significant Accounting Policies, continued

Income Taxes

Income taxes are provided for the tax effects of the transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the tax and financial reporting of the allowance for loan losses, accumulated depreciation, organization costs and conversion from accrual to cash basis.

The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred tax assets and liabilities are reflected at income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense (benefit) is the income tax payable (receivable) for the year and the change during the year in deferred tax assets and liabilities.

In accordance with authoritative guidance issued by the FASB, the Bank performed an evaluation to determine if there were any uncertain tax positions that would have an impact on the financial statements. No uncertain tax positions were identified. The December 31, 2012 through December 31, 2015 tax years remain subject to examination by the Internal Revenue Service. The Bank does not believe that any reasonably possible changes will occur within the next 12 months which will have a material impact on the financial statements. The Bank records incurred penalties and interest in other non-interest expense. There were no penalties and interest assessed by taxing authorities during 2015 or 2014.

Advertising Costs

The Bank expenses advertising costs as they are incurred. Total advertising expense was \$104,273 and \$30,345 for the years ended December 31, 2015 and 2014, respectively.

Stock-Based Employee Compensation

The Bank has a stock-based compensation plan described more fully in Note 15. The Bank has adopted authoritative guidance issued by the FASB regarding stock compensation.

The Bank's statements of income include \$40,795 and \$27,537 of compensation expense related to stock-based compensation for options for the years ended December 31, 2015 and 2014, respectively.

Financial Instruments

In the ordinary course of business, the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit and commercial letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

SAVIBANK
(FORMERLY KNOWN AS BUSINESS BANK)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2015 AND 2014

Note 2 Summary of Significant Accounting Policies, continued

Fair Values of Financial Instruments

The FASB has issued authoritative guidance which requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. The FASB authoritative guidance excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Bank.

The following methods and assumptions were used by the Bank in estimating its fair value disclosures for financial instruments:

Cash and due from banks: The carrying amounts reported in the balance sheet for cash and due from banks approximate those assets' fair values.

Interest-bearing deposits with financial institutions: The carrying amounts of interest-bearing deposits at other financial institutions approximate fair values.

Investment securities: Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

FHLB stock and PCBB stock: These are restricted investments carried at cost which approximates fair value.

Loans: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values for other loans (for example, fixed rate commercial real estate and rental property mortgage loans and commercial and industrial loans) are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics. The fair value of impaired loans is estimated using discounted cash flow analysis or underlying collateral values, where applicable.

Deposits: The fair values disclosed for demand deposits (for example, interest-bearing checking accounts and savings accounts) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair values for time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated contractual maturities on such time deposits.

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

Short-Term Borrowings: The carrying amount of short-term borrowings approximates their fair values.

Accrued Interest: The carrying amount of accrued interest approximates its fair value.

SAVIBANK
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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2015 AND 2014

Note 2 Summary of Significant Accounting Policies, continued

Reclassifications

Certain reclassifications have been made to the 2014 financial statements to conform to current year presentations. Such reclassifications have had no effect upon previously reported net income.

Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before the financial statements are available to be issued. The Bank recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the financial statements. The Bank's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before the financial statements are available to be issued. The Bank has evaluated subsequent events from December 31, 2015 through April 4, 2016, the date the financial statements were available to be issued. Refer to Note 20 for subsequent events identified for disclosure.

New Accounting Standards

In January 2014, the FASB issued Accounting Standards Update (ASU) 2014-04, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40)*, which amended its authoritative guidance related to residential real estate to clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendment requires interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. This amendment became effective in 2015 and did not have a significant impact on the Bank's financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This guidance is a comprehensive new revenue recognition standard that will supersede substantially all existing revenue recognition guidance. The new standard's core principle is that a bank will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the bank expects to be entitled in exchange for those goods or services. In doing so, banks will need to use more judgement and make more estimates than under existing guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. On July 9, 2015, the FASB agreed to delay the effective date of the standard by one year. Therefore, the new standard will be effective for annual reporting periods beginning after December 31, 2018. Implementation of this standard is not expected to have a significant impact on the Bank's financial statements.

SAVIBANK
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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2015 AND 2014

Note 2 Summary of Significant Accounting Policies, continued

New Accounting Standards, continued

In August 2014, the FASB issued ASU 2014-14, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure*. This guidance amended its authoritative guidance related to foreclosed home loans with government backed guarantees. The amendment requires lenders to measure the unpaid principal and interest they expect to recover through the loan guarantee. The loan should be removed from the lender's asset total and added to the balance sheet as a new receivable. The amendment became effective during 2015 and did not have a significant impact on the Bank's financial statements.

In April 2015, FASB issued ASU 2015-03, *Interest – Imputation of Interest (Subtopic 835-30)*, which amended its authoritative guidance related to debt issuance costs. The amendment requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability. However, the recognition and measurement guidance related to debt issuance costs is not affected by this amendment. The amendment is effective for annual and interim reporting periods beginning after December 15, 2015 and is to be applied on a retrospective basis. Early adoption is permitted. Implementation of this standard is not expected to have a significant impact on the Bank's financial statement.

In February 2016, FASB issued ASU 2016-02, *Leases (Topic 842)*. This guidance amends previous guidance related to accounting for leases. The amendment will require organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases with a term of more than 12 months. This amendment is effective for annual and interim periods beginning after December 15, 2018 for public companies. For other organizations, it is effective for annual periods beginning after December 15, 2019. Management has not yet determined the impact of implementation of this standard on the Bank's financial statements.

Note 3 Investment Securities

The amortized cost and fair values of investment securities at December 31, 2015 are as follows:

	December 31, 2015			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Available-for-Sale:				
U.S. Government agency mortgage-backed securities	\$ 1,265,313	\$ 3,965	\$ (4,025)	\$ 1,265,253
SBA pools	<u>3,687,934</u>	<u>462</u>	<u>(26,901)</u>	<u>3,661,495</u>
Totals	<u>\$ 4,953,247</u>	<u>\$ 4,427</u>	<u>\$ (30,926)</u>	<u>\$ 4,926,748</u>

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Note 3 Investment Securities, continued

The balance sheet as of December 31, 2015 reflects the fair value of available-for-sale securities of \$4,926,748. A net unrealized loss of \$26,499 is in the available-for-sale investment securities balance. The unrealized loss is included in shareholders' equity.

The amortized cost and fair values of investment securities at December 31, 2014 are as follows:

	December 31, 2014			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Available-for-Sale:				
U.S. Government agency mortgage-backed securities	\$ 1,884,949	\$ 4,121	\$ (6,192)	\$ 1,882,878
SBA pools	3,980,066	2,461	(33,930)	3,948,597
Totals	<u>\$ 5,865,015</u>	<u>\$ 6,582</u>	<u>\$ (40,122)</u>	<u>\$ 5,831,475</u>

The balance sheet as of December 31, 2014 reflects the fair value of available-for-sale securities of \$5,831,475. A net unrealized loss of \$33,540 is in the available-for-sale investment securities balance. The unrealized loss is included in shareholders' equity.

At December 31, 2015 and 2014, the Bank's investment securities consist only of mortgage-backed securities and SBA pools which are not due at a single maturity date; therefore, a schedule of contractual maturities is not presented.

There were no sales of investment securities during 2015 or 2014.

Securities with carrying amounts of \$9,124 and \$1,667,957 at December 31, 2015 and 2014, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law.

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Note 3 Investment Securities, continued

Information pertaining to securities with gross unrealized losses at December 31, 2015 and 2014 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	<u>Less Than 12 Months</u>		<u>12 Months or Greater</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>
December 31, 2015:						
U.S. Government agency mortgage-backed securities	\$ 485,342	\$ (823)	\$ 142,851	\$ (3,202)	\$ 628,193	\$ (4,025)
SBA pools	<u>2,000,177</u>	<u>(7,222)</u>	<u>1,604,429</u>	<u>(19,679)</u>	<u>3,604,606</u>	<u>(26,901)</u>
Totals	<u>\$ 2,485,519</u>	<u>\$ (8,045)</u>	<u>\$ 1,747,280</u>	<u>\$ (22,881)</u>	<u>\$ 4,232,799</u>	<u>\$ (30,926)</u>
December 31, 2014:						
U.S. Government agency mortgage-backed securities	\$ 661,610	\$ (3,126)	\$ 703,210	\$ (3,066)	\$ 1,364,820	\$ (6,192)
SBA pools	<u>3,257,893</u>	<u>(33,930)</u>	<u>-</u>	<u>-</u>	<u>3,257,893</u>	<u>(33,930)</u>
Totals	<u>\$ 3,919,503</u>	<u>\$ (37,056)</u>	<u>\$ 703,210</u>	<u>\$ (3,066)</u>	<u>\$ 4,622,713</u>	<u>\$ (40,122)</u>

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Certain investment securities shown above currently have fair values less than amortized cost and therefore contain unrealized losses. At December 31, 2015, there are 17 investment securities with an unrealized loss of less than 1% from their amortized cost. The Bank has evaluated these securities and has determined that the decline in value is temporary and is related to the change in market interest rates since purchase. The decline in value is not related to any company or industry specific event. The Bank anticipates full recovery of amortized cost with respect to these securities at maturity or sooner in the event of a more favorable market interest rate. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other-than-temporary.

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Note 4 Loans Receivable and Allowance for Loan Losses

An analysis of loan categories at December 31, 2015 and 2014 is as follows:

	<u>2015</u>	<u>2014</u>
Commercial and agricultural loans	\$ 14,256,776	\$ 14,273,756
Real estate (RE) loans:		
Construction, land and land development	10,122,653	9,720,605
Residential 1-4 family	36,104,463	34,661,903
Commercial RE	50,953,538	44,455,187
Consumer and other loans	<u>5,129,982</u>	<u>3,697,891</u>
	116,567,412	106,809,342
Less: Deferred loan fees	(84,407)	(149,148)
Allowance for loan losses	<u>(1,283,853)</u>	<u>(1,369,109)</u>
Loans, net	<u>\$ 115,199,152</u>	<u>\$ 105,291,085</u>

Included in total loans above are \$8,162 and \$3,377 in overdrawn accounts at December 31, 2015 and 2014, respectively.

Transactions in the allowance for loan losses in 2015 are summarized as follows:

	<u>Commercial and Agricultural</u>	<u>Construction, Land and Land Development</u>	<u>Residential 1-4 Family</u>	<u>Commercial RE</u>	<u>Consumer and Other</u>	<u>Unallocated</u>	<u>2015 Total</u>
<u>Allowance for Loan Losses:</u>							
Balance, beginning of year	\$ 177,604	\$ 114,325	\$ 321,919	\$ 350,115	\$ 8,679	\$ 396,467	\$ 1,369,109
Provisions, charged (credited) to income	<u>632,051</u>	<u>(63,757)</u>	<u>(178,388)</u>	<u>(72,024)</u>	<u>13,548</u>	<u>(48,482)</u>	<u>282,948</u>
	809,655	50,568	143,531	278,091	22,227	347,985	1,652,057
Loans charged-off	(470,550)	-	-	-	(2,792)	-	(473,342)
Recoveries of loans previously charged-off	<u>22,647</u>	<u>-</u>	<u>69,206</u>	<u>13,285</u>	<u>-</u>	<u>-</u>	<u>105,138</u>
Net (charge-offs) recoveries	<u>(447,903)</u>	<u>-</u>	<u>69,206</u>	<u>13,285</u>	<u>(2,792)</u>	<u>-</u>	<u>(368,204)</u>
Balance, end of year	<u>\$ 361,752</u>	<u>\$ 50,568</u>	<u>\$ 212,737</u>	<u>\$ 291,376</u>	<u>\$ 19,435</u>	<u>\$ 347,985</u>	<u>\$ 1,283,853</u>
Amounts allocated to: Individually evaluated for impairment	\$ 3,824	\$ 15,576	\$ 87,185	\$ 86,885	\$ -	\$ -	\$ 193,470
Amounts allocated to: Collectively evaluated for impairment	<u>357,928</u>	<u>34,992</u>	<u>125,552</u>	<u>204,491</u>	<u>19,435</u>	<u>347,985</u>	<u>1,090,383</u>
Balance, end of year	<u>\$ 361,752</u>	<u>\$ 50,568</u>	<u>\$ 212,737</u>	<u>\$ 291,376</u>	<u>\$ 19,435</u>	<u>\$ 347,985</u>	<u>\$ 1,283,853</u>
<u>Loans:</u>							
Individually evaluated for impairment	\$ 377,045	\$ 1,465,436	\$ 806,048	\$ 1,622,141	\$ -		\$ 4,270,670
Collectively evaluated for impairment	<u>13,879,731</u>	<u>8,657,217</u>	<u>35,298,415</u>	<u>49,331,397</u>	<u>5,129,982</u>		<u>112,296,742</u>
Ending balance total loans	<u>\$ 14,256,776</u>	<u>\$ 10,122,653</u>	<u>\$ 36,104,463</u>	<u>\$ 50,953,538</u>	<u>\$ 5,129,982</u>		<u>\$ 116,567,412</u>

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Note 4 Loans Receivable and Allowance for Loan Losses, continued

Transactions in the allowance for loan losses in 2014 are summarized as follows:

	<u>Commercial and Agricultural</u>	<u>Construction, Land and Development</u>	<u>Residential 1-4 Family</u>	<u>Commercial RE</u>	<u>Consumer and Other</u>	<u>Unallocated</u>	<u>2014 Total</u>
<u>Allowance for Loan Losses:</u>							
Balance, beginning of year	\$ 280,002	\$ 267,875	\$ 357,172	\$ 397,360	\$ 11,555	\$ 188,204	\$ 1,502,168
Provisions, charged (credited) to income	<u>53,114</u>	<u>(154,394)</u>	<u>(48,005)</u>	<u>(56,102)</u>	<u>(2,876)</u>	<u>208,263</u>	<u>-</u>
	<u>333,116</u>	<u>113,481</u>	<u>309,167</u>	<u>341,258</u>	<u>8,679</u>	<u>396,467</u>	<u>1,502,168</u>
Loans charged-off	(190,335)	-	-	-	-	-	(190,335)
Recoveries of loans previously charged-off	<u>34,823</u>	<u>844</u>	<u>12,752</u>	<u>8,857</u>	<u>-</u>	<u>-</u>	<u>57,276</u>
Net (charge-offs) recoveries	<u>(155,512)</u>	<u>844</u>	<u>12,752</u>	<u>8,857</u>	<u>-</u>	<u>-</u>	<u>(133,059)</u>
Balance, end of year	<u>\$ 177,604</u>	<u>\$ 114,325</u>	<u>\$ 321,919</u>	<u>\$ 350,115</u>	<u>\$ 8,679</u>	<u>\$ 396,467</u>	<u>\$ 1,369,109</u>
Amounts allocated to: Individually evaluated for impairment	\$ 21,294	\$ 9,130	\$ 143,784	\$ 156,918	\$ -	\$ -	\$ 331,126
Amounts allocated to: Collectively evaluated for impairment	<u>156,310</u>	<u>105,195</u>	<u>178,135</u>	<u>193,197</u>	<u>8,679</u>	<u>396,467</u>	<u>1,037,983</u>
Balance, end of year	<u>\$ 177,604</u>	<u>\$ 114,325</u>	<u>\$ 321,919</u>	<u>\$ 350,115</u>	<u>\$ 8,679</u>	<u>\$ 396,467</u>	<u>\$ 1,369,109</u>
<u>Loans:</u>							
Individually evaluated for impairment	\$ 629,980	\$ 1,823,187	\$ 817,893	\$ 1,686,638	\$ -		\$ 4,957,698
Collectively evaluated for impairment	<u>13,643,776</u>	<u>7,897,418</u>	<u>33,844,010</u>	<u>42,768,549</u>	<u>3,697,891</u>		<u>101,851,644</u>
Ending balance total loans	<u>\$ 14,273,756</u>	<u>\$ 9,720,605</u>	<u>\$ 34,661,903</u>	<u>\$ 44,455,187</u>	<u>\$ 3,697,891</u>		<u>\$ 106,809,342</u>

Federal regulations require that the Bank periodically evaluate the risks inherent in its loan portfolio. In addition, the Bank's regulatory agencies have authority to identify problem loans and, if appropriate, require them to be reclassified. There are three classifications for problem loans: Substandard, Doubtful and Loss. Substandard loans have one or more defined weaknesses and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Doubtful loans have the weaknesses of loans classified as "Substandard," with additional characteristics that suggest the weaknesses make collection or recovery in full after liquidation of collateral questionable on the basis of currently existing facts, conditions and values. There is a high possibility of loss in loans classified as "Doubtful." A loan classified as "Loss" is considered uncollectible and of such little value that continued classification of the credit as a loan is not warranted. If a loan or a portion thereof is classified as "Loss," it must be charged-off, meaning the amount of the loss is charged against the allowance for loan losses, thereby reducing that reserve. The Bank also classifies some loans as "Watch" or "Other Loans Especially Mentioned" ("OLEM"). Loans classified as Watch are performing assets and classified as pass credits but have elements of risk that require more monitoring than other performing loans. Loans classified as OLEM are assets that continue to perform but have shown deterioration in credit quality and require close monitoring.

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Note 4 Loans and Allowance for Loan Losses, continued

Loans by credit quality risk rating at December 31, 2015 and 2014 are as follows:

	<u>Pass</u>	<u>Other Loans Especially Mentioned</u>	<u>Sub- Standard</u>	<u>Doubtful</u>	<u>Total</u>
December 31, 2015:					
Commercial and agricultural loans	\$ 13,522,850	\$ -	\$ 733,926	\$ -	\$ 14,256,776
Real estate (RE) loans:					
Construction, land and land development	10,044,332	-	78,321	-	10,122,653
Residential 1-4 family	35,872,262	-	232,201	-	36,104,463
Commercial RE	49,331,396	-	1,622,142	-	50,953,538
Consumer and other loans	<u>5,127,192</u>	<u>-</u>	<u>2,790</u>	<u>-</u>	<u>5,129,982</u>
Subtotal	<u>\$ 113,898,032</u>	<u>\$ -</u>	<u>\$ 2,669,380</u>	<u>\$ -</u>	116,567,412
Less: Deferred loan fees					<u>(84,407)</u>
Total loans					<u>\$ 116,483,005</u>
December 31, 2014:					
Commercial and agricultural loans	\$ 11,783,056	\$ 1,126,810	\$ 1,347,042	\$ 16,848	\$ 14,273,756
Real estate (RE) loans:					
Construction, land and land development	9,613,787	-	106,818	-	9,720,605
Residential 1-4 family	34,353,792	-	307,143	968	34,661,903
Commercial RE	42,365,601	-	2,089,586	-	44,455,187
Consumer and other loans	<u>3,697,891</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,697,891</u>
Subtotal	<u>\$ 101,814,127</u>	<u>\$ 1,126,810</u>	<u>\$ 3,850,589</u>	<u>\$ 17,816</u>	106,809,342
Less: Deferred loan fees					<u>(149,148)</u>
Total loans					<u>\$ 106,660,194</u>

An analysis of nonaccrual loans by category at December 31, 2015 and 2014 is as follows:

	<u>2015</u>	<u>2014</u>
Commercial and agricultural loans	\$ 224,829	\$ 287,760
Real estate (RE) loans:		
Construction, land and land development	78,321	106,817
Residential 1-4 family	-	968
Commercial RE	1,622,141	504,480
Consumer and other loans	<u>2,711</u>	<u>-</u>
Total nonaccrual loans	<u>\$ 1,928,002</u>	<u>\$ 900,025</u>

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Note 4 Loans and Allowance for Loan Losses, continued

At December 31, 2015 and 2014, a summary of information pertaining to impaired loans is as follows:

	<u>Unpaid Contractual Principal Balance</u>	<u>Recorded Investment with No Allowance</u>	<u>Recorded Investment with Allowance</u>	<u>Total Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
December 31, 2015:							
Commercial and agricultural loans	\$ 412,141	\$ 224,829	\$ 152,216	\$ 377,045	\$ 3,824	\$ 503,513	\$ 11,513
Real estate (RE) loans:							
Construction, land and land development	1,553,866	1,129,728	335,708	1,465,436	15,576	1,644,312	78,151
Residential 1-4 family	806,048	232,201	573,847	806,048	87,185	811,971	36,246
Commercial RE	<u>1,737,479</u>	<u>1,535,256</u>	<u>86,885</u>	<u>1,622,141</u>	<u>86,885</u>	<u>1,654,540</u>	<u>36,165</u>
Total	<u>\$ 4,509,534</u>	<u>\$ 3,122,014</u>	<u>\$ 1,148,656</u>	<u>\$ 4,270,670</u>	<u>\$ 193,470</u>	<u>\$ 4,614,336</u>	<u>\$ 162,075</u>
December 31, 2014:							
Commercial and agricultural loans	\$ 703,431	\$ 287,760	\$ 342,220	\$ 629,980	\$ 21,294	\$ 720,247	\$ 24,549
Real estate (RE) loans:							
Construction, land and land development	1,876,176	1,476,403	346,784	1,823,187	9,130	2,454,683	93,808
Residential 1-4 family	834,863	236,272	581,621	817,893	143,784	710,584	36,799
Commercial RE	<u>1,721,103</u>	<u>504,479</u>	<u>1,182,159</u>	<u>1,686,638</u>	<u>156,918</u>	<u>1,701,028</u>	<u>63,101</u>
Total	<u>\$ 5,135,573</u>	<u>\$ 2,504,914</u>	<u>\$ 2,452,784</u>	<u>\$ 4,957,698</u>	<u>\$ 331,126</u>	<u>\$ 5,586,542</u>	<u>\$ 218,257</u>

The Bank has no commitments to loan additional funds to borrowers whose loans are impaired.

Troubled Debt Restructurings – The restructuring of a loan is considered a “troubled debt restructuring” if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. There were no troubled debt restructurings during 2015 or 2014.

At December 31, 2015, two commercial real estate loans totaling \$1,238,767 and one construction loan totaling \$78,321, which were restructured in a prior year were on nonaccrual and not in compliance with the loans’ modified terms.

At December 31, 2014, one commercial real estate loan totaling \$134,744 and one construction loan totaling \$106,817, which were restructured in a prior year were on nonaccrual and not in compliance with the loans’ modified terms.

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Note 4 Loans and Allowance for Loan Losses, continued

The following table illustrates an age analysis of past due loans as of December 31, 2015:

	<u>30-89 Days Past Due</u>	<u>90 Days or More Past Due</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans</u>	<u>Recorded Investment 90 Days or More Past Due and Still Accruing</u>
December 31, 2015:						
Commercial and agricultural loans	\$ 50,000	\$ -	\$ 50,000	\$ 14,206,776	\$ 14,256,776	\$ -
Real estate (RE) loans:						
Construction, land and land development	-	-	-	10,122,653	10,122,653	-
Residential 1-4 family	-	-	-	36,104,463	36,104,463	-
Commercial RE	383,375	-	383,375	50,570,163	50,953,538	-
Consumer and other loans	<u>79</u>	<u>-</u>	<u>79</u>	<u>5,129,903</u>	<u>5,129,982</u>	<u>-</u>
Subtotal	<u>\$ 433,454</u>	<u>\$ -</u>	<u>\$ 433,454</u>	<u>\$ 116,133,958</u>	116,567,412	<u>\$ -</u>
Less: Deferred loan fees					(84,407)	
Total					<u>\$ 116,483,005</u>	

The following table illustrates an age analysis of past due loans as of December 31, 2014:

	<u>30-89 Days Past Due</u>	<u>90 Days or More Past Due</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans</u>	<u>Recorded Investment 90 Days or More Past Due and Still Accruing</u>
December 31, 2014:						
Commercial and agricultural loans	\$ -	\$ 16,848	\$ 16,848	\$ 14,256,908	\$ 14,273,756	\$ -
Real estate (RE) loans:						
Construction, land and land development	-	-	-	9,720,605	9,720,605	-
Residential 1-4 family	-	968	968	34,660,935	34,661,903	-
Commercial RE	-	369,735	369,735	44,085,452	44,455,187	-
Consumer and other loans	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,697,891</u>	<u>3,697,891</u>	<u>-</u>
Subtotal	<u>\$ -</u>	<u>\$ 387,551</u>	<u>\$ 387,551</u>	<u>\$ 106,421,791</u>	106,809,342	<u>\$ -</u>
Less: Deferred loan fees					(149,148)	
Total					<u>\$ 106,660,194</u>	

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Note 4 Loans and Allowance for Loan Losses, continued

At December 31, 2014, included in past due loans are four nonaccrual loans with outstanding balances of \$387,551 which are past due 90 days or more.

Loans totaling approximately \$40,907,000 and \$32,940,000 were pledged to secure borrowings at December 31, 2015 and 2014, respectively. Refer to Notes 9 and 10.

Note 5 Premises and Equipment

The components of premises and equipment at December 31 are as follows:

	2015	2014
Land	\$ 1,024,771	\$ 1,024,771
Buildings	3,984,219	3,984,219
Leasehold improvements	300,091	300,091
Equipment, furniture and fixtures	1,019,359	1,025,561
Fixed assets in process	46,884	154,340
Total cost	6,375,324	6,488,982
Less accumulated depreciation	(1,639,776)	(1,580,710)
Total	\$ 4,735,548	\$ 4,908,272

Depreciation and amortization charged against operations for the years ended December 31, 2015 and 2014 was \$269,541 and \$221,897, respectively.

The Bank leases its branch facilities in Bellingham under an operating lease with an initial lease term of five years. The lease includes renewal options and provides for rate adjustments based on changes in various economic indicators. This lease was renewed in July 2014 for an additional three-year term. Refer to Note 20 – Subsequent Event for additional information on the Bellingham branch location.

In May 2013, the Bank opened a loan production center in Anacortes with a 12-month lease term at \$1,050 per month. In July 2014, a two year lease was signed at \$947 per month for the loan production center at a new location in Anacortes.

Minimum gross rental commitments under existing leases having an original or remaining term of more than one year are as follows at December 31, 2015:

Year Ending December 31,		
2016	\$	46,831
2017		20,829
2018		-
2019		-
2020		-
Total	\$	67,660

Rental expense was \$68,263 and \$51,737 for 2015 and 2014, respectively, which is included in occupancy and equipment expense.

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Note 5 Premises and Equipment, continued

In August 2011, the Bank acquired the land and building where the South Mount Vernon branch is located for \$2,100,000. This property was financed by the Bank; therefore, the Bank agreed to pay the building owner by reducing his debt by the purchase price. At December 31, 2015, there are three tenants in this building obligated under operating leases with one scheduled to expire in 2017 and two expiring in 2019. Future minimum rental income under these leases is as follows:

Year Ending December 31,	
2016	\$ 75,881
2017	58,838
2018	46,783
2019	12,854
2020	-
Total	<u>\$ 194,356</u>

Rental income of \$75,151 and \$97,388 was received during 2015 and 2014, respectively, under these lease agreements and is recorded as non-interest income in the accompanying financial statements.

Note 6 Deposits

The composition of deposits at December 31 is as follows:

	2015	2014
Non-interest checking	\$ 25,344,048	\$ 20,429,288
Interest-bearing checking and money market	40,725,640	32,285,246
Savings deposits	11,840,485	8,668,111
Time deposits, less than \$100,000	24,779,769	32,278,908
Time deposits, \$100,000 or more	17,146,370	5,148,155
Total deposits	<u>\$ 119,836,312</u>	<u>\$ 98,809,708</u>

The scheduled maturities of time deposits at December 31, 2015 are as follows:

Year Ending December 31,	
2016	\$ 33,163,435
2017	3,423,600
2018	2,340,604
2019	359,101
2020	2,263,764
Thereafter	375,635
Total	<u>\$ 41,926,139</u>

Included in deposits are institutional deposits obtained from institutions outside of the Bank's primary market area of approximately \$7,003,000 and \$15,018,000 at December 31, 2015 and 2014, respectively. The aggregate amount of time deposits in denominations that meet or exceed the FDIC insurance limit of \$250,000 at December 31, 2015 was \$4,111,000.

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Note 7 Federal Income Taxes

No income tax expense or benefit was recorded on the Bank's books during 2015 or 2014 due to net operating losses incurred.

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities are:

	<u>2015</u>	<u>2014</u>
Deferred tax assets:		
Organizational expenditures	\$ 22,621	\$ 27,136
Net operating loss carryover	4,955,068	5,285,233
Basis difference on other real estate owned	116,486	116,486
Off-balance-sheet liability	18,006	12,818
Nonqualified stock options	12,646	-
Nonaccrual loan interest	43,738	-
Other	2,930	2,794
	<u>5,171,495</u>	<u>5,444,467</u>
Deferred tax liabilities:		
Allowance for possible loan losses in excess of tax reserves	(48,351)	(144,553)
Accrual to cash adjustment	(102,856)	(33,600)
Premises and equipment	(50,683)	(52,170)
Other	(223)	(162)
	<u>(202,113)</u>	<u>(230,485)</u>
Net Deferred Tax Asset	4,969,382	5,213,982
Less Valuation Allowance	<u>(4,969,382)</u>	<u>(5,213,982)</u>
Net deferred tax asset	<u>\$ -</u>	<u>\$ -</u>

The Bank recorded net income of approximately \$702,000 and \$138,000 for financial reporting purposes for the years ended December 31, 2015 and 2014, respectively. The Bank reported taxable income of approximately \$974,000 and \$95,000 for the years ended December 31, 2015 and 2014, respectively.

As of December 31, 2015, the Bank has net operating losses of approximately \$14,573,000 which may be carried forward a period of twenty years to offset future taxable income. If not used, these losses will begin to expire in 2028.

Realization of the future tax benefits of the net operating loss is dependent upon the Bank's ability to generate future taxable income. Due to the uncertainty of future earnings, management is unable to predict whether the deferred tax asset will be realized and therefore has recorded a valuation allowance of \$4,969,382 and \$5,213,982 as of December 31, 2015 and 2014, respectively. The net change in the valuation allowance during the year was a decrease of \$244,600.

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Note 8 Related Party Transactions

During 2015 and 2014, the Bank had transactions made in the ordinary course of business with certain of its officers, directors and principal shareholders. All loans included in such transactions were made on substantially the same terms, including interest rate and collateral, as those prevailing at the time for comparable transactions with other persons, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features.

A summary of these transactions follows:

	<u>Balance Beginning of Year</u>	<u>Additions</u>	<u>Amounts Collected</u>	<u>Balance End of Year</u>
For the year ended:				
December 31, 2015	<u>\$ 2,411,568</u>	<u>\$ 157,273</u>	<u>\$ (132,438)</u>	<u>\$ 2,436,403</u>
For the year ended:				
December 31, 2014	<u>\$ 1,253,035</u>	<u>\$ 1,336,787</u>	<u>\$ (178,254)</u>	<u>\$ 2,411,568</u>

The Bank also had unfunded commitments to executive officers, directors and principal shareholders of approximately \$354,000 and \$257,300 at December 31, 2015 and 2014, respectively.

At December 31, 2015 and 2014, the Bank held related party deposits of \$2,353,312 and \$1,770,919, respectively, which includes deposits held for directors, executive officers, principal shareholders and related business entities.

Note 9 Federal Home Loan Bank Borrowings

The Bank is a member of the Federal Home Loan Bank (FHLB) of Des Moines (formerly FHLB of Seattle), which entitles it to certain benefits including a variety of borrowing options. The FHLB borrowings at December 31, 2015 and 2014 consist of a warehouse securities credit line (securities line), which also allows for advances with interest rates fixed at the time of borrowing, an Overnight Funds line, which allows daily advances at variable interest rates, and a putable advance option, in which the borrower is “paid” for selling the options embedded in the advance, which enables the Bank to borrow at rates below those for regular fixed-rate advances. It also has a “Bermudan” option, which means that the option is exercisable at June 1, 2008 and every quarter thereafter. Credit capacity is primarily determined by the value of assets collateralized at the FHLB, funds on deposit at the FHLB, and stock owned by the Bank. Credit is limited to 25% of the Bank’s total assets.

Collateral pledged to the FHLB as of December 31, 2015 and 2014 included loans with outstanding balances of approximately \$40,907,000 and \$31,532,000, respectively. The Bank has available borrowing capacity of an additional \$26,303,000 at December 31, 2015.

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Note 9 Federal Home Loan Bank Borrowings, continued

Advances on these lines at December 31, 2015 were as follows:

Securities line:		
Putable advance, interest rate 3.28%		\$ 3,000,000
Putable advance, interest rate 4.61%		<u>2,000,000</u>
Total		<u>\$ 5,000,000</u>

Both of the above advances will mature in 2017. At December 31, 2015 and 2014, outstanding FHLB borrowings totaled \$5,000,000 and \$12,000,000, respectively.

Note 10 Lines of Credit

At December 31, 2015, the Bank has a \$3,000,000 unsecured line of credit with Pacific Coast Bankers' Bank (PCBB) which expires June 30, 2016. At December 31, 2014, the Bank had a secured line of credit with PCBB which was secured by investment securities with a carrying amount of \$1,661,511. There were no borrowings on this line at December 31, 2015 or 2014.

At December 31, 2014, the Bank had available a collateralized line of credit with the Federal Reserve Bank of San Francisco (FRB). Loans with outstanding balances of approximately \$1,408,000 were pledged to the FRB for available borrowings of \$478,669 at December 31, 2014. There were no outstanding borrowings on this line as of December 31, 2014. The Bank cancelled this line during 2015.

The Bank also has a line of credit with Federal Home Loan Bank as discussed in Note 9.

Note 11 Commitments and Contingent Liabilities

In the normal course of business, the Bank has outstanding commitments and contingent liabilities, such as commitments to extend credit, which are not included in the accompanying financial statements. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit is represented by the contractual or notional amount of those instruments. The Bank uses the same credit policies in making such commitments as it does for instruments that are included in the balance sheet.

Commitments to extend credit and possible credit risk were approximately as follows:

	2015	2014
Commitments to extend credit	\$ 23,840,000	\$ 15,858,000
Standby letters of credit	255,000	238,000

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Note 11 Commitments and Contingent Liabilities, continued

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. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties. The Bank has not been required to perform on any financial guarantees nor incurred any losses on its commitments during 2015 or 2014.

The Bank is subject to claims and lawsuits which arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the financial position of the Bank.

The Bank issues various representations and warranties associated with the sale of loans. The Bank has not experienced any significant losses in the years ended December 31, 2015 and 2014 regarding these representations and warranties.

The Bank participates in the Washington State Public Depository program which requires institutions to collateralize uninsured public deposits at 100 percent. At December 31, 2015 and 2014, the Bank had pledged \$9,124 and \$13,973, respectively, to secure public deposits. Refer to Note 3 – Investment Securities.

Note 12 Concentrations of Credit Risk

The Bank maintains its cash accounts with several correspondent banks. Generally, amounts placed or invested in bank accounts are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 per bank. There were uninsured deposits in bank accounts of \$156,898 and \$62,299 at December 31, 2015 and 2014, respectively. Management regularly evaluates the credit risk associated with the counterparties to these transactions and believes that the Bank is not exposed to any significant credit risks on cash and cash equivalents.

The Bank grants agribusiness, commercial, consumer and real estate loans to customers within Skagit, Island, and Whatcom Counties, Washington and the surrounding areas. Concentrations of credit by loan type are set forth in Note 4 – Loans Receivable and Allowance for Loan Losses.

Note 13 Regulatory Matters

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

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Note 13 **Regulatory Matters, continued**

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of: Total Risk-Based capital, Tier 1 capital and Common Equity Tier 1 capital to risk-weighted assets (as defined in the regulations), and Leverage capital, which is Tier 1 capital to adjusted total assets (as defined). Management believes, as of December 31, 2015 and 2014, that the Bank meets all capital adequacy requirements to which it is subject.

The Bank's Tier 1 capital consists of shareholder's equity excluding unrealized gains and losses on securities available-for-sale and other intangible assets.

SaviBank has been notified by its regulator that, as of its most recent regulatory examination, the Bank is regarded as well capitalized under the regulatory framework for prompt corrective action. Such determination has been made based on the Bank's Common Equity Tier 1, Tier 1, total capital and leverage ratios. There have been no conditions or events since this notification that management believes would change the Bank's categorization as well capitalized under the ratios listed on the next page.

Beginning January 1, 2015, community banking organizations became subject to a new regulatory rule recently adopted by federal banking agencies (commonly referred to as Basel III). The new rule establishes a new regulatory capital framework that incorporates revisions to the Basel capital framework, strengthens the definition of regulatory capital, increases risk-based capital requirements, and amends the methodologies for determining risk-weighted assets. These changes are expected to increase the amount of capital required by community banking organizations. Basel III includes a multiyear transition period from January 1, 2015 through December 31, 2019.

Management believes that, as of December 31, 2015, the Bank would meet all capital adequacy requirements under the Basel III Capital rules on a fully phased-in basis as if such requirements were currently in effect; however, final rules are subject to regulatory discretion and could result in the need for additional capital levels in the future.

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Note 13 Regulatory Matters, continued

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

	<u>Actual</u>		<u>Minimum Required for Capital Adequacy Purposes</u>		<u>Required to be Well Capitalized Under the Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
As of December 31, 2015:						
Total Risk-based Capital (to Risk-weighted Assets)	\$ 15,568	12.52%	\$ 9,950	8.00%	\$ 12,438	10.00%
Tier 1 Capital (to Risk- weighted Assets)	\$ 14,231	11.44%	\$ 7,463	6.00%	\$ 9,950	8.00%
Common Equity Tier 1 Capital (to Risk-weighted Assets)	\$ 14,231	11.44%	\$ 5,597	4.50%	\$ 8,085	6.50%
Leverage Capital (to adjusted Total Average Assets)	\$ 14,231	10.38%	\$ 5,484	4.00%	\$ 6,855	5.00%
As of December 31, 2014:						
Total Risk-based Capital (to Risk-weighted Assets)	\$ 13,836	12.88%	\$ 8,593	8.00%	\$ 10,741	10.00%
Tier 1 Capital (to Risk- weighted Assets)	\$ 12,493	11.63%	\$ 4,296	4.00%	\$ 6,445	6.00%
Leverage Capital (to adjusted Total Average Assets)	\$ 12,493	10.12%	\$ 4,938	4.00%	\$ 11,112	9.00%

On December 5, 2014, the Bank was released from the September 2009 Order to Cease and Desist (Order) with the FDIC and Washington Department of Financial Institutions based on improvements in the Bank's overall condition and compliance with the Order.

The Bank was subject to the Order during 2014 which required the Bank to take certain actions to strengthen board oversight, strengthen credit risk management, reduce loan concentrations, improve asset quality, adopt and implement a comprehensive policy for determining the adequacy of the allowance for loan losses, achieve and maintain a primary liquidity ratio of at least 15%, and maintain specified capital levels.

Note 14 Equity Transactions

The Bank had secondary stock offerings during 2015 and 2014. In 2015, 896,000 additional shares were sold at \$1.25 per share for total proceeds of \$1,120,000. During 2014, an additional 4,900,000 shares were sold at \$1.00 to \$1.15 per share for total proceeds of \$5,170,000. Stock proceeds were offset by stock issuance costs of \$16,047 and \$21,900 for the years ended December 31, 2015 and 2014, respectively. Also, an additional 5,000 shares of common stock were granted during 2015.

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Note 15 Stock-Based Compensation

Stock Option Plan

Effective July 25, 2013, the shareholders approved the adoption of the 2013 Long-Term Equity Incentive Plan (2013 Plan) which provides for the grant of stock awards to eligible employees, officers and non-employee directors. The 2013 Plan replaced the 2005 Stock Option Plan ("2005 Plan"), which provided for the grant of up to 250,000 shares. The 2013 Plan permits the grant of Nonqualified Stock Options, Incentive Stock Options, Restricted Stock and Restricted Stock Unit Awards. The maximum number of shares of Common Stock which may be issued under all awards granted to participants under the 2013 Plan shall be 500,000 shares. No more than 125,000 shares of the 500,000 shares may be issued as Restricted Stock Grants or Restricted Stock Unit Awards. Shares of Common Stock issued under the Plan shall be authorized but unissued shares. At December 31, 2015 and 2014, respectively, there were 266,599 shares and 380,249 shares available for future grants under the 2013 Plan.

In April 2015, there were 125,000 stock options granted, including 50,000 nonqualified stock options granted to non-employee directors. The options were granted at a price of \$1.15 per share, vest over three to five years and have a term of ten years. In December 2014, there were 120,051 stock options granted, including 50,000 granted to non-employee directors. These options were granted at a price of \$1.15 per share, vest over three to five years and have a term of ten years.

The compensation cost that has been charged against income for this Plan was \$40,795 and \$27,537 for the years ended December 31, 2015 and 2014, respectively.

The Bank uses the Black-Scholes option pricing model to estimate the fair value of each option grant on the date of grant or modification. The Bank amortizes the estimated fair value to stock compensation expense using the straight-line method over the vesting period of the option. Following is a description of the significant assumptions used in the option-pricing model:

Expected Term: The expected term is the period of time that granted options are expected to be outstanding. The Bank estimates the expected term based on historical patterns of option exercises, as well as potential future events that may increase liquidity. These factors are believed to reflect future exercise behavior.

Expected Volatility: Volatility is calculated based on trading of the Bank's stock over the last three years, which is comparable to historical stock prices of similar banks going back over the estimated life of the option and averaging the volatilities of these banks.

Risk-Free Interest Rate: The Bank bases the risk-free interest rate used in the Black-Scholes option valuation model on the market yield in effect at the time of the option grant provided from the Federal Reserve Board's Statistical Releases and Historical publications from the Treasury constant maturities rates for the equivalent remaining terms.

Dividends: The Bank does not have plans to pay cash dividends in the future. Therefore, the Bank uses an expected dividend yield of zero in the Black-Scholes option valuation model.

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Note 15 Stock-Based Compensation, continued

Stock Option Plan, continued

The following assumptions were used to estimate the value of options granted for the years ended December 31, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Weighted-average expected term	7.00 years	7.00 years
Expected stock price volatility	22.68%	35.80%
Risk-free interest rate	1.73%	0.36% - 0.77%
Weighted-average risk-free interest rate	1.73%	0.64%
Expected dividends	0%	0%

Option activity under the Plan for the years ended December 31, 2015 and 2014 is summarized as follows:

<u>Options</u>	<u>Shares</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted-Average Remaining Contractual Term</u>
Outstanding at January 1, 2014	224,050	\$ 1.75	9.17
Granted	120,051	1.15	
Exercised	-	-	
Forfeited or cancelled	(8,800)	1.73	
Outstanding at December 31, 2014	<u>335,301</u>	<u>\$ 1.54</u>	<u>8.80</u>
Vested or expected to vest at December 31, 2014	<u>335,301</u>	<u>\$ 1.54</u>	<u>8.80</u>
Exercisable at December 31, 2014	<u>52,709</u>	<u>\$ 1.75</u>	<u>8.17</u>
Outstanding at January 1, 2015	335,301	\$ 1.54	8.80
Granted	125,000	1.15	
Exercised	(200)	1.75	
Forfeited or cancelled	(13,800)	1.28	
Outstanding at December 31, 2015	<u>446,301</u>	<u>\$ 1.42</u>	<u>8.03</u>
Vested or expected to vest at December 31, 2015	<u>446,301</u>	<u>\$ 1.42</u>	<u>8.03</u>
Exercisable at December 31, 2015	<u>133,462</u>	<u>\$ 1.62</u>	<u>7.56</u>

There were 125,000 and 120,051 options granted during the years ended December 31, 2015 and 2014, respectively. Options for 200 shares were exercised during the year ended December 31, 2015 for total proceeds of \$350. There were no options exercised during the year ended December 31, 2014.

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Note 15 Stock-Based Compensation, continued

Stock Option Plan, continued

A summary of the status of the Bank's nonvested shares as of December 31, 2015, and changes during the year ended December 31, 2015, is presented below:

<u>Nonvested Shares</u>	<u>Shares</u>	<u>Weighted- Average Grant-Date Fair Value</u>
Nonvested at January 1, 2015	282,592	\$ 0.41
Granted	125,000	0.33
Vested	(81,673)	0.41
Forfeited	(13,080)	0.34
Nonvested at December 31, 2015	<u>312,839</u>	<u>\$ 0.38</u>

As of December 31, 2015 and 2014, there was \$87,854 and \$91,976, respectively, of total unrecognized compensation cost related to non-vested stock options granted under the Plan. Total unrecognized compensation costs will be adjusted for future changes in estimated forfeitures. The Bank expects to recognize that cost over a period of approximately 4.25 years.

Stock Warrants

On October 2, 2014, a stock warrant was issued which entitles the warrant holder to purchase 1,550,000 shares of common stock of the Bank at a price of \$1.25 per share on or before October 2, 2019. This stock warrant remains outstanding as of December 31, 2015 and 2014.

During 2012, a total of 577,644 stock warrants were issued in conjunction with the March 2012 Stock Offering. One stock warrant to purchase one share of common stock was issued to each person who purchased two shares of common stock through this offering. The warrants entitle the warrant holder the right to purchase Bank stock at a price of \$2.00 per share on or before June 29, 2015. On March 12, 2015, the expiration date was extended for three years to June 29, 2018. These stock warrants remain outstanding as of December 31, 2015 and 2014.

In June 2005, the Board of Directors authorized the granting of stock warrants to the Bank's organizers in exchange for providing \$700,000 in seed capital which funded the organizational expenses of the Bank. Each Director (eight) received 8,750 warrants that entitles the holder to purchase one share of common stock at a price of \$10.00 per share on or before May 31, 2015. On March 12, 2015, the existing warrants were allowed to expire and were replaced with new warrants for the same amount of shares, (8,750 per Director) to expire on October 2, 2019 at a price of \$1.25 per share for those Directors (four) who are on the Board as of the date of this action and who provided seed capital which funded the organization expenses of the Bank. At December 31, 2015 and 2014, there were 35,000 and 70,000 stock warrants outstanding, respectively, for the Bank's organizing Directors.

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Note 16 Employee Benefit Plan

The Bank has a 401(k) profit sharing plan (the “Plan”) covering substantially all of its employees. Employees are eligible to participate in the Plan if they are 21 years of age and have completed three months of service. Eligible employees may contribute through payroll deductions and are 100% vested at all times in their deferral contributions account. The Bank is allowed to make annual matching contributions and/or employer “non-elective” contributions at its discretion. Participants are 100% vested in employer contributions after five years of service. During 2015 and 2014, employer matching contributions to the 401(k) Plan totaled \$51,630 and \$29,735, respectively.

Note 17 Compensated Absences

Employees of the Bank are entitled to paid vacation, paid sick days and personal days off, depending on job classification, length of service and other factors. The Bank’s policy allows employees to accumulate a certain amount of vacation time. Management does not accrue for the full amount of the potential vacation liability, but instead uses a formula to estimate the probable liability. The amount of accrued vacation time recorded at December 31, 2015 and 2014 is \$92,706 and \$111,324, respectively, and is included in accrued expenses and other liabilities in the accompanying financial statements.

Note 18 Fair Values of Financial Instruments

The estimated fair values of the Bank’s financial instruments as of December 31, 2015 and 2014 are as follows (in thousands):

	2015		2014	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and due from banks	\$ 2,080	\$ 2,080	\$ 1,777	\$ 1,777
Interest-bearing deposits with financial institutions	9,216	9,216	2,550	2,550
Investment securities	4,927	4,927	5,831	5,831
Federal Home Loan Bank stock	349	349	1,012	1,012
Pacific Coast Bankers’ Bank stock	190	190	190	190
Loans, net	115,199	115,918	105,291	105,441
Interest receivable	296	296	266	266
Financial liabilities:				
Deposits	119,836	120,486	98,810	99,380
FHLB borrowings	5,000	5,210	12,000	12,372
Interest payable	58	58	57	57

The carrying amounts in the preceding table are included in the balance sheet under the applicable captions.

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Note 19 Fair Value Measurements

The Bank has adopted authoritative guidance issued by the FASB regarding fair value measurements for financial assets and financial liabilities. The authoritative guidance defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements.

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

The authoritative guidance issued by the FASB requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

In that regard, the authoritative guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

- **Level 1 Inputs:** Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- **Level 2 Inputs:** Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.
- **Level 3 Inputs:** Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth on the next page.

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Note 19 Fair Value Measurements continued

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Bank's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Bank's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Bank's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Securities Available-for-Sale: U.S. Treasury securities are reported at fair value utilizing Level 1 inputs. Other securities classified as available-for-sale are reported at fair value utilizing Level 2 inputs. For these securities, the Bank obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things.

Impaired Loans: Certain impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria.

Other Real Estate Owned: Other real estate owned represents foreclosed assets that are reported at the fair value less estimated selling costs of the underlying property. The fair values are estimated using Level 2 inputs based on observable market data or Level 3 inputs based on information obtained from customized discounting criteria.

The following table summarizes financial assets measured at fair value on a recurring basis as of December 31, 2015 and 2014, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure the fair value. At December 31, 2015 and 2014, there were no financial liabilities measured at fair value on a recurring basis.

	<u>Level 1 Inputs</u>	<u>Level 2 Inputs</u>	<u>Level 3 Inputs</u>	<u>Total Fair Value</u>
December 31, 2015				
Available-for-Sale				
U.S. Government agency				
mortgage-backed securities	\$ -	\$ 1,265,253	\$ -	\$ 1,265,253
SBA pools	-	3,661,495	-	3,661,495
Totals	<u>\$ -</u>	<u>\$ 4,926,748</u>	<u>\$ -</u>	<u>\$ 4,926,748</u>
December 31, 2014				
Available-for-Sale				
U.S. Government agency				
mortgage-backed securities	\$ -	\$ 1,882,878	\$ -	\$ 1,882,878
SBA pools	-	3,948,597	-	3,948,597
Totals	<u>\$ -</u>	<u>\$ 5,831,475</u>	<u>\$ -</u>	<u>\$ 5,831,475</u>

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Note 19 Fair Value Measurements, continued

Certain financial assets are measured at fair value on a non-recurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets measured at fair value on a non-recurring basis include certain impaired loans reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on observable market data (current appraisals) or Level 3 inputs based on customized discounting criteria.

The following table summarizes financial assets measured at fair value on a non-recurring basis as of December 31, 2015 and 2014, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure the fair value:

	<u>Level 1 Inputs</u>	<u>Level 2 Inputs</u>	<u>Level 3 Inputs</u>	<u>Total Fair Value</u>
December 31, 2015:				
Impaired loans	\$ -	\$ 1,781,801	\$ 2,488,869	\$ 4,270,670
Less specific valuation allowance for possible loan losses	-	(86,885)	(106,585)	(193,470)
Impaired loans, net	<u>\$ -</u>	<u>1,694,916</u>	<u>\$ 2,382,284</u>	<u>\$ 4,077,200</u>
December 31, 2014:				
Impaired loans	\$ -	\$ 1,267,810	\$ 3,689,888	\$ 4,957,698
Less specific valuation allowance for possible loan losses	-	-	(331,126)	(331,126)
Impaired loans, net	<u>\$ -</u>	<u>1,267,810</u>	<u>\$ 3,358,762</u>	<u>\$ 4,626,572</u>

A reconciliation of assets measured using level 3 inputs for the years ended December 31, 2015 and 2014 is provided below:

	<u>December 31, 2015</u>	<u>December 31, 2014</u>
Opening Balance	\$ 3,689,888	\$ 4,310,799
(a) Transfers into level 3	253,150	140,635
(b) Transfers out of level 3	(1,253,111)	(106,818)
Settlements/payments	<u>(201,058)</u>	<u>(654,728)</u>
Ending Balance	<u>\$ 2,488,869</u>	<u>\$ 3,689,888</u>

(a) Transfer from level 2 to level 3; loans are no longer collateral dependent and impairment is based on discounted cash flows.

(b) Transferred from level 3 to level 2 because loan is now considered to be collateral dependent. Impairment based on current appraisal.

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Note 19 Fair Value Measurements, continued

Certain nonfinancial assets are measured at fair value on a non-recurring basis. Nonfinancial assets measured at fair value on a non-recurring basis include other real estate owned which, upon initial recognition, were remeasured and reported at fair value through a charge-off to the allowance for loan losses and certain other real estate owned, which subsequent to their initial recognition, were remeasured at fair value through a writedown included in other non-interest expense. The fair value of other real estate owned is estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria. At December 31, 2015 and 2014, the Bank had other real estate owned totaling \$1,920,656 and \$1,641,938, respectively. Fair values were determined using Level 2 measurements.

The following table presents other real estate owned that were remeasured and reported at fair value:

	<u>2015</u>	<u>2014</u>
Other real estate owned remeasured at initial recognition:		
Carrying value of other real estate owned prior to remeasurement	\$ 369,736	\$ -
Charge-offs recognized in the allowance for loan losses	-	-
Fair Value	<u>\$ 369,736</u>	<u>\$ -</u>
Other real estate owned remeasured subsequent to initial recognition:		
Carrying value of other real estate owned prior to remeasurement	\$ -	\$ 1,299,066
Writedowns included in other non-interest expense	-	(206,736)
Fair Value	<u>\$ -</u>	<u>\$ 1,092,330</u>

Charge-offs recognized upon loan foreclosures are generally offset by general or specific allocations of the allowance for loan losses and generally do not significantly impact the Bank's provision for loan losses. Regulatory guidelines require the Bank to reevaluate the fair value of other real estate owned on at least an annual basis.

Note 20 Subsequent Event

In March 2016, the Bank opened a new loan production office (LPO) in Freeland, WA expanding their presence in Island County, along with opening a branch in the location of its Oak Harbor LPO office. The Bank also purchased a building in Bellingham, WA to relocate the current Bellingham branch to a new location that has improved visibility, better ingress and egress, and drive-up access which the present location doesn't have. Management anticipates relocation in late 2016 or early 2017 based on regulatory approval.