



2018 CONSOLIDATED FINANCIAL STATEMENTS

Index:

	<u>Page</u>
Independent Auditors Report.....	1
Consolidated Balance Sheets	2
Consolidated Statements of Income.....	3
Consolidated Statements of Comprehensive Income	4
Consolidated Statements of Changes in Shareholders' Equity.....	5
Consolidated Statements of Cash Flows.....	6
Notes to Consolidated Financial Statements.....	7

These consolidated financial statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.



Report of Independent Auditors

The Board of Directors and Shareholders
Citizens Bancorp

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Citizens Bancorp and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Citizens Bancorp and Subsidiary as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Portland, Oregon
March 13, 2019

Citizens Bancorp and Subsidiary
December 31, 2018 and 2017

Consolidated Balance Sheets
(In thousands, except share amounts)

	2018	2017
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	\$ 17,194	\$ 18,692
Interest-bearing deposits in banks	32,034	30,044
Total cash and cash equivalents	49,228	48,736
Interest-bearing time deposits with banks	-	992
Securities available-for-sale, at fair value	277,547	281,770
Securities held-to-maturity, at amortized cost; (estimated fair value: 2017 - \$301)	-	300
Federal Home Loan Bank (FHLB) stock	926	868
Loans held-for-sale	-	174
Loans	409,778	404,342
Allowance for loan losses	(4,886)	(4,561)
Net loans	404,892	399,781
Premises and equipment - net	11,996	11,767
Accrued interest receivable	3,012	2,539
Bank-owned life insurance (BOLI)	15,889	15,454
Other real estate owned (OREO)	807	823
Other assets	7,494	8,284
Total assets	<u>\$ 771,791</u>	<u>\$ 771,488</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits:		
Demand	\$ 261,849	\$ 246,229
Savings	47,193	44,323
Interest-bearing demand	315,895	337,530
Time	23,315	26,460
Total deposits	648,252	654,542
Repurchase agreements	34,510	34,785
Cash dividends payable	2,931	2,147
Other liabilities	6,857	8,070
Total liabilities	692,550	699,544
Commitments and contingencies (Note 10)		
Shareholders' equity		
Series A preferred stock (no par value); authorized 500,000 shares; issued and outstanding: 2018 - 370,224 shares; 2017 - 370,224 shares	2,224	2,224
Common stock (no par value); authorized 10,000,000 shares; issued and outstanding: 2018 - 5,463,009 shares; 2017 - 5,402,540 shares	42,209	41,422
Retained earnings	36,377	29,994
Accumulated other comprehensive loss	(1,569)	(1,696)
Total shareholders' equity	79,241	71,944
Total liabilities and shareholders' equity	<u>\$ 771,791</u>	<u>\$ 771,488</u>

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Consolidated Statements of Income
(In thousands, except per share amounts)

	2018	2017
Interest income		
Loans	\$ 22,694	\$ 21,507
Interest-bearing deposits in banks	894	730
Securities		
Taxable	4,731	3,070
Tax-exempt	2	15
Total interest income	<u>28,321</u>	<u>25,322</u>
Interest expense		
Deposits	520	503
Other borrowings	55	66
Total interest expense	<u>575</u>	<u>569</u>
Net interest income	27,746	24,753
Provision for loan losses	900	1,200
Net interest income after provision for loan losses	<u>26,846</u>	<u>23,553</u>
Noninterest income		
Service charges on deposit accounts	965	929
Debit and ATM interchange fee income, net	684	646
Earnings on BOLI	435	401
Merchant fee income	322	371
Mortgage department income	191	300
Other	439	440
Total noninterest income	<u>3,036</u>	<u>3,087</u>
Noninterest expense		
Salaries and employee benefits	12,197	11,538
Occupancy	1,108	1,030
Furniture and equipment	752	591
Data processing	614	779
FDIC insurance	327	234
Telephone - data line	312	320
Professional fees	237	263
Other	1,917	1,837
Total noninterest expense	<u>17,464</u>	<u>16,592</u>
Income before income taxes	12,418	10,048
Provision for income taxes	3,104	4,649
Net income	<u>\$ 9,314</u>	<u>\$ 5,399</u>
Basic and diluted earnings per common share	<u>\$ 1.59</u>	<u>\$ 0.93</u>

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Consolidated Statements of Comprehensive Income
(In thousands)

	<u>2018</u>	<u>2017</u>
Net income	\$ 9,314	\$ 5,399
Other comprehensive income (loss) - net of tax		
Change in unrealized gains and losses on securities available-for-sale, net of tax of (\$114) and \$173, respectively	127	(686)
Total comprehensive income - net	<u>\$ 9,441</u>	<u>\$ 4,713</u>

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Consolidated Statements of Changes in Shareholders' Equity
(In thousands, except share and per share amounts)

	Shares of Series A Preferred Stock	Shares of Common Stock	Series A Preferred Stock	Common Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balances at December 31, 2016	372,486	5,345,441	\$ 2,249	\$ 40,747	\$ 26,455	\$ (1,010)	\$ 68,441
Net income	-	-	-	-	5,399	-	5,399
Change in unrealized gains and losses on securities available-for-sale - net of income taxes of \$173	-	-	-	-	-	(399)	(399)
Adoption of ASU 2018-02	-	-	-	-	287	(287)	-
Cash dividend reinvestment	-	57,103	-	675	-	-	675
Cash dividend declared							
(\$0.37 per common share)	-	-	-	-	(1,999)	-	(1,999)
(\$0.40 per share - Series A preferred)	-	-	-	-	(148)	-	(148)
Stock repurchased	(2,262)	(4)	(25)	-	-	-	(25)
Balances at December 31, 2017	370,224	5,402,540	2,224	41,422	29,994	(1,696)	71,944
Net income	-	-	-	-	9,314	-	9,314
Change in unrealized gains and losses on securities available-for-sale - net of income taxes of (\$114)	-	-	-	-	-	127	127
Cash dividend reinvestment	-	60,469	-	787	-	-	787
Cash dividend declared							
(\$0.50 per common share)	-	-	-	-	(2,731)	-	(2,731)
(\$0.54 per share - Series A preferred)	-	-	-	-	(200)	-	(200)
Balances at December 31, 2018	<u>370,224</u>	<u>5,463,009</u>	<u>\$ 2,224</u>	<u>\$ 42,209</u>	<u>\$ 36,377</u>	<u>\$ (1,569)</u>	<u>\$ 79,241</u>

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Consolidated Statements of Cash Flows
(In thousands)

	2018	2017
Cash flows from operating activities		
Net income	\$ 9,314	\$ 5,399
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	900	1,200
Depreciation and amortization	476	460
Write-down of OREO	16	65
Gains on sales of OREO - net	-	(9)
Originations of loans held-for-sale	(10,801)	(17,479)
Proceeds from sales of loans held-for-sale	11,287	18,355
Gains on sales of loans held-for-sale	(312)	(497)
Provision for deferred income taxes	(95)	435
Earnings on BOLI	(435)	(401)
Amortization of bond premiums	256	608
Increase in accrued interest receivable	(473)	(233)
Other - net	(442)	(1,441)
Net cash provided by operating activities	<u>9,691</u>	<u>6,462</u>
Cash flows from investing activities		
Decrease in interest-bearing time deposits in banks	992	992
Activity in securities available-for-sale:		
Purchases	(66,795)	(128,836)
Maturities, prepayments, and calls	71,003	75,289
Activity in securities held-to-maturity:		
Maturities, prepayments, and calls	300	165
Increase in loans - net	(6,011)	(24,066)
Purchases of premises and equipment - net	(705)	(195)
Purchase of FHLB Stock	(58)	(118)
Purchases of BOLI	-	(4,200)
Proceeds from sales of OREO	-	135
Net cash used in investing activities	<u>(1,274)</u>	<u>(80,834)</u>
Cash flows from financing activities		
Net (decrease) increase in deposits	(6,290)	49,302
Net decrease in repurchase agreements	(275)	(4,766)
Cash dividends paid	(1,360)	(1,221)
Repurchases of preferred stock	-	(25)
Net cash provided by financing activities	<u>(7,925)</u>	<u>43,290</u>
Net change in cash and cash equivalents	492	(31,082)
Cash and cash equivalents at beginning of year	48,736	79,818
Cash and cash equivalents at end of year	<u>\$ 49,228</u>	<u>\$ 48,736</u>
Supplemental disclosures of cash flow information		
Interest paid	\$ 575	\$ 570
Income taxes paid	<u>\$ 2,645</u>	<u>\$ 3,644</u>
Supplemental disclosures of non-cash investing and financing activities		
Change in unrealized gains and losses on securities available-for-sale - net of tax	\$ 127	\$ (686)
Accrued dividends declared	<u>\$ 2,931</u>	<u>\$ 2,147</u>
Dividends reinvested	<u>\$ 787</u>	<u>\$ 675</u>

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

In preparing these consolidated financial statements, Management has evaluated subsequent events that have occurred through March 13, 2019 (which is the date that the consolidated financial statements were available to be issued) for potential recognition or disclosure in the consolidated financial statements. All dollar amounts in the following notes are expressed in thousands, except per share data.

1. Basis of Presentation, Nature of Operations, Method of Accounting, and Summary of Significant Accounting Policies

Basis of presentation

The accompanying consolidated financial statements include the accounts of Citizens Bancorp ("Bancorp"), a bank holding company; and its wholly-owned subsidiary, Citizens Bank (the "Bank") (collectively, "the Company"). All significant intercompany transactions and balances have been eliminated in consolidation.

Nature of operations

Bancorp is a financial holding company which operates primarily through its subsidiary, the Bank. The Bank operates fifteen branches located in Benton, Clackamas, Lane, Linn, Marion, Polk, Washington, and Yamhill Counties in Oregon. The Bank provides loan and deposit services to customers who are predominately individuals and small- and medium-sized businesses in western Oregon.

Method of accounting

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and prevailing practices within the banking industry. The Company utilizes the accrual method of accounting which recognizes income and gains when earned and expenses and losses when incurred. The preparation of consolidated financial statements in conformity with GAAP requires management of the Company ("Management") to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities, as of the dates of the consolidated balance sheets, and the reported amounts of income, gains, expenses, and losses during the reporting periods. Actual results could differ from those estimates. A material estimate that is particularly susceptible to change in the near term relates to the allowance for loan losses.

Cash equivalents and cash flows

For purposes of presentation in the accompanying consolidated statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks (including cash items in process of collection), and interest-bearing deposits in banks. Generally, interest-bearing deposits in banks are invested for a maximum of 90 days.

The Company maintains its cash in depository institution accounts which, at times, may exceed Federal Deposit Insurance Corporation ("FDIC") insured limits. Management believes that its risk of loss associated with such balances in excess of FDIC insured limits is minimal due to the financial strength of the correspondent banks. The Company has not experienced any historical losses in such accounts.

Interest-bearing time deposits with banks

Interest-bearing time deposits with banks with original maturities greater than 90 days are carried at cost, which approximates fair value.

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

Investment securities

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

Investment securities that are purchased and held principally for the purpose of selling them in the near term are classified as trading securities and are reported at fair value, with unrealized gains and losses included in noninterest income. The Company had no trading securities during 2018 or 2017.

Investment securities that are not classified as either held-to-maturity or trading securities are classified as available-for-sale securities and are reported at fair value, with unrealized gains and losses, net of the related deferred income tax effect, reported as a net amount in a separate component of shareholders' equity entitled "accumulated other comprehensive income (loss)." Securities available-for-sale consist of debt securities that may be sold to implement the Bank's asset/liability management strategies or in response to changes in interest rates and similar factors.

Management determines the appropriate classification of securities at the time of purchase.

Realized gains and losses on the sales of available-for-sale securities are determined using the specific identification method and are included in noninterest income. Amortization of premiums and accretion of discounts are recognized in interest income using the interest method over the period to maturity.

Management assesses the Company's investment securities quarterly for the presence of other-than-temporary impairment ("OTTI"). OTTI is considered to have occurred if the security is in an unrealized loss position and (1) the Company intends to sell the security, (2) it is "more likely than not" that the Company will be required to sell the security before recovery of its amortized cost basis, or (3) the present value of expected cash flows is not sufficient to recover the entire amortized cost basis.

When OTTI is identified, the amount of the impairment is bifurcated into two components: the amount representing credit loss and the amount related to all other factors. The amount representing credit loss would be recognized in earnings as a realized loss and the amount representing all other factors would be recognized in other comprehensive income (loss) as an unrealized loss.

For individual securities for which credit loss has been recognized in earnings, interest accruals and amortization and accretion of premiums and discounts are suspended when the credit loss is recognized. Interest received after accruals have been suspended is recognized on a cash basis. Management believes that all unrealized losses on investment securities as of December 31, 2018 and 2017 are temporary.

Federal Home Loan Bank stock

The Bank is a member of the Federal Home Loan Bank ("FHLB") system. As such, the Bank is required to maintain a minimum level of investment in the stock of its regional FHLB cooperative based on specific percentages of its outstanding mortgages, total assets, or FHLB advances. As of December 31, 2018 and 2017, the Bank met its minimum required FHLB investment.

The Bank's investment in FHLB stock (which has limited marketability) is carried at cost, which approximates fair value. The Bank evaluates its FHLB stock for impairment as needed. The Bank's determination of whether this investment is impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared with the capital stock amount and the length of time any decline has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB. Based on its evaluation, the Bank determined that there was no impairment of its FHLB stock held as of December 31, 2018 and 2017.

Mortgage banking activities

Mortgage loans originated may be held in the Bank's loan portfolio as earning assets or sold into the secondary market with the servicing released. Mortgage loans intended for sale are reported as loans held-for-sale and are carried at the lower of cost or estimated fair value. Fair value is determined on an aggregate loan basis. Loans held-for-sale are generally sold shortly after origination so cost typically approximates fair value. The Company does not service any third-party mortgage loans.

Loans and allowance for loan losses

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

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

Loans are underwritten by the Bank's lenders and credit personnel consistent with the Bank's underwriting standards. These standards are designed to promote relationship banking by encouraging a complete understanding of each borrower's banking needs. The Company examines current and projected cash flows to determine the ability of the borrower to repay the obligation as agreed upon and, secondarily, evaluates the underlying collateral provided by the borrower.

The Company periodically obtains an independent review of its loan portfolio for quality and accuracy in underwriting loans. Results of these reviews are presented to Management and the Board's Audit and Loan Committees. The loan review process complements and reinforces the risk identification and assessment decisions made by the Bank's lenders and credit personnel, as well as the Company's policies and procedures.

Nonaccrual loans and recoveries

Interest income on loans is accrued over the terms of the loans based upon the principal outstanding. The accrual of interest on loans is discontinued when, in Management's opinion, collection of principal or interest is doubtful. At a minimum, loans that are past due as to maturity or payment of principal or interest by 90 days or more are placed on nonaccrual status, unless such loans are well-secured and in the process of collection. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income on nonaccrual loans that have not been fully charged off is subsequently recognized only to the extent that cash payments are received satisfying all delinquent principal and interest amounts and, in Management's judgment, the prospects for future payments in accordance with the loan agreements appear relatively certain. In accordance with regulatory guidance, cash payments received by the Company on loans that had been fully charged off in previous years are credited to the allowance for loan losses to the extent of any previous charge-offs; any additional cash payments received on such loans are recorded in noninterest income as recoveries.

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

Allowance for loan losses methodology

Because some loans may not be repaid in full, an allowance for loan losses is recorded. The allowance for loan losses represents Management's recognition of the assumed risks of extending credit. The allowance is established to absorb Management's best estimate of known and inherent losses in the loan portfolio as of the consolidated balance sheet date. The allowance requires complex subjective judgments as a result of the need to make estimates about matters that are uncertain. The allowance is maintained at a level currently considered adequate to provide for potential loan losses based on Management's assessment of the various factors affecting the portfolio.

The allowance for loan losses is increased by a provision for loan losses charged to expense and decreased by loan charge-offs (net of recoveries). The amount of the allowance is based on ongoing, quarterly assessments of the probable and estimated losses inherent in the loan portfolio. While Management has allocated the allowance for loan losses to various loan classes, the allowance is general in nature and is available for the loan portfolio in its entirety.

The Company's methodology for estimating the allowance for loan losses consists of several key elements, which include a general allowance and a specific allowance for impaired loans. The general component covers all loans not specifically identified for impairment testing. The specific component relates to loans that are individually assessed for impairment. The combined general and specific components of the allowance constitute the Company's allocated allowance for loan losses. An unallocated allowance may be maintained to provide for credit losses inherent in the loan portfolio that may not have been contemplated in the general or the specific allowance analyses.

When a loan is originated, it is assigned a risk rating that is reassessed periodically throughout the term of the loan through the credit review process and independent third-party loan reviews. The credit review process includes Management's evaluation of the risks associated with each loan. Loans with greater risk of loss are assigned higher risk factors.

As of December 31, 2018 and 2017, the general allowance was calculated by applying the Bank's five-year historical loss rates to pools of loans with similar risk ratings. The results were adjusted based on Management's subjective review of several qualitative risk factors, including Management's estimate of the predictive value of the Bank's historical loss rates.

Qualitative or environmental factors that are likely to cause estimated credit losses to differ from historical losses include, but are not limited to:

- Changes in international, regional, and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments.
- Changes in the nature and volume of the portfolio and in the terms of loans.
- Changes in the experience, ability, and depth of lending management and other relevant staff.
- Changes in the volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans.
- Changes in the quality of the Company's loan review system.
- Changes in the value of underlying collateral for collateral-dependent loans.
- The existence and effect of any concentrations of credit, and changes in the level of such concentrations.
- The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the Company's existing portfolio.
- Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses.

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

As part of the Company's ongoing credit review process, certain loans may be identified as impaired. A loan is deemed to be impaired when, based on current information and events, Management believes that the Company is unlikely to collect all principal and interest amounts according to the contractual terms. Generally, the Bank evaluates a loan for impairment when it is placed on non-accrual status. Impairment is measured on a loan-by-loan basis using the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the estimated fair value of either the loan's underlying collateral (less estimated selling costs) or any related guarantee. Since a significant portion of the Bank's loans are collateralized by real estate, the Bank primarily measures impairment based on the estimated fair value of the underlying collateral less estimated selling costs. The valuation of real estate collateral is subjective in nature and may be adjusted in future periods because of changes in economic conditions. Management considers third-party appraisals, as well as independent fair market value assessments from realtors or persons involved in selling real estate in determining the estimated fair value of particular real estate collateral. In addition, as certain of these third-party appraisals and independent fair market value assessments are only updated periodically, changes in the values of specific properties may have occurred subsequent to the most recent appraisals. Accordingly, the amounts of any such potential changes and any related adjustments are generally recorded at the time such information is received. Impairment is recognized as a specific component within the allowance for loan losses if the estimated value of the impaired loan is less than the recorded investment in the loan. When the amount of the impairment represents a confirmed loss, it is charged off against the allowance for loan losses. Impaired loans are excluded from the general allowance calculation.

The Company's Lending/CRA Committee and Board are responsible for, among other things, regularly reviewing the allowance for loan losses methodology including quantitative and qualitative loss factors, and ensuring that it is designed and applied in accordance with GAAP.

The ultimate recovery of the carrying value of loans is susceptible to future market conditions beyond the Company's control, which may result in losses or recoveries differing from those provided in the accompanying consolidated financial statements. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses and may require the Bank to recognize additions to the allowance based on their judgment about information available to them at the time of their examinations of the Bank.

Charge-off methodology

When Management determines that a loan has a probable loss and is deemed uncollectable, regardless of delinquency status, the loan is charged off. A partial charge-off may be recorded to the extent the loan is not well secured or guaranteed by a federal or state government agency and is in the process of collection. Overdrafts are charged off within the month a delinquent deposit account becomes 90 days delinquent.

Troubled debt restructured loans ("TDRs")

A TDR is a loan for which the Bank, for reasons related to a borrower's financial difficulties, grants a concession to the borrower that the Bank would not otherwise consider. These concessions may include – but are not limited to – certain interest rate reductions; certain extensions of maturity dates; a reduction in the face amount of the debt; a reduction in the accrued interest; or re-aging, extensions, deferrals, and renewals. TDRs are considered impaired and are individually evaluated for impairment.

Reserve for unfunded loan commitments

The Bank maintains a separate reserve for estimated losses related to unfunded loan commitments. Management estimates the amount of probable losses related to unfunded loan commitments by applying an estimated loss factor to the expected amount of commitments that will actually require funding. In accordance with industry practice and regulatory guidance, the reserve for estimated losses related to unfunded loan commitments is included in other liabilities in the accompanying consolidated balance sheets. Changes in the reserve for estimated losses related to unfunded loan commitments are recorded in noninterest expense in the accompanying consolidated statements of income.

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

Premises and equipment

Premises and equipment are stated at cost, less accumulated depreciation and amortization, which is computed on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the shorter of the term of the lease or the estimated useful life of the asset. Expenditures for repairs and maintenance are charged to expense as incurred. Additions and betterments are capitalized. The cost and related accumulated depreciation and amortization on premises and equipment sold or otherwise disposed of are removed from the Bank's accounts, and any gain or loss is reported as current year income or expense.

Bank-owned life insurance ("BOLI")

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

Other real estate owned ("OREO")

OREO consists of properties acquired through or in lieu of foreclosure, and is recorded initially at the estimated fair value of the properties, less estimated costs of disposal. When a property is acquired, any excess of the loan balance over the estimated net realizable value is charged to the allowance for loan losses. Costs relating to development and improvement of the properties or assets are capitalized; while costs relating to holding the properties or assets, rental income earned on the properties, subsequent write-downs, or any disposition gains or losses are included in noninterest expense. Management considers third-party appraisals, as well as independent fair market value assessments from realtors or persons involved in selling real estate, in determining the estimated fair value of particular properties. In addition, as certain of these third-party appraisals and independent fair market value assessments are only updated periodically, changes in the values of specific properties may have occurred subsequent to the most recent appraisals. Accordingly, the amounts of any such potential changes and any related adjustments are generally recorded at the time such information is received.

The valuation of OREO is subjective in nature and may be adjusted in future periods because of changes in economic conditions. The valuation of OREO is also subject to review by bank regulatory authorities who may require increases or decreases to carrying amounts based on their evaluation of the information available to them at the time of their examination of the Bank.

Preferred stock

The Company's Series A Preferred Stock has no par value, and holders of Series A Preferred Stock are entitled to a 7% preference in the distribution of dividends, when and if declared and paid by the Company. Holders of Series A Preferred Stock do not have any preemptive rights to purchase any additional shares of Series A Preferred Stock; the Series A Preferred Stock ranks senior to common stock with respect to dividend rights; the Series A Preferred Stock does not have voting rights except under very limited circumstances; and the Series A Preferred Stock does not have any liquidation preference and is converted to common stock upon a change of control.

Earnings per common share

The Company's basic earnings per common share is calculated as net income less preferred share dividends declared and undistributed earnings allocable to the participating preferred shares, divided by the weighted average number of common shares outstanding. Diluted earnings per common share would be calculated as net income less preferred share dividends declared and undistributed earnings allocable to the participating

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

preferred shares, divided by the weighted average number of common shares outstanding plus any dilutive common stock equivalents. During the years ended December 31, 2018 and 2017, the Company had no dilutive common stock equivalents.

Revenue recognition

Service charges on deposit accounts

The Company earns fees from its deposit customers for account maintenance, transaction-based activity and overdraft services. Account maintenance fees consist primarily of account fees and analyzed account fees charged on deposit accounts on a monthly basis. The performance obligation is satisfied and the fees are recognized on a monthly basis as the service period is completed. Transaction-based fees on deposit accounts are charged to deposit customers for specific services provided to the customer, such as non-sufficient funds fees, overdraft fees, and wire fees. The performance obligation is completed as the transaction occurs and the fees are recognized at the time each specific service is provided to the customer.

Debit and ATM interchange fee income, net

Debit and ATM interchange income represent fees earned when a debit card issued by the Company is used. The Company earns interchange fees from debit cardholder transactions through the Visa payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. The performance obligation is satisfied and the fees are earned when the cost of the transaction is charged to the cardholders' debit card. Certain expenses directly associated with the credit and debit card are recorded on a net basis with the interchange income.

Merchant fee income

Merchant fee income represents fees earned by the Company for card payment services provided to its merchant customers. The Company has a contract with a third party to provide card payment services to merchants that contract for those services. The third party provider passes the payments made by the merchants through to the Company. The Company, in turn, pays the third party provider for the services it provides to the merchants. These payments to the third party provider are recorded as expenses as a net reduction against fee income. In addition, a portion of the payment received represents interchange fees which are passed through to the card issuing bank. Income is primarily earned based on the dollar volume and number of transactions processed. The performance obligation is satisfied and the related fee is earned when each payment is accepted by the processing network.

Gain/loss on other real estate owned, net

The Company records a gain or loss from the sale of other real estate owned when control of the property transfers to the buyer, which generally occurs at the time of an executed deed of trust. When the Company finances the sale of other real estate owned to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the other real estate owned asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on sale, the Company adjusts the transaction price and related gain or loss on sale if a significant financing component is present.

Transfers of financial assets

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

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

Advertising

Costs for advertising are expensed as incurred. Advertising costs charged to expense were approximately \$39 and \$56 during the years ended December 31, 2018 and 2017, respectively.

Income taxes

The provision for income taxes is based on income and expenses as reported for consolidated financial statement purposes using the "asset and liability method" for accounting for deferred taxes. Deferred tax assets and liabilities result from tax credits and differences between the financial statement carrying amounts and the tax bases of assets and liabilities, and are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. Deferred tax assets are reduced by a valuation allowance when, in the opinion of Management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

The Tax Cuts and Jobs Act of 2017 was enacted on December 22, 2017. It changed the federal corporate tax rate to 21% from 34% and preserved the full deductibility of state corporate taxes, effective January 1, 2018. Accordingly, the Company has recognized the effects of changes in tax laws and rates on the deferred tax assets and liabilities as of December 31, 2017 (see Note 9 – Income Taxes). The resulting adjustment of \$1,199 to decrease the value of the net deferred tax asset was recognized by the Company in December 2017 as tax expense.

The Company files income tax returns for federal and State of Oregon jurisdictions. Uncertain tax positions may arise when the Company takes or expects to take a tax position that is ultimately disallowed by the relevant taxing authority. Management periodically reviews the Company's consolidated balance sheets, consolidated statements of income, income tax provisions, and income tax returns as well as the permanent and temporary adjustments affecting current and deferred income taxes and assesses whether uncertain tax positions exist. As of December 31, 2018 and 2017, Management does not believe that any uncertain tax positions exist that are not more-likely-than-not sustainable upon examination. The Company's policy with respect to interest and penalties ensuing from income tax settlements is to recognize them as noninterest expense.

Fair Value

GAAP defines fair value, establishes a framework for measuring fair value, and requires certain disclosures about fair value measurements. GAAP permits an entity to choose to measure many financial instruments and certain other items at fair value and contains financial statement presentation and disclosure requirements for assets and liabilities for which the fair value option is elected. As of December 31, 2018 and 2017, Management has elected to not report any of the Company's assets or liabilities at fair value under the "fair value option" provided by GAAP. The hierarchy of fair value valuation techniques under GAAP provides for three levels: Level 1 provides the most reliable measure of fair value, whereas Level 3, if applicable, generally would require significant Management judgment.

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

The three levels for categorizing assets and liabilities under GAAP's fair value measurement requirements are as follows:

- Level 1: Fair value of the asset or liability is determined using unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2: Fair value of the asset or liability is determined using inputs other than quoted prices that are observable for the applicable asset or liability, either directly or indirectly, such as quoted prices for similar (as opposed to identical) assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
- Level 3: Fair value of the asset or liability is determined using unobservable inputs that are significant to the fair value measurement and reflect Management's own assumptions regarding the applicable asset or liability.

An asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. GAAP requires that valuation techniques used maximize the use of observable inputs and minimize the use of unobservable inputs.

Certain assets and liabilities are measured at fair value on a recurring or non-recurring basis. Assets and liabilities measured at fair value on a recurring basis are initially measured at fair value and then re-measured at fair value at each financial statement reporting date. Assets and liabilities measured at fair value on a non-recurring basis result from write-downs due to impairment or lower-of-cost-or-market accounting on assets or liabilities not initially measured at fair value.

The Company's valuation methodologies may produce fair value calculations that may not be indicative of net realizable value or reflective of future fair values. While Management believes that the Company'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. Furthermore, the reported fair value amounts have not been comprehensively revalued since the presentation dates, and, therefore, estimates of fair value after the consolidated balance sheet date may differ significantly from the amounts presented herein.

The Company's investment securities classified as available-for-sale have been valued by reference to prices for similar securities or through model-based techniques in which all significant inputs are observable, and, therefore, such valuations have been classified as Level 2.

Certain impaired loans are measured at estimated fair value on a non-recurring basis including impaired loans measured at an observable market price (if available), the present value of expected future cash flows discounted at the loan's effective interest rate, or at the fair value of the loan's collateral (if collateral dependent). Periodically, the Company records non-recurring adjustments to the carrying value of impaired loans – based on fair value measurements – for partial charge-offs of the uncollectable portions of those loans. Nonrecurring adjustments also include certain impairment amounts for collateral dependent loans when establishing the allowance for loan losses. Such amounts are generally based on the estimated fair value of the underlying collateral supporting the loan, and, as a result, the carrying value of the loan less the calculated valuation amount does not necessarily represent the fair value of the loan. Estimated fair value of the loan's collateral is determined by appraisals or independent valuation which is then adjusted for the estimated costs related to liquidation of the collateral. Management's ongoing review of appraisal information may result in additional discounts or adjustments to valuation based upon more recent market sales activity or more current appraisal information derived from properties of similar type and/or location. A significant portion of the Bank's impaired loans are measured using the estimated fair market value of the collateral less the estimated costs to sell.

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

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

In cases where quoted market values are not available, the Company primarily uses present value techniques to estimate the fair value of its financial instruments. Valuation methods require considerable judgment, and the resulting estimates of fair value can be significantly affected by the assumptions made and methods used. Accordingly, the estimates provided herein do not necessarily indicate amounts which could be realized in a current market exchange.

In addition, as the Company normally intends to hold the majority of its financial instruments until maturity, it does not expect to realize many of the estimated amounts disclosed. The disclosures also do not include estimated fair value amounts for items which are not defined as financial instruments but which may have significant value. These include such off-balance sheet items as core deposit intangibles. The Company does not believe that it would be practicable to estimate a representational fair value for these types of items as of December 31, 2018 and 2017.

New accounting pronouncements

Effective January 1, 2018, the Company adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, and all subsequent amendments to the ASU (collectively, "ASC 606"), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the Company performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the Company satisfies a performance obligation. The majority of the Company's revenues come from interest income and other sources, including loans, leases, securities and derivatives that are outside the scope of ASC 606. The Company's services that fall within the scope of ASC 606 are presented within noninterest income or noninterest expense and are recognized as revenue as the Company satisfies its obligation to the customer. Services within the scope of ASC 606 include Service charges on deposit accounts, debit and ATM interchange fee income, net, merchant fee income, and gain (loss) on other real estate owned, net.

The Company adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606 while prior period amounts continue to be reported in accordance with legacy GAAP. The adoption of ASC 606 did not result in a material change to the accounting for any of the in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

All of the Company's revenue from contracts with customers in the scope of ASC 606 is recognized in Non-Interest Income. Gains/losses on the sale of other real estate owned are included in non-interest expense and are generally recognized when the performance obligation is complete. This is typically at delivery of control over the property to the buyer at time of each real estate closing.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities* ("ASU 2016-01"). ASU 2016-01 generally requires equity investments – except those accounted for under the equity method of accounting or those that result in consolidation of the investee – to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. ASU 2016-01 is intended to simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. ASU 2016-01 also eliminates certain disclosures related to the fair value of financial instruments and requires entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The adoption of ASU 2016-01 did not have a significant impact on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases* ("ASU 2016-02"). ASU 2016-02 is intended to increase transparency and comparability among organizations by requiring the recognition of lease assets and lease liabilities on the balance sheet and disclosure of key information about leasing arrangements. The principal change required by ASU 2016-02 relates to lessee accounting, and is that for operating leases, a lessee is required to (1) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position, (2) recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis, and (3) classify all cash payments within operating activities in the statement of cash flows. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term. ASU 2016-02 also changes disclosure requirements related to leasing activities, and requires certain qualitative disclosures along with specific quantitative disclosures. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the impact that the adoption of ASU 2016-02 will have on the Company's future consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses* ("ASU 2016-13"). ASU 2016-13 replaces the existing incurred losses methodology for estimating allowances with a current expected credit losses methodology with respect to most financial assets measured at amortized cost and certain other instruments, including trade and other receivables, loans, held-to-maturity investment securities and off-balance sheet commitments. In addition, ASU 2016-13 requires credit losses relating to available-for-sale debt securities to be recorded through an allowance for credit losses rather than a reduction of the carrying amount. ASU 2016-13 also changes the accounting for purchased credit-impaired debt securities and loans. ASU 2016-13 retains many of the disclosure requirements in current GAAP and expands certain disclosure requirements. ASU 2016-13 is effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. The Company is currently evaluating the impact that the adoption of ASU 2016-13 will have on the Company's future consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs* ("ASU 2017-08"). ASU 2017-08 amends the amortization period for certain purchased callable debt securities held at a premium by shortening the amortization period for the premium to the earliest call date. The amendments in this update do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. ASU 2017-08 is effective for fiscal years beginning after December 15, 2018. Adoption of ASU 2017-08 is not expected to have a material impact on the Company's consolidated financial statements.

In August 2018, FASB issued ASU 2018-13, *Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement*. The amendments in this ASU modify the disclosure requirements on fair value measurements in Topic 820, Fair Value Measurement. The ASU removes, modifies and adds disclosure requirements in Topic 820. The following disclosure requirements were removed: 1) the amount and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, 2) the policy for timing of transfers between levels, and 3) the valuation processes for Level 3 fair value measurements. This ASU modified disclosure requirements by requiring that the measurement uncertainty disclosure communicates information about the uncertainty in measurement as of the reporting date. The following disclosure requirements were

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

added: 1) changes in unrealized gains and losses for the period included in other comprehensive income for the recurring Level 3 fair value measurements held at the end of the reporting period, and 2) the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. The amendments in this ASU are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this ASU and delay adoption of the additional disclosures until their effective date. Adoption of ASU 2018-13 is not expected to have a material impact on the Company's consolidated financial statements.

Reclassifications

Certain account reclassifications and adjustments have been made to the consolidated financial statements of the prior year in order to conform with current year presentation. These reclassifications have no effect on previously reported net income or shareholders' equity.

2. Restricted Assets

By regulation, the Bank must meet reserve requirements – based on a percentage of deposits – as established by the Federal Reserve Bank ("FRB"). The Bank complies with such requirements by holding cash and maintaining average reserve balances with the FRB in accordance with the regulations. As of December 31, 2018 and 2017, the Bank met the requirements by holding cash and was not required to maintain a reserve balance with the FRB.

3. Investment Securities

The amortized cost and estimated fair values of securities available-for-sale and held-to-maturity as of December 31, 2018 and 2017 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
2018				
Available-for-sale				
U.S. agency securities	<u>\$ 279,695</u>	<u>\$ 878</u>	<u>\$ (3,026)</u>	<u>\$ 277,547</u>
2017				
Available-for-sale				
U.S. agency securities	<u>\$ 284,159</u>	<u>\$ 3</u>	<u>\$ (2,392)</u>	<u>\$ 281,770</u>
Held-to-maturity				
State and municipal securities	<u>\$ 300</u>	<u>\$ 1</u>	<u>\$ -</u>	<u>\$ 301</u>

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

The fair value and gross unrealized losses of the Bank's investment securities, aggregated by the length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2018 and 2017, were as follows:

	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
2018						
U.S. agency securities	\$ 75	\$ (1)	\$ 210,020	\$ (3,025)	\$ 210,095	\$ (3,026)
2017						
U.S. agency securities	\$ 117,741	\$ (475)	\$ 163,863	\$ (1,917)	\$ 281,604	\$ (2,392)

The Company has no current intent to sell, nor is it more likely than not that it will be required to sell, these securities before the recovery of cost. The unrealized losses on these U.S. agency securities are deemed by Management to be temporary. The decreases in fair value are associated with changes in market interest rates or the widening of market spreads subsequent to the initial purchase of the securities, and are not due to concerns regarding the underlying credit of the issuers.

The Company has the intent and ability to hold the investment securities classified as held-to-maturity until they mature, at which time the Company will receive the cost of such investment securities.

The amortized cost and estimated fair value of investment securities as of December 31, 2018, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities, because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 67,537	\$ 67,024
Due from one year through five years	182,772	180,674
Due from six years through ten years	29,386	29,849
Total	\$ 279,695	\$ 277,547

Investment securities with a carrying value of approximately \$45,556 and \$45,151 as of December 31, 2018 and 2017, respectively, were pledged to secure repurchase agreements and for other purposes as required or permitted by law.

There were no sales of investment securities available-for-sale for the years ended December 31, 2018 and 2017.

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

4. Loans and Allowance for Loan Losses

Loans, excluding loans held-for-sale, as of December 31, 2018 and 2017 consisted of the following:

	2018	2017
Commercial	\$ 55,080	\$ 57,685
Commercial real estate		
Owner occupied	117,422	112,541
Non-owner occupied	71,839	61,871
Multi-family	28,629	35,121
Commercial and residential construction		
Commercial construction	6,353	10,538
Residential construction	5,176	5,337
Residential real estate	42,851	39,425
Consumer	3,826	4,244
Agriculture		
Operating	27,593	33,908
Farmland	51,009	43,672
Total loans	\$ 409,778	\$ 404,342

The above loans have been reduced by net deferred loan origination fees/costs of approximately \$1,557 and \$1,336 as of December 31, 2018 and 2017, respectively.

Commercial loans are made based primarily on the historical and projected cash flows of the borrower and, secondarily, on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not behave as forecasted, and collateral securing such loans may fluctuate in value due to economic or individual performance factors. Minimum standards and underwriting guidelines have been established for all commercial loan types.

Commercial real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. The repayment of these loans is largely dependent on the successful operation of the related property, and collateral securing such loans may fluctuate in value due to economic or individual performance factors.

Loan performance may be adversely affected by factors impacting the general economy and conditions specific to the real estate market such as geographic location and/or property type.

Commercial and residential construction loans are loans used by the borrower exclusively for the improvement of real estate on which the Company holds a mortgage. Due to the inherent risk in this type of loan, they are monitored closely and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, government regulation of real property, general economic conditions, the availability of long-term financing, and fluctuations in collateral values. In addition, they are considered to involve a higher degree of risk because of the inherent difficulty in estimating both a property's value at completion of the project and the estimated cost of the project.

Residential real estate loans are secured by collateral that may fluctuate in value due to economic or individual performance factors.

Consumer loans are loans to purchase various items such as automobiles, boats, and recreational vehicles. The terms and rates are established periodically by Management. Consumer loans tend to involve relatively small loan amounts that are spread across many individual borrowers, minimizing the risk of significant loss to the Company.

Agriculture loans are made to farmers for operating capital (not to exceed their annual production and marketing cycle) or for the purchase of equipment and real estate on a longer-term basis. Operating loans are

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

generally secured by livestock or crops. The ability to sell livestock or crops, however, may not be as forecasted, and collateral securing such loans may fluctuate in value due to economic or individual performance factors.

Changes in the allowance for loan losses, by portfolio segment, for the years ended December 31, 2018 and 2017 were as follows:

	<u>Beginning Allowance</u>	<u>Provision (Credit)</u>	<u>Charge-offs</u>	<u>Recoveries</u>	<u>Ending Allowance</u>
2018					
Commercial	\$ 643	\$ 785	\$ (610)	\$ 10	\$ 828
Commercial real estate	1,559	334	-	-	1,893
Commercial and residential construction	218	(5)	-	-	213
Residential real estate	327	159	-	-	486
Consumer	22	2	(11)	12	25
Agriculture	1,792	(375)	-	24	1,441
Total	<u>\$ 4,561</u>	<u>\$ 900</u>	<u>\$ (621)</u>	<u>\$ 46</u>	<u>\$ 4,886</u>
	<u>Beginning Allowance</u>	<u>Provision (Credit)</u>	<u>Charge-offs</u>	<u>Recoveries</u>	<u>Ending Allowance</u>
2017					
Commercial	\$ 602	\$ 40	\$ -	\$ 1	\$ 643
Commercial real estate	1,016	543	-	-	1,559
Commercial and residential construction	115	103	-	-	218
Residential real estate	322	5	-	-	327
Consumer	26	(32)	(4)	32	22
Agriculture	1,701	541	(450)	-	1,792
Total	<u>\$ 3,782</u>	<u>\$ 1,200</u>	<u>\$ (454)</u>	<u>\$ 33</u>	<u>\$ 4,561</u>

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

The allowance for loan losses and the recorded investment in loans, by portfolio segment and impairment method, as of December 31, 2018 and 2017, were as follows:

	Allowance for Loan Losses			Recorded Investment in Loans		
	Individually	Collectively	Total	Individually	Collectively	Total
	Evaluated for Impairment	Evaluated for Impairment		Evaluated for Impairment	Evaluated for Impairment	
2018						
Commercial	\$ 15	\$ 813	\$ 828	\$ 75	\$ 55,005	\$ 55,080
Commercial real estate	-	1,893	1,893	-	217,890	217,890
Commercial and residential construction	-	213	213	-	11,529	11,529
Residential real estate	-	486	486	-	42,851	42,851
Consumer	-	25	25	-	3,826	3,826
Agriculture	-	1,441	1,441	-	78,602	78,602
Total	\$ 15	\$ 4,871	\$ 4,886	\$ 75	\$ 409,703	\$ 409,778

	Allowance for Loan Losses			Recorded Investment in Loans		
	Individually	Collectively	Total	Individually	Collectively	Total
	Evaluated for Impairment	Evaluated for Impairment		Evaluated for Impairment	Evaluated for Impairment	
2017						
Commercial	\$ 19	\$ 624	\$ 643	\$ 399	\$ 57,286	\$ 57,685
Commercial real estate	-	1,559	1,559	672	208,861	209,533
Commercial and residential construction	-	218	218	-	15,875	15,875
Residential real estate	11	316	327	56	39,369	39,425
Consumer	-	22	22	-	4,244	4,244
Agriculture	488	1,304	1,792	2,802	74,778	77,580
Total	\$ 518	\$ 4,043	\$ 4,561	\$ 3,929	\$ 400,413	\$ 404,342

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

	December 31, 2018			For the Year Ended
	Recorded Investment	Unpaid Principal		December 31, 2018
		Balance	Related Allowance	Average Recorded Investment
With an allowance recorded				
Commercial	\$ 75	\$ 75	\$ 15	\$ 86
Subtotal	75	75	15	86
Totals				
Commercial	75	75	15	86
Total	\$ 75	\$ 75	\$ 15	\$ 86

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

Information related to impaired loans, by class of loans, as of and for the year ended December 31, 2017 was as follows:

	December 31, 2017			For the Year Ended
	Recorded Investment	Unpaid Principal Balance	Related Allowance	December 31, 2017 Average Recorded Investment
With no related allowance recorded				
Commercial	\$ 304	\$ 304	\$ -	\$ 311
Commercial real estate				
Owner occupied	672	672	-	1,098
Agriculture				
Operating	361	1,780	-	1,196
Subtotal	<u>1,337</u>	<u>2,756</u>	<u>-</u>	<u>2,605</u>
With an allowance recorded				
Commercial	95	95	19	95
Residential real estate	56	56	11	63
Agriculture				
Operating	2,423	2,460	484	2,265
Farmland	18	18	4	22
Subtotal	<u>2,592</u>	<u>2,629</u>	<u>518</u>	<u>2,445</u>
Totals				
Commercial	399	399	19	406
Commercial real estate				
Owner occupied	672	672	-	1,098
Residential real estate	56	56	11	63
Agriculture				
Operating	2,784	4,240	484	3,461
Farmland	18	18	4	22
Total	<u>\$ 3,929</u>	<u>\$ 5,385</u>	<u>\$ 518</u>	<u>\$ 5,050</u>

Interest income recognized on impaired loans and interest income recognized on a cash basis on impaired loans was insignificant to the accompanying consolidated financial statements.

Loans that are 30 days or more past due are reported to the Board. A written plan for the resolution of such past due amounts is prepared for all loans 60 days or more past due. Loans may be placed on non-accrual status at any point in time that payments are past due. Loans 90 days past due generally must be transferred to non-accrual status.

The recorded investment in non-accrual loans, by class of loans, as of December 31, 2018 and 2017 was as follows:

	2018	2017
Commercial	\$ -	\$ 304
Agriculture		
Operating	-	2,699
Total	<u>\$ -</u>	<u>\$ 3,003</u>

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

The recorded investment in loans by aging category and in total, by class of loans, as of December 31, 2018 and 2017 was as follows:

	Days Past Due			Total Past Due	Current	Total Loans
	30 - 59	60 - 89	90 or More			
2018						
Commercial	\$ -	\$ -	\$ -	\$ -	\$ 55,080	\$ 55,080
Commercial real estate						
Owner occupied	-	-	-	-	117,422	117,422
Non-owner occupied	-	-	-	-	71,839	71,839
Multi-family	-	-	-	-	28,629	28,629
Commercial and residential construction						
Commercial construction	-	-	-	-	6,353	6,353
Residential construction	-	-	-	-	5,176	5,176
Residential real estate	-	-	-	-	42,851	42,851
Consumer	-	-	-	-	3,826	3,826
Agriculture						
Operating	73	-	-	73	27,520	27,593
Farmland	-	74	-	74	50,935	51,009
Total	<u>\$ 73</u>	<u>\$ 74</u>	<u>\$ -</u>	<u>\$ 147</u>	<u>\$ 409,631</u>	<u>\$ 409,778</u>

	Days Past Due			Total Past Due	Current	Total Loans
	30 - 59	60 - 89	90 or More			
2017						
Commercial	\$ 38	\$ -	\$ 304	\$ 342	\$ 57,343	\$ 57,685
Commercial real estate						
Owner occupied	100	-	-	100	112,441	112,541
Non-owner occupied	-	-	-	-	61,871	61,871
Multi-family	-	-	-	-	35,121	35,121
Commercial and residential construction						
Commercial construction	-	-	-	-	10,538	10,538
Residential construction	-	-	-	-	5,337	5,337
Residential real estate	-	-	-	-	39,425	39,425
Consumer	-	-	-	-	4,244	4,244
Agriculture						
Operating	-	-	-	-	33,908	33,908
Farmland	-	-	-	-	43,672	43,672
Total	<u>\$ 138</u>	<u>\$ -</u>	<u>\$ 304</u>	<u>\$ 442</u>	<u>\$ 403,900</u>	<u>\$ 404,342</u>

As of December 31, 2018 and 2017 there were no loans contractually past due 90 days or more on which the Company continued to accrue interest.

Credit quality indicators

The Company utilizes an internal asset classification system as a means of reporting problem and potential problem loans. The Company's risk rating matrix assigns risk ratings on a scale from one to ten. Loans that are risk rated one through six are considered to be "Pass" loans. Problem and potential problem loans that are risk rated seven, eight, nine, and ten are considered to be "Special Mention," "Substandard," "Doubtful," and "Loss" loans, respectively. Loans that do not currently expose the Company to sufficient risk to warrant classification as Substandard, Doubtful, or Loss but possess weaknesses that deserve Management's close attention are deemed to be Special Mention. Substandard loans include those characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Loans classified as Doubtful have all the weaknesses inherent in those classified as Substandard with the added characteristic that the weaknesses make collection or liquidation in full – on the basis of currently existing facts, conditions, and values – highly questionable and improbable. Loans classified as Loss are considered uncollectable and of such little value that continuance as an asset is not warranted. Risk ratings are updated as the Bank becomes aware of changing facts and circumstances. As of December 31, 2018 and 2017, the Company does not have any Doubtful or Loss loans. Any loans identified as Loss by Management are charged off.

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

The following tables present, by class of loans, the recorded investment in loans by risk rating as of December 31, 2018 and 2017 based on the most recent rating assigned to each loan as of those dates:

	Pass	Special Mention	Substandard	Total
2018				
Commercial	\$ 55,005	\$ -	\$ 75	\$ 55,080
Commercial real estate				
Owner occupied	116,333	1,089	-	117,422
Non-owner occupied	71,839	-	-	71,839
Multi-family	28,629	-	-	28,629
Commercial and residential construction				
Commercial construction	6,353	-	-	6,353
Residential construction	5,176	-	-	5,176
Residential real estate	42,809	42	-	42,851
Consumer	3,826	-	-	3,826
Agriculture				
Operating	26,793	800	-	27,593
Farmland	50,422	587	-	51,009
Total	<u>\$ 407,185</u>	<u>\$ 2,518</u>	<u>\$ 75</u>	<u>\$ 409,778</u>

	Pass	Special Mention	Substandard	Total
2017				
Commercial	\$ 57,162	\$ 124	\$ 399	\$ 57,685
Commercial real estate				
Owner occupied	111,742	127	672	112,541
Non-owner occupied	61,871	-	-	61,871
Multi-family	35,121	-	-	35,121
Commercial and residential construction				
Commercial construction	10,538	-	-	10,538
Residential construction	5,337	-	-	5,337
Residential real estate	39,284	85	56	39,425
Consumer	4,145	99	-	4,244
Agriculture				
Operating	30,942	182	2,784	33,908
Farmland	43,006	648	18	43,672
Total	<u>\$ 399,148</u>	<u>\$ 1,265</u>	<u>\$ 3,929</u>	<u>\$ 404,342</u>

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

TDRs are included in the impaired loan totals and are generally deemed by Management to be nonaccrual loans. The Bank's policy is that a loan placed on nonaccrual status will typically remain on nonaccrual status

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

until all principal and interest payments are brought current and the prospect for future payment in accordance with the terms of the loan agreement appear relatively certain. The Bank generally considers six months of payment performance as sufficient to warrant a return to accrual status.

As of December 31, 2018, the Company had two commercial loans categorized as TDRs with a total outstanding recorded investment of \$53. The loans were modified in 2018 and 2016 to extend the amortization period and add a balloon payment. The loans continue to perform as modified and have been returned to accrual status. As of December 31, 2017, the Company had one commercial loan categorized as a TDR with an outstanding recorded investment of \$37.

5. Premises and Equipment

Premises and equipment consisted of the following as of December 31, 2018 and 2017:

	2018	2017
Land	\$ 4,157	\$ 4,157
Buildings and leasehold improvements	14,197	13,938
Furniture and equipment	3,240	2,951
	<u>21,594</u>	<u>21,046</u>
Less: accumulated depreciation and amortization	9,598	9,279
Premises and equipment - net	<u>\$ 11,996</u>	<u>\$ 11,767</u>

Depreciation expense totaled \$476 and \$460 in 2018 and 2017, respectively.

6. OREO

The following table presents the activity related to OREO for the years ended December 31, 2018 and 2017:

	2018	2017
Balance at beginning of year	\$ 823	\$ 1,014
Additions	-	-
Capitalized improvements	-	-
Write-downs - net	(16)	(65)
Dispositions	-	(126)
Balance at end of year	<u>\$ 807</u>	<u>\$ 823</u>

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

7. Time Deposits

Time deposits that met or exceeded the FDIC insurance limit of \$250 aggregated approximately \$3,904 and \$4,695 as of December 31, 2018 and 2017, respectively. As of December 31, 2018, the scheduled annual maturities of all time deposits were approximately as follows:

2019	\$	16,351
2020		3,653
2021		740
2022		918
2023		1,639
Thereafter		14
Total	<u>\$</u>	<u>23,315</u>

8. Other Borrowings

The Bank had securities sold under agreements to repurchase ("REPOs") of approximately \$34,510 and \$34,785 as of December 31, 2018 and 2017, respectively. A REPO represents an agreement between the Bank and a customer to collateralize funds deposited by the customer in an interest-bearing repurchase sweep account. The Bank secures the REPO account with U.S. Government or U.S. agency securities. In consideration of the funds deposited, the Bank pledges the security to the customer. The Bank agrees to repurchase the security on the next business day for the amount of the deposit plus simple interest on that amount calculated for one day at the rate established for REPO accounts as set by the Bank for the day. The funds provided by REPOs are considered borrowings, not deposits, and are not covered by FDIC insurance. The average cost of REPOs was 0.16% and 0.18% in 2018 and 2017, respectively.

The Bank has a borrowing line with the FHLB equal to 45 percent of the Bank's total assets, subject to certain discounted collateral and FHLB stock holdings limitations. As of December 31, 2018, the maximum borrowing line based on the Bank's total assets was \$354,460; however, this line is generally limited based upon the amount of FHLB stock held and the discounted value of collateral pledged. As of December 31, 2018, the Bank's line was limited to \$93,345. To access this line, the Bank would be required to purchase additional stock in the FHLB. As of December 31, 2018 and 2017, the Company had no outstanding borrowings with the FHLB. As of December 31, 2018, assets pledged as collateral had a total book value of approximately \$156,303.

As an additional source of liquidity, the Bank had federal fund borrowing agreements with correspondent banks totaling \$48,000 as of December 31, 2018 and 2017. These unsecured lines may be reduced or withdrawn at any time, but are generally reaffirmed annually. As of December 31, 2018 and 2017, there were no outstanding borrowings under these agreements.

9. Income Taxes

The provision for income taxes was comprised of the following for the years ended December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Current expense		
Federal	\$ 2,734	\$ 4,012
State	465	202
Deferred expense		
Federal	(90)	416
State	(5)	19
Provision for income taxes	<u>\$ 3,104</u>	<u>\$ 4,649</u>

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

The following is a reconciliation of the expected provision for federal income taxes at the statutory rate to the actual provision for income taxes for the years ended December 31, 2018 and 2017:

	2018	2017
Expected federal income tax provision at statutory rate	\$ 2,608	\$ 3,416
Increase (decrease) resulting from:		
Impact of federal tax rate change	8	1,199
Tax-exempt income	(54)	(101)
State income taxes, net of federal effect	700	473
Earnings on BOLI	(117)	(156)
Federal deduction for Oregon tax credits	(82)	(157)
Other - net	41	(25)
Provision for income taxes	<u>\$ 3,104</u>	<u>\$ 4,649</u>

The tax effects of temporary differences that give rise to deferred tax assets and liabilities as of December 31, 2018 and 2017 were as follows:

	2018	2017
Deferred tax assets		
Allowance for loan losses	\$ 1,319	\$ 1,232
Reserve for unfunded loan commitments	82	68
Deferred compensation	1,190	1,122
Oregon tax credits	1,389	1,929
Interest income on non-accrual loans	-	10
Net unrealized losses on investment securities available-for-sale	580	693
Other	83	77
Total deferred tax assets	<u>4,643</u>	<u>5,131</u>
Deferred tax liabilities		
Accumulated depreciation and amortization	(118)	(17)
Deferred loan income	(324)	(319)
Other	(85)	(121)
Total deferred tax liabilities	<u>(527)</u>	<u>(457)</u>
Net deferred tax assets	<u>\$ 4,116</u>	<u>\$ 4,674</u>

Purchased Oregon tax credits, which aggregate \$1,389 as of December 31, 2018, will be utilized to offset future state income taxes. These credits are generally recognized over a five-year period beginning in the year of purchase and have an eight year carry-forward period. If unused, \$1,389 of the credits expire in 2029. It is anticipated that all credits and other deferred asset items will be fully utilized in the normal course of operations based on Management's expectations of future taxable income and/or because they were supported by recoverable taxes paid in prior years. Accordingly, Management has not reduced the deferred tax asset by a valuation allowance. Net deferred tax assets are included in other assets in the accompanying consolidated balance sheets.

10. Commitments and Contingencies

In the normal course of business, the Bank is a party to financial instruments with off-balance sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized in the accompanying consolidated balance sheets.

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet financial instruments.

A summary of the Bank's off-balance sheet commitments as of December 31, 2018 and 2017 is as follows:

	2018	2017
Commitments to extend credit		
Real estate secured	\$ 37,994	\$ 24,613
Commercial and industrial	46,995	40,728
Other - net	37,434	34,691
Standby letters of credit	2,945	2,616
Total	<u>\$ 125,368</u>	<u>\$ 102,648</u>

A commitment to extend credit is an agreement to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of fees. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bank upon the extension of credit, is based on Management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property and equipment, residential real estate, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third-party. These guarantees are primarily issued to support public and private borrowing arrangements. In the event the customer does not perform in accordance with the terms of the agreement with the third-party, the Bank would be required to fund the commitment. The maximum potential amount of future payments the Bank could be required to make is represented by the contractual amount of the commitment. If the commitment were funded, the Bank would be entitled to seek recovery from the customer. The Bank's policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those involved in extending loans to customers. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances when Management deems it necessary.

As described in Note 1, the Bank maintains a reserve for unfunded loan commitments. The Bank's reserve for unfunded loan commitments totaled \$302 and \$252 as of December 31, 2018 and 2017, respectively.

The Bank is a participant in the Oregon Public Deposit Protection Program ("the Program"). The Program was established to provide additional protection for Oregon public funds in the event of a bank loss. Each Program participant is required to pledge securities or obtain a letter of credit for a defined percentage of its average of public funds held in excess of FDIC deposit insurance limits. This percentage is based on the Bank's capital adequacy and the discretion of the Office of the State Treasurer. In the event of an Oregon bank failure and to the extent sufficient collateral is unavailable to repay its public funds, any uninsured public deposits would be fully repaid by the other Program participants. As of December 31, 2018, the Bank pledged approximately \$3,950 in U.S. agency securities to satisfy its commitment under the Program and there was no liability associated with the Bank's participation in the Program. The maximum future contingent liability is dependent upon the occurrence of an actual loss, the amount of such loss, the failure of collateral to cover such a loss, and the resulting share of loss to be assessed to the Company, all of which cannot presently be determined.

During 2016, the Bank purchased an equity interest in a Low-Income Housing Tax Credit ("LIHTC") partnership. The partnership's underlying activities include the development and operation of quality

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

affordable housing units. The Bank elected to use the proportional allocation method of accounting. As of December 31, 2018, the Bank included \$2,551 in other assets (representing the remaining unamortized investment in the LIHTC partnership) and \$399 in other liabilities (representing the Bank's remaining funding obligation). The Bank expects to fulfill the majority of its remaining funding commitment by the end of 2019 with all required payments made by the end of 2024.

Due to the nature of its activities, the Company is subject to pending and threatened legal actions which arise in the ordinary course of business. In the opinion of Management, liabilities arising from these claims, if any, will not have a material effect on the Company's consolidated financial statements as of and for the year ended December 31, 2018.

The Bank leases certain branch premises under operating leases which expire at various dates through May 31, 2048. Rental expense for leased premises was \$180 and \$146 for 2018 and 2017, respectively, which is included in occupancy expense in the accompanying consolidated statements of income.

As of December 31, 2018 the aggregate annual future minimum net rental commitments under noncancellable leases having an original or remaining term of more than one year were approximately as follows:

2019	\$	111
2020		93
2021		78
2022		52
2023		32
Thereafter		745
Total	\$	<u>1,111</u>

Certain leases contain renewal options from one to five years and escalation clauses based on increases in the consumer price index, property taxes, and other costs.

11. Significant Concentrations of Credit Risk

Most of the Bank's business activity is with customers located in Oregon. Investments in state and municipal securities involve governmental entities within Oregon. Loans to individual borrowers are generally limited by state banking regulations to 15% of the Bank's shareholders' equity excluding accumulated other comprehensive income (loss) for loans not fully secured by a first lien on real estate, and to 25% of such amount for loans fully secured by a first lien on real estate.

The Bank has credit risk exposure, including off-balance sheet credit risk exposure, as disclosed in Notes 1 and 10. The ultimate collectability of a substantial portion of the Bank's loan portfolio is susceptible to changes in economic and market conditions in its operating region. The Bank generally requires collateral on all real estate loans and typically originates loans with loan-to-value ratios of no greater than 70% to 80%.

The Bank has a concentration in real estate loans, particularly in commercial real estate loans. These loans require additional evaluation including, but not limited to, industry, geographic, and collateral analysis. Commercial real estate is further categorized to reflect owner occupied and non-owner occupied properties. Any non-owner occupied category that is over 100% of tier 1 capital is further analyzed as to the type of property being taken as collateral.

Citizens Bancorp and Subsidiary

Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

The contractual amounts of credit-related financial instruments such as commitments to extend credit and standby letters of credit represent the amounts of potential accounting loss should the contract be fully drawn upon, the customer defaults, and the value of any existing collateral becomes worthless.

12. Benefit Plans

401(k) Profit Sharing Plan

The Bank has a 401(k) Plan (the "Plan") which covers substantially all employees who have completed one month or more of service. Employer contributions are at the discretion of the Board and currently begin after employees have completed six months of service. For the years ended December 31, 2018 and 2017, contributions to the Plan consisted of employer matching contributions of 200% of eligible participants' contributions up to 3% of a participant's eligible compensation. Total contributions by the Bank to the Plan in 2018 and 2017 were \$526 and \$503, respectively.

Supplemental Executive Retirement Plan

The Company has a Supplemental Executive Retirement Plan ("SERP") covering its executive officers. The post-retirement benefit provided by the SERP is designed to supplement a participating officer's other sources of retirement income. Compensation expense related to this plan totaled \$580 and \$444 in 2018 and 2017, respectively. Liabilities to employees, which are being accrued over their expected time to retirement, were \$4,319 and \$3,934 as of December 31, 2018 and 2017, respectively, and are included in other liabilities in the accompanying consolidated balance sheets.

To assist in the funding of the SERP and other employee benefits, the Company has purchased BOLI policies which had a cash surrender value of \$15,889 and \$15,454 as of December 31, 2018 and 2017, respectively. Income derived from BOLI policies totaled \$434 and \$401 in 2018 and 2017, respectively.

13. Common Stock Plans

Cash Dividend Reinvestment Plan

The Company has a dividend reinvestment plan which allows – at the participating common shareholder's option – for 100% of cash dividends to be reinvested in shares of the Company's common stock. As of December 31, 2018 and 2017, 855,345 and 915,814 shares were reserved and available for future issuance under the dividend reinvestment plan, respectively.

Stock Repurchase Plan

As of December 31, 2018, the Board has authorized the repurchase of up to 187,358 shares of the Company's common stock and up to 370,224 shares of the Company's Series A preferred stock. Repurchases are made from time to time at Management's discretion under the terms of the plan. The Board's authorization has no expiration date.

14. Regulatory Matters

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital adequacy guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

Company's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of common equity tier 1 capital (CET1), tier 1 capital to risk-weighted assets, total capital to risk-weighted assets and tier 1 capital to average assets (all as defined in the regulations). Management believes that, as of December 31, 2018, the Company and the Bank met or exceeded all capital requirements to which they are subject.

To be categorized as "well capitalized," banks must generally maintain minimum CET1 risk-based, tier 1 risk-based, total risk-based, and tier 1 leverage ratios as set forth in the following tables. As of December 31, 2017, the most recent notification from the Bank's regulator categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that Management believes would change the Bank's regulatory capital categorization.

The Company's and the Bank's actual capital amounts and ratios as of December 31, 2018 and 2017 are presented in the following tables:

	Actual		Regulatory Minimum to be "Adequately Capitalized"		Regulatory Minimum to be "Well Capitalized" Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2018						
Common equity tier 1 capital (to risk-weighted assets)						
Company	\$ 80,810	16.50%	\$ 22,045	4.50%	N/A	N/A
Bank	\$ 80,780	16.49%	\$ 22,045	4.50%	\$ 31,843	6.50%
Tier 1 capital (to risk-weighted assets)						
Company	\$ 80,810	16.50%	\$ 29,394	6.00%	N/A	N/A
Bank	\$ 80,780	16.49%	\$ 29,394	6.00%	\$ 39,192	8.00%
Total capital (to risk-weighted assets)						
Company	\$ 85,998	17.55%	\$ 39,192	8.00%	N/A	N/A
Bank	\$ 85,968	17.55%	\$ 39,192	8.00%	\$ 48,990	10.00%
Tier 1 capital (to average assets)						
Company	\$ 80,810	10.17%	\$ 31,790	4.00%	N/A	N/A
Bank	\$ 80,780	10.16%	\$ 31,790	4.00%	\$ 39,738	5.00%
	Actual		Regulatory Minimum to be "Adequately Capitalized"		Regulatory Minimum to be "Well Capitalized" Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2017						
Common equity tier 1 capital (to risk-weighted assets)						
Company	\$ 73,640	15.22%	\$ 21,776	4.50%	N/A	N/A
Bank	\$ 73,601	15.21%	\$ 21,776	4.50%	\$ 31,455	6.50%
Tier 1 capital (to risk-weighted assets)						
Company	\$ 73,640	15.22%	\$ 29,035	6.00%	N/A	N/A
Bank	\$ 73,601	15.21%	\$ 29,035	6.00%	\$ 38,714	8.00%
Total capital (to risk-weighted assets)						
Company	\$ 78,453	16.21%	\$ 38,714	8.00%	N/A	N/A
Bank	\$ 78,414	16.20%	\$ 38,714	8.00%	\$ 48,392	10.00%
Tier 1 capital (to average assets)						
Company	\$ 73,640	9.43%	\$ 31,227	4.00%	N/A	N/A
Bank	\$ 73,601	9.43%	\$ 31,227	4.00%	\$ 39,033	5.00%

N/A indicates that this measure is not applicable at the Company level as of December 31, 2018 and 2017.

The Bank is required to establish and phase-in a "conservation buffer," consisting of a common equity Tier 1 capital amount equal to 2.5% of risk-weighted assets by 2019. An institution that does not meet the conservation buffer requirement will be subject to restrictions on certain activities including payment of

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

dividends, stock repurchases, and discretionary bonuses to executive officers. The phase-in began in 2016 and increases annually until fully phased-in by 2019.

Restrictions on retained earnings

There were no restrictions on the Company's or the Bank's retained earnings regarding payment of dividends as of December 31, 2018 and 2017.

15. Fair Value

Recurring fair value measurements

As of December 31, 2018 and 2017, the Company had no liabilities measured at fair value on a recurring basis. The Company's assets measured at fair value on a recurring basis as of December 31, 2018 and 2017 were as follows:

	Level 1	Level 2	Level 3
2018			
Investment securities available-for-sale			
U.S. agency securities	\$ -	\$ 277,547	\$ -
2017			
Investment securities available-for-sale			
U.S. agency securities	\$ -	\$ 281,770	\$ -

Non-recurring fair value measurements

As of December 31, 2018 and 2017, the Company had no liabilities measured at fair value on a non-recurring basis. The Company's assets measured at fair value on a non-recurring basis as of December 31, 2018 and 2017 were as follows:

	Level 1	Level 2	Level 3
2018			
Impaired loans with specific valuation allowances	\$ -	\$ -	\$ 60
OREO	-	-	807
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 867</u>
2017			
Impaired loans with specific valuation allowances	\$ -	\$ -	\$ 2,074
OREO	-	-	823
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,897</u>

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at the dates indicated:

	December 31, 2018			
	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range
Impaired loans	\$ 60	Market approach	Discounted cash flows or appraised value of collateral less selling costs	5% - 20%
OREO	\$ 807	Market approach	Lower of appraised value of collateral or listing price less selling costs	6% - 10%

	December 31, 2017			
	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range
Impaired loans	\$ 2,074	Market approach	Discounted cash flows or appraised value of collateral less selling costs	5% - 20%
OREO	\$ 823	Market approach	Lower of appraised value of collateral or listing price less selling costs	6% - 10%

Other fair value disclosures

The Company did not change the methodology used to determine fair value for any financial instruments during the years ended December 31, 2018 and 2017. Nor did the Company have any transfers among Level 1, Level 2, or Level 3 during these years.

The following disclosures are made in accordance with the provisions of GAAP which require the disclosure of fair value information about financial instruments where it is practicable to estimate that value.

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

	Recorded Amount	Fair Value	Fair Value Measurements Using:		
			Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	\$ 49,228	\$ 49,228	\$ 49,228	\$ -	\$ -
Securities available-for-sale	277,547	277,547	-	277,547	-
FHLB stock	926	926	-	-	926
Net loans	404,892	397,747	-	-	397,747
Accrued interest receivable	3,012	3,012	3,012	-	-
BOLI	15,889	15,889	15,889	-	-
Financial liabilities					
Deposits	648,252	649,324	626,580	22,744	-
REPOs	34,510	34,510	34,510	-	-

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

The estimated fair values of the Company's financial instruments as of December 31, 2017, were as follows:

	Recorded Amount	Fair Value	Fair Value Measurements Using:		
			Level 1	Level 2	Level 3
Financial assets					
Cash and cash equivalents	\$ 48,736	\$ 48,736	\$ 48,736	\$ -	\$ -
Interest-bearing time deposits with banks	992	992	992	-	-
Securities available-for-sale	281,770	281,770	-	281,770	-
Securities held-to-maturity	300	301	-	301	-
FHLB stock	868	868	-	-	868
Loans held-for-sale	174	174	174	-	-
Net loans	399,781	416,311	-	-	416,311
Accrued interest receivable	2,539	2,539	2,539	-	-
BOLI	15,454	15,454	15,454	-	-
Financial liabilities					
Deposits	654,542	655,561	629,475	26,086	-
REPOs	34,785	34,785	34,785	-	-

16. Basic and Diluted Earnings per Common Share

The numerators and denominators used in computing basic and diluted earnings per common share for the years ended December 31, 2018 and 2017 can be reconciled as follows:

	2018	2017
Numerator		
Net income	\$ 9,314	\$ 5,399
Less:		
Preferred shares dividends declared	(200)	(148)
Earnings allocable to preferred shares	(432)	(222)
Net income available to common shareholders	<u>\$ 8,682</u>	<u>\$ 5,029</u>
Denominator		
Weighted average shares outstanding - basic and diluted	<u>5,462,347</u>	<u>5,401,707</u>
Basic and diluted earnings per share	<u>\$ 1.59</u>	<u>\$ 0.93</u>

17. Transactions with Related Parties

In the normal course of business, certain key officers and directors (and the companies with which they are associated) are customers of, and have had banking transactions with, the Bank. In addition, the Bank expects to continue to have such banking transactions in the future. All loans and commitments to lend to such parties were made in compliance with applicable laws, and on substantially the same terms – including interest rates and collateral – as those prevailing at the time for comparable transactions with other persons.

Citizens Bancorp and Subsidiary
Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

In the opinion of Management, these transactions do not involve more than the normal risk of collectability or present any unfavorable features. Loans outstanding to key officers and directors (and the companies with which they are associated) for the years ended December 31, 2018 and 2017 were approximately as follows:

	2018	2017
Balance at beginning of year	\$ 810	\$ 1,156
Net additions	2,501	500
Net repayments	(82)	(846)
Balance at end of year	<u>\$ 3,229</u>	<u>\$ 810</u>

All related party loans were current as to principal and interest as of December 31, 2018 and 2017.

As of December 31, 2018 and 2017, the Bank held \$12,809 and \$11,256 in deposits from its key officers and directors.