



Report of Independent Auditors
and Consolidated Financial Statements for
**Washington Bancorp, Inc. and
Subsidiaries**

December 31, 2010 and 2009

MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

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WASHINGTON BANCORP, INC. AND SUBSIDIARIES

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December 31, 2010 and 2009

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NOTE: This annual report serves as the Bank's annual disclosure statement under requirements of the Federal Deposit Insurance Corporation (FDIC). This statement has not been reviewed, or confirmed for accuracy or relevance, by the FDIC.

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareholders
Washington Bancorp, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheet of Washington Bancorp, Inc. (the Corporation) and Subsidiaries as of December 31, 2010 and 2009, and the related consolidated statement of operations, consolidated statement of changes in shareholders' equity, and consolidated statement of cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Washington Bancorp, Inc. and Subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Everett, Washington
March 10, 2011

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

ASSETS

	DECEMBER 31,	
	2010	2009
CASH AND DUE FROM BANKS	\$ 9,250,207	\$ 14,244,851
INTEREST-BEARING DEPOSITS WITH BANKS	8,586,626	7,707,878
INVESTMENTS		
Securities available-for-sale	6,030,394	1,044,142
Securities held-to-maturity	-	252,852
FEDERAL HOME LOAN BANK STOCK, at cost	559,000	559,000
LOANS	111,597,552	156,149,349
Less allowance for loan losses	(3,002,474)	(4,198,637)
Total loans, net	108,595,078	151,950,712
PREMISES AND EQUIPMENT, net	6,761,424	6,994,399
ACCRUED INTEREST RECEIVABLE	372,991	457,621
BANK-OWNED LIFE INSURANCE	3,196,909	3,105,682
OTHER REAL ESTATE OWNED	16,131,273	5,377,662
INCOME TAX RECEIVABLE	385,823	2,864,042
OTHER ASSETS	590,399	1,259,898
Total assets	\$ 160,460,124	\$ 195,818,739

LIABILITIES AND SHAREHOLDERS' EQUITY

DEPOSITS		
Noninterest-bearing	\$ 16,725,386	\$ 16,315,798
Interest-bearing	121,556,555	154,172,414
Total deposits	138,281,941	170,488,212
OTHER BORROWINGS	4,495,161	8,607,661
JUNIOR SUBORDINATED DEBENTURES PAYABLE	3,093,000	3,093,000
ACCRUED INTEREST PAYABLE	276,763	412,337
OTHER LIABILITIES	815,974	769,532
Total liabilities	146,962,839	183,370,742
SHAREHOLDERS' EQUITY		
Common stock, no par value, 8,776,709 shares authorized at December 31, 2010 and 2009; 3,478,167 and 2,716,453 issued and outstanding at December 31, 2010 and 2009, respectively	19,987,583	18,356,887
Accumulated deficit	(6,442,354)	(5,948,208)
Accumulated other comprehensive income (loss), net of tax	(47,944)	39,318
Total shareholders' equity	13,497,285	12,447,997
Total liabilities and shareholders' equity	\$ 160,460,124	\$ 195,818,739

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

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

	FOR THE YEAR ENDED DECEMBER 31,	
	2010	2009
INTEREST INCOME		
Loans, including fees	\$ 7,991,625	\$10,316,791
Investments	68,242	126,223
Deposits with banks	174,374	75,672
Total interest income	8,234,241	10,518,686
INTEREST EXPENSE		
Deposits	2,523,386	4,267,388
Other borrowings	298,147	389,148
Junior subordinated debentures payable	58,941	78,438
Total interest expense	2,880,474	4,734,974
NET INTEREST INCOME	5,353,767	5,783,712
PROVISION FOR LOAN LOSSES	475,000	5,175,000
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	4,878,767	608,712
NONINTEREST INCOME		
Service charges on deposit accounts	225,708	250,736
Earnings on cash surrender value of bank-owned life insurance	118,523	135,259
Other income	263,201	122,818
Gain on sale of securities	94,875	339,235
Total noninterest income	702,307	848,048
NONINTEREST EXPENSES		
Salaries and employee benefits	2,497,525	2,824,781
Occupancy and equipment	649,902	695,381
Loss on impairment and sale of other real estate owned	109,965	563,585
Regulatory assessments	620,128	573,912
Loan and credit card expenses	677,485	471,136
Other expenses	1,520,215	1,410,065
Total noninterest expenses	6,075,220	6,538,860
LOSS BEFORE BENEFIT FOR INCOME TAX	(494,146)	(5,082,100)
BENEFIT FOR INCOME TAX	-	(1,097,690)
NET LOSS	\$ (494,146)	\$ (3,984,410)

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

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

For the Years Ended December 31, 2010 and 2009

	Common Stock		Comprehensive Loss	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount				
BALANCE, December 31, 2008	2,713,454	\$ 18,238,610		\$ (1,963,798)	\$ (21,624)	\$ 16,253,188
Employee stock purchase plan	2,999	21,743				21,743
Stock-based compensation expense		96,534				96,534
Comprehensive loss						
Net loss			\$ (3,984,410)	(3,984,410)		(3,984,410)
Other comprehensive loss						
Unrealized gain on securities, net of tax			<u>60,942</u>		60,942	60,942
Comprehensive loss			<u>\$ (3,923,468)</u>			
BALANCE, December 31, 2009	2,716,453	18,356,887		(5,948,208)	39,318	12,447,997
Issuance of common stock	752,208	1,504,416				1,504,416
Stock-based compensation expense	9,506	126,280				126,280
Comprehensive loss						
Net loss			\$ (494,146)	(494,146)		(494,146)
Other comprehensive loss						
Unrealized loss on securities, net of tax			<u>(87,262)</u>		(87,262)	(87,262)
Comprehensive loss			<u>\$ (581,408)</u>			
BALANCE, December 31, 2010	<u>3,478,167</u>	<u>\$ 19,987,583</u>		<u>\$ (6,442,354)</u>	<u>\$ (47,944)</u>	<u>\$ 13,497,285</u>

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

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

	FOR THE YEAR ENDED DECEMBER 31,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (494,146)	\$ (3,984,410)
Adjustments to reconcile net loss to net cash from operating activities		
Provision for loan losses	475,000	5,175,000
Depreciation	254,472	271,454
Stock-based compensation	126,280	96,534
Deferred income taxes	530,000	2,029,700
Net accretion of investment security discounts/premiums	11,678	(14,385)
Change in cash surrender value of bank-owned life insurance	(91,227)	(110,093)
Gain on sale of securities	(94,875)	(339,235)
Loss on impairment and sale of other real estate owned	109,965	563,585
Changes in operating assets and liabilities		
Accrued interest receivable	84,630	401,164
Other assets	139,499	85,078
Accrued interest payable	(135,574)	(217,954)
Income tax receivable	2,498,419	(2,864,042)
Other liabilities	46,442	296,053
	<u>3,460,563</u>	<u>1,388,449</u>
Net cash from operating activities		
CASH FLOWS FROM INVESTING ACTIVITIES		
Net change in interest-bearing deposits with banks	(878,748)	(6,895,267)
Purchases of investments available-for-sale	(6,599,065)	-
Proceeds from sale of investments available-for-sale	1,081,400	-
Proceeds from calls and maturities of investments available-for-sale	500,000	1,616,897
Proceeds from maturity of investments held-to-maturity	260,000	-
Proceeds from sale of investments held-to-maturity	-	797,747
Net change in loans made to customers	29,451,876	19,869,618
Net proceeds from sale of other real estate owned	3,232,558	3,149,309
Improvements to other real estate owned	(667,376)	(226,479)
Additions to premises and equipment	(21,497)	(947,597)
	<u>26,359,148</u>	<u>17,364,228</u>
Net cash from investing activities		

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

WASHINGTON BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

	FOR THE YEAR ENDED DECEMBER 31,	
	2010	2009
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits, excluding time deposits	998,927	4,897,674
Net increase in time deposits	(33,205,198)	(8,655,565)
Net increase in other borrowings	(4,112,500)	(3,287,500)
Proceeds from issuance of stock	1,504,416	-
Proceeds from employee stock purchase plan	-	21,743
	<u> </u>	<u> </u>
Net cash used in financing activities	<u>(34,814,355)</u>	<u>(7,023,648)</u>
NET CHANGE IN CASH AND DUE FROM BANKS	(4,994,644)	11,729,029
CASH AND DUE FROM BANKS, beginning of year	<u>14,244,851</u>	<u>2,515,822</u>
CASH AND DUE FROM BANKS, end of year	<u>\$ 9,250,207</u>	<u>\$ 14,244,851</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for interest	<u>\$ 3,016,048</u>	<u>\$ 4,952,928</u>
Cash paid during the year for income taxes	<u>\$ -</u>	<u>\$ 50,000</u>
Net noncash transfer of loans to other real estate owned	<u>\$ 13,428,758</u>	<u>\$ 7,209,102</u>

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

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) *Principles of Consolidation and Nature of Operations* - The consolidated financial statements include the transactions of Washington Bancorp, Inc. (the Corporation) and its wholly owned subsidiaries, The Bank of Washington (the Bank), and Fifth and Dayton Properties LLC (the LLC). All significant intercompany transactions and balances have been eliminated in consolidation. During 2005, Washington Bancorp, Inc. was issued a certificate of incorporation as a Washington Profit Corporation. During 2005, the Federal Reserve Bank of San Francisco granted authority to Washington Bancorp, Inc. to become a bank holding company through a reorganization of the ownership interests of The Bank of Washington. The Washington Department of Financial Institutions Division of Banks approved the articles of share exchange and plan of share exchange, and issued a certificate of reorganization. The authorized capital stock for the Bank consists of 8,776,709 shares of no par value common stock.

The Bank provides a full range of banking services to individual and corporate customers through its offices in Edmonds, Mukilteo, Lynnwood, Redmond, Issaquah, and Everett, Washington. The Bank is subject to significant competition from other financial institutions. The Bank is also subject to the regulations of certain federal and state of Washington agencies and undergoes periodic examinations by those regulatory authorities.

The LLC was created in 2006 for the sole purpose of acquiring real property and related structures and obtaining financing.

Washington Bancorp Statutory Trust I (the Trust), a subsidiary of Washington Bancorp, Inc., was formed in 2007 for the exclusive purpose of issuing trust-preferred securities and using the proceeds to acquire junior subordinated debentures issued by the Corporation. The Trust is not consolidated into Washington Bancorp, Inc. (Note 8).

(b) *Consolidated Financial Statement Presentation and Use of Estimates* - The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and reporting practices applicable to the banking industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet, and revenues and expenses for the period. Actual results could differ from estimated amounts. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, deferred income taxes, and other real estate owned.

(c) *Cash Equivalents* - For purposes of reporting cash flows, cash and cash equivalents are cash on hand and amounts due from banks with maturities of three months or less and may, at times, exceed FDIC-insured limits.

(d) *Interest-Bearing Deposits With Banks* - These instruments mature within one year, are carried at cost, and may, at times, exceed FDIC-insured limits.

(e) *Investment Securities* - Investment securities are classified into one of three categories: (1) held-to-maturity, (2) available-for-sale, or (3) trading. The Bank had no trading securities as of December 31, 2010 and 2009. Investment securities are categorized as held-to-maturity when the Bank has the positive intent and ability to hold those securities to maturity. Securities that are held-to-maturity are stated at cost and adjusted for amortization of premiums and accretion of discounts, which are recognized as adjustments to interest income.

Investment securities categorized as available-for-sale are generally held for investment purposes (to maturity), although unanticipated future events may result in the sale of some securities. Available-for-sale securities are recorded at estimated fair value, with the net unrealized gain or loss included in comprehensive loss, net of the related tax effect. Realized gains or losses on dispositions are based on the net proceeds and the adjusted carrying amount of securities sold, using the specific identification method. Amortization of premiums and accretion of discounts are recognized in interest income over the period to maturity.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Management reviews investment securities on an ongoing basis for the presence of other-than-temporary impairment (OTTI) or permanent impairment, taking into consideration current market conditions; fair value in relationship to cost; extent and nature of the change in fair value; issuer rating changes and trends; whether to sell the security before recovery of the amortized cost basis of the investment, which may be maturity; and other factors. For debt securities, if management intends to sell the security or it is likely that the Bank will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If management does not intend to sell the security and it is not likely that the Bank will be required to sell the security, but management does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Project cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, i.e., the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income. Impairment losses related to all other factors are presented as separate categories within other comprehensive loss.

(f) *Federal Home Loan Bank Stock* - The Bank's investment in Federal Home Loan Bank (FHLB) stock is carried at par value (\$100 per share), which reasonably approximates its fair value. As a member of the FHLB system, the Bank is required to maintain a minimum level of investment in FHLB stock, based on specified percentages of its outstanding FHLB advances. The Bank may request redemption at par value of any stock in excess of the amount the Bank is required to hold. Stock redemptions are at the discretion of the FHLB.

At December 31, 2010, the Bank had 5,590 shares of FHLB stock. FHLB stock is carried at par and does not have a readily determinable fair value. Ownership of FHLB stock is restricted to the FHLB and member institutions, and can only be purchased and redeemed at par. Due to ongoing turmoil in the capital and mortgage markets, the FHLB of Seattle has a risk-based capital deficiency largely as a result of write-downs on its private label mortgage-backed securities portfolios.

The Bank evaluates FHLB stock for impairment. The determination of whether these investments are impaired is based on the Bank's 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 for the FHLB and the length of time this situation has persisted; (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB; (3) the impact of legislative and regulatory changes on institutions, and, accordingly, the customer base of the FHLB; and (4) the liquidity position of the FHLB.

Under Federal Housing Finance Agency regulations, a Federal Home Loan Bank that fails to meet any regulatory capital requirement may not declare a dividend or redeem or repurchase capital stock in excess of what is required for members' current loans. Standard & Poor's stated that the FHLB system has a special public status (organized under the Federal Home Loan Bank Act of 1932) and because of the extraordinary support offered to it by the U.S. Treasury in a crisis (though not used), it can be considered an extension of the government. The U.S. government would almost certainly support the credit obligations of the FHLB system. Based on the above, the Bank has determined there is not an other-than-temporary impairment on the FHLB stock investment as of December 31, 2010.

(g) *Loans and Allowance for Loan Losses* - Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal, adjusted for any charge-offs, the allowance for loan losses, any deferred fees or costs on originated loans, and unamortized premiums or discounts on purchased loans.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Interest income is accrued on the unpaid principal balance. The Bank's policy is to defer loan origination and commitment fees as well as certain loan origination costs, and to amortize the net amount as an adjustment of the yield of the related loan over its contractual life using the interest method.

The Bank considers loans impaired when it is probable the Bank will be unable to collect all amounts as scheduled under the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or, as a practical expedient, at the loan's observable market price or the fair value of the collateral, if the loan is collateral-dependent. Changes in these values will be reflected in income and as adjustments to the allowance for possible credit losses.

The accrual of interest on impaired loans is discontinued at the time the loan is 90 days delinquent unless it is well secured or when, in management's opinion, the borrower may be unable to meet payments as they become due. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received or payment is considered certain. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The allowance for loan losses is maintained at a level management believes is adequate to provide for probable loan losses. The allowance is based on a continuing review of loans, which includes consideration of actual loss experience, changes in the size and character of the portfolio, identification of individual problem situations that may affect the borrower's ability to repay, and evaluations of the prevailing and anticipated economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance for loan losses is increased by charges to income and decreased by charge-offs (net of recoveries). While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revision of the estimate in future years. In addition, various regulatory agencies, as an integral part of their examination processes, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additional losses based on their judgment using information available to them at the time of their examination.

The allowance for loan losses consists of specific, general, and unallocated components. The specific component relates to loans that are classified as doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers nonclassified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a troubled debt restructuring.

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

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) *Premises and Equipment* - Premises and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the related assets, which range up to 39 years.

(j) *Bank-Owned Life Insurance* - The carrying amount of bank-owned life insurance approximates its fair value, net of any surrender charges.

(k) *Income Taxes* - The Bank records its provision for income tax under the liability method. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Deferred taxes result from temporary differences in the recognition of certain income and expense amounts between the Bank's financial statements and its tax returns.

(l) *Financial Instruments* - In the ordinary course of business, the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit and commitments under credit card arrangements. Such financial instruments are recorded in the financial statements when they are funded or when related fees are incurred or received.

(m) *Other Real Estate Owned* - Assets acquired through or in lieu of loan foreclosure are held-for-sale and are initially recorded at the lower of cost or estimated fair value at the date of foreclosure. Losses arising from the acquisition of property, in full or partial satisfaction of loans, are charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets.

(n) *Share-Based Compensation* - Share-based payments to employees, including stock options and restricted stock, are recognized as share-based compensation expense in the consolidated statement of operations based on the grant-date fair value of the award with a corresponding increase in common stock. The fair value is amortized over the requisite service period, which is generally the vesting period. The fair value at the grant date is determined using the Black-Scholes pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option, the volatility of the underlying stock, the expected dividend yield, and the risk-free interest rate over the expected life of the option. The Black-Scholes option valuation model requires the input of subjective assumptions, including the expected life of the share-based award and stock price volatility. The assumptions used represent management's best estimates, but these estimates involve inherent uncertainties and the application of management's best judgment.

(o) *Comprehensive Loss* - Accounting principles generally require that recognized revenue, expenses, and gains and losses be included in net loss. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net loss, are components of comprehensive loss.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The components of other comprehensive income (loss) and related tax effects are as follows:

	YEAR ENDED DECEMBER 31,	
	2010	2009
Unrealized holding gain (loss) on available-for-sale securities	\$ (12,587)	\$ 431,477
Reclassification adjustment for gains realized in income	(94,875)	(339,235)
Net unrealized gains (losses)	(107,462)	92,242
Tax effect	20,200	(31,300)
Net-of-tax amount	<u>\$ (87,262)</u>	<u>\$ 60,942</u>

The components of accumulated other comprehensive income (loss) and related tax effects are as follows:

	DECEMBER 31,	
	2010	2009
Net unrealized gain (loss) on available-for-sale securities	\$ (47,944)	\$ 59,518
Tax effect	-	(20,200)
Net-of-tax amount	<u>\$ (47,944)</u>	<u>\$ 39,318</u>

(p) *Advertising Costs* - The Bank expenses advertising costs as they are incurred. Total advertising expenses were approximately \$13,000 and \$23,000 in 2010 and 2009, respectively.

(q) *Fair Value Measurements* - Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. It also establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value measurements. In determining fair value, the Bank maximizes the use of observable inputs and minimizes the use of unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Bank's estimates for market assumptions.

Valuation inputs refer to the assumptions market participants would use in pricing a given asset or liability using one of the three valuation techniques. Inputs can be observable or unobservable. Observable inputs are those assumptions that market participants would use in pricing the particular asset or liability. These inputs are based on market data and are obtained from a source independent of the Bank.

Unobservable inputs are assumptions based on the Bank's own information or estimate of assumptions used by market participants in pricing the asset or liability. Unobservable inputs are based on the best and most current information available on the measurement date.

All inputs, whether observable or unobservable, are ranked in accordance with a prescribed fair value hierarchy that gives the highest ranking to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest ranking to unobservable inputs (Level 3). Fair values for assets or liabilities classified as Level 2 are based on one or a combination of the following factors: (i) quoted prices for similar assets; (ii) observable inputs for the asset or liability, such as interest rates or yield curves; or (iii) inputs derived principally from or corroborated by observable market data.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(r) *Subsequent Events* - Subsequent events are events or transactions that occur after the date of the consolidated balance sheet but before consolidated financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the consolidated balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the consolidated balance sheet but arose after that date. Management has reviewed events through March 10, 2011, the date the financial statements were issued, and no subsequent events occurred requiring accrual or disclosure.

NOTE 2 - REGULATORY ORDER AND MANAGEMENT'S PLANS

On November 17, 2009, the Bank entered into a Stipulation to the Issuance of a Consent Order (the FDIC order) with the Federal Deposit Insurance Corporation (FDIC) and the Washington Department of Financial Institutions, Division of Banks (DFI). On November 17, 2009, the FDIC and DFI determined that the Bank had engaged in unsafe or unsound banking practices by engaging in lending and collecting practices with less than satisfactory capital in relation to its large volume of poor quality. The Bank was deemed to have an adequate valuation reserve and provisions for liquidity, but inadequate policies and practices.

Under the terms of the FDIC order, the Bank cannot declare dividends without the prior written approval of the FDIC and the DFI. Other material provisions of the FDIC order require the Bank to (i) maintain specified capital and liquidity ratios and (ii) prepare and submit progress reports to the FDIC and DFI. The FDIC order will remain in effect until modified or terminated by the FDIC and the DFI. The Bank has been actively engaged in responding to the concerns raised by the FDIC.

The FDIC order does not restrict the Bank from transacting its normal banking business. The Bank will serve its customers in all areas including making loans, establishing lines of credit, accepting deposits, and processing banking transactions. All customer deposits remain fully insured to the highest limits set by the FDIC. The FDIC and the DFI did not impose any monetary penalties.

In response to financial results, and to address the provisions of the FDIC Order, the Bank has developed specific plans focused on increasing liquidity, reducing nonperforming assets, and improving capital levels to offset net losses incurred. The Bank has completed capital raises of \$1,507,416 in December 2010 and \$502,592 in January 2011, for a total of \$2,010,008. At December 31, 2010, the Bank was in compliance with the primary liquidity ratio requirement of the FDIC Order.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 3 - INVESTMENT SECURITIES

Amortized cost and approximate fair values of investment securities at December 31, 2010 and 2009, are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		Estimated Fair Value
			Less Than 12 Months	12 Months or Longer	
2010					
Available-for-sale securities					
U.S. Treasury and obligations of U.S government agencies	\$ 4,501,577	\$ 257	\$ (47,119)	\$ -	\$ 4,454,715
Corporate bonds	<u>1,576,761</u>	<u>93</u>	<u>(1,175)</u>	<u>-</u>	<u>1,575,679</u>
	<u>\$ 6,078,338</u>	<u>\$ 350</u>	<u>\$ (48,294)</u>	<u>\$ -</u>	<u>\$ 6,030,394</u>
2009					
Available-for-sale securities					
Corporate bonds	<u>\$ 984,624</u>	<u>\$ 59,518</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,044,142</u>
Held-to-maturity securities					
Corporate bonds	<u>\$ 252,852</u>	<u>\$ 13,953</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 266,805</u>

At December 31, 2010, the Bank had five securities with gross unrealized losses totaling \$48,294 with fair value of \$4,276,471. At December 31, 2009, the Bank had no securities with gross unrealized losses. The Bank does not consider these securities to be other-than-temporarily impaired.

The amortized cost and estimated fair value of securities at December 31, 2010, by contractual or expected maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale	
	Amortized Cost	Fair Value
Due in 1 year or less	\$ 2,006,961	\$ 2,007,040
Due in 1 to 5 years	<u>4,071,377</u>	<u>4,023,354</u>
	<u>\$ 6,078,338</u>	<u>\$ 6,030,394</u>

Proceeds from the sale of securities were \$1,081,400 in 2010 and \$797,747 in 2009. Gross gains on sale of securities were \$94,875 and \$339,235 for 2010 and 2009, respectively. There were no gross losses on sale of securities for 2010 or 2009. Proceeds from called and matured securities were \$760,000 in 2010 and \$1,616,897 in 2009, and there were no gains or losses related to called securities. Investments in interest-bearing deposits with banks and federal funds sold are made with major banks as approved by the board of directors. Investment securities with an estimated fair value of \$280,000 and \$635,000 at December 31, 2010 and 2009, respectively, have been pledged to secure public deposits, as required by law.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 4 - LOANS

The major classifications of loans are summarized as follows:

	DECEMBER 31,	
	2010	2009
Commercial real estate and mortgages	\$ 81,841,730	\$ 108,182,206
Commercial	11,957,154	12,614,049
Consumer	16,238,067	20,187,348
Real estate construction	1,896,353	15,578,264
Deferred loan fees, net	<u>(335,752)</u>	<u>(412,518)</u>
Total loans	<u>\$ 111,597,552</u>	<u>\$ 156,149,349</u>

Loans are originated at both fixed and variable interest rates. Loans with a carrying value of \$15,691,000 and \$31,207,000 were pledged as collateral on other borrowings at December 31, 2010 and 2009, respectively.

The changes in the allowance for loan losses are as follows:

	DECEMBER 31,	
	2010	2009
Balance at beginning of year	\$ 4,198,637	\$ 4,407,000
Provision for loan losses charged to operating expenses	475,000	5,175,000
Loans charged off	(1,799,363)	(5,429,081)
Loan recoveries	<u>128,200</u>	<u>106,340</u>
	<u>3,002,474</u>	<u>4,259,259</u>
Reclassification of allowance for unfunded credit commitments to other liabilities	<u>-</u>	<u>(60,622)</u>
Allowance for loan losses	<u>\$ 3,002,474</u>	<u>\$ 4,198,637</u>

Information about impaired loans is as follows:

	DECEMBER 31,	
	2010	2009
Impaired loans without a valuation allowance	\$ 23,582,036	\$ 39,633,979
Impaired loans with a valuation allowance	<u>-</u>	<u>4,567,445</u>
Total impaired loans	<u>\$ 23,582,036</u>	<u>\$ 44,201,424</u>
Valuation allowance related to impaired loans	<u>\$ -</u>	<u>\$ 547,791</u>
Average investment in impaired loans	<u>\$ 32,507,041</u>	<u>\$ 24,317,000</u>
Interest income recognized on a cash basis on impaired loans	<u>\$ 1,265,544</u>	<u>\$ 550,949</u>

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 4 - LOANS (continued)

	Total Nonaccrual Loans	Loans 90 Days or More Past Due and Still Accruing
December 31, 2010	\$ 7,528,138	\$ -
December 31, 2009	\$ 29,172,517	\$ 783,501

Restructured loans are an option that the Bank uses to minimize risk of loss and are included in impaired loans. The modifications have included items such as lowering the interest on the loan for a period of time and extending the maturity date of the loan. These modifications are made only when there is a reasonable and attainable workout plan that has been agreed to by the borrower and is in the Bank's best interest. At December 31, 2010, there were no commitments to lend additional funds to borrowers whose loans have been modified in troubled debt restructurings.

At December 31, 2010 and 2009, respectively, loans (including amounts committed) of \$12,531,556 and \$29,145,669 represent real estate secured loans that have loan-to-value ratios above supervisory guidelines.

NOTE 5 - PREMISES AND EQUIPMENT

Premises and equipment are classified as follows:

	DECEMBER 31,	
	2010	2009
Land	\$ 2,678,684	\$ 2,697,595
Buildings	3,768,469	3,768,469
Leasehold improvements	169,279	169,279
Furniture, fixtures, and equipment	2,049,677	2,030,574
Construction in process	11,303	11,302
	8,677,412	8,677,219
Less accumulated depreciation and amortization	(1,915,988)	(1,682,820)
	\$ 6,761,424	\$ 6,994,399

Depreciation expense for the years ended December 31, 2010 and 2009, was \$254,472 and \$271,454, respectively.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 6 - OTHER REAL ESTATE OWNED

The following table is a summary of other real estate owned (OREO):

	DECEMBER 31,	
	2010	2009
Balance at beginning of year	\$ 5,377,662	\$ 1,654,975
Loans transferred to OREO	13,428,758	7,209,102
Capitalized improvements	667,376	226,479
Sales of OREO	(3,232,558)	(3,149,309)
Loss on impairment and sale of OREO	(109,965)	(563,585)
	<u>\$ 16,131,273</u>	<u>\$ 5,377,662</u>

NOTE 7 - DEPOSITS

Deposits consisted of the following:

	DECEMBER 31,	
	2010	2009
Noninterest-bearing demand accounts	\$ 16,725,386	\$ 16,315,798
Interest-bearing demand accounts	8,855,756	10,337,132
Money market accounts	30,113,882	29,032,741
Savings accounts	3,546,195	2,556,620
Time deposits under \$100,000	51,600,601	74,976,738
Time deposits over \$100,000	27,440,121	37,269,183
	<u>\$ 138,281,941</u>	<u>\$ 170,488,212</u>

At December 31, 2010, the scheduled maturities of time deposits are as follows:

2011	\$ 61,284,282
2012	16,297,103
2013	996,020
2014	-
2015	463,317
	<u>\$ 79,040,722</u>

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 8 - CREDIT ARRANGEMENTS AND JUNIOR SUBORDINATED DEBENTURES PAYABLE

At December 31, 2010, a committed line-of-credit arrangement totaling approximately \$4,540,968 was available to the Bank from the Federal Reserve Bank subject to certain collateral requirements. The line provides for interest at the then-existing federal funds rate. There were no borrowings outstanding under this credit arrangement at December 31, 2010 or 2009.

The Bank is a member of the FHLB of Seattle and, as such, has a committed line-of-credit arrangement totaling approximately \$9,784,485. Borrowings generally provide for interest at the then-current published rates. Borrowings under the FHLB credit line totaled \$4,495,161 at December 31, 2010, all of which related to fixed-rate arrangements. Borrowings under the FHLB credit line totaled \$8,607,661 at December 31, 2009, all of which related to fixed-rate arrangements. The weighted-average interest rate on fixed-rate borrowings at December 31, 2010 and 2009, was 5.08% and 4.45%, respectively.

Maturity dates of FHLB advances were as follows:

	DECEMBER 31,	
	2010	2009
FHLB advances due		
Within 1 year	\$ -	\$ 2,000,000
1 to 3 years	-	2,000,000
3 to 5 years	-	-
More than 5 years	4,495,161	4,607,661
	\$ 4,495,161	\$ 8,607,661

The FHLB advances are collateralized as provided for in the Advances, Pledge, and Security Agreement with certain mortgage loans, commercial loans, and investment securities as provided in the agreements with the FHLB.

Washington Bancorp Statutory Trust I is a statutory business trust created with capital of \$93,000 for the exclusive purpose of issuing and selling capital securities and using the sales proceeds to acquire junior subordinated debentures issued by the Corporation. The Trust is a finance subsidiary 100% owned by the Corporation and the Corporation has fully and unconditionally guaranteed the securities. In June 2007, the Trust issued 3,000 capital securities, with a liquidation value of \$1,000 per security, for gross proceeds of \$3,000,000, with a 30-year maturity, callable after the fifth year by the Corporation. The rate adjusts quarterly based on the 3-month LIBOR plus 1.60%. The entire proceeds of the issuance were invested by the Trust in \$3,093,000 of junior subordinated debentures issued by the Corporation, with identical maturity, repricing, and payment forms as the trust-preferred securities. The junior subordinated debentures are the sole asset of the Trust, and payments under the junior subordinated debentures will be the sole revenues of the Trust. The junior subordinated debentures are considered capital for the purposes of regulatory capital requirements, subject to regulatory limitation. The Corporation has guaranteed, on a subordinated basis, distributions and other payments due on the trust-preferred securities. The subordinated debentures issued and guaranteed by the Corporation and held by the Trust are reflected on the consolidated balance sheet. The outstanding balance at December 31, 2010, was \$3,093,000. The Corporation exercised its right to defer payment of interest on the debentures beginning with the September 2009 payment. Interest payments can be deferred for up to 20 consecutive quarters, so long as no acceleration event of default has occurred.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 9 - INCOME TAXES

The components of the (benefit) provision for income taxes are as follows:

	DECEMBER 31,	
	2010	2009
Current	\$ (530,000)	\$ (3,127,390)
Deferred	530,000	2,029,700
	<u>\$ -</u>	<u>\$ (1,097,690)</u>

The reasons for the differences between the statutory federal income tax rate and the effective tax rates are summarized as follows:

	DECEMBER 31,	
	2010	2009
Statutory federal tax rate	34.0%	34.0%
Increase (decrease) resulting from		
Tax-exempt income	6.3%	0.7%
Valuation allowance	-40.3%	-13.1%
Effective tax rate	<u>0.0%</u>	<u>21.6%</u>

The nature and components of the Corporation's net deferred tax asset, established at an estimated tax rate of 34%, are as follows:

	DECEMBER 31,	
	2010	2009
Deferred tax assets		
Reserve for loan losses	\$ 784,000	\$ 1,104,000
Unrealized losses on securities	16,000	-
Nonaccrual interest	-	96,000
Write-downs on real estate owned	290,000	175,000
Equity-based compensation	73,000	32,000
Other	7,000	56,000
	<u>1,170,000</u>	<u>1,463,000</u>
Deferred tax liabilities		
FHLB stock dividends	23,000	23,000
Other	32,000	18,000
Deferred loan origination fees and costs	142,000	142,000
Unrealized gains on securities	-	20,000
Depreciation	90,000	66,000
	<u>287,000</u>	<u>269,000</u>
Less valuation allowance	<u>(883,000)</u>	<u>(664,000)</u>
Net deferred tax asset	<u>\$ -</u>	<u>\$ 530,000</u>

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 9 - INCOME TAXES (continued)

The Corporation believes, based upon the available information, that some portion, or all, of the deferred tax asset may not be realized in the normal course of operations; therefore, the Corporation established a valuation allowance of \$883,000 and \$664,000 for the years ended December 31, 2010 and 2009, respectively.

The Corporation recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2010 and 2009, the Corporation recognized no interest and penalties. At December 31, 2010 and 2009, the Corporation had no unrecognized tax benefits.

The Corporation files income tax returns in the U.S. federal jurisdiction. With few exceptions, the Corporation is no longer subject to U.S. federal income tax examinations by tax authorities for years before 2007.

NOTE 10 - SHAREHOLDERS' EQUITY AND REGULATORY MATTERS

The Corporation (on a consolidated basis) 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 Corporation's and Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices.

The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

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

Although the Bank is "well capitalized" at December 31, 2010, based on financial statements prepared in accordance with generally accepted accounting principles in the United States and the general percentages in the regulatory guidelines, the Bank understands that it is no longer regarded as "well capitalized" for federal regulatory purposes as a result of the deficiencies cited in the FDIC order (Note 2). As a result of this reclassification, the Bank's borrowing costs and terms from the FRB and FHLB, as well as the Bank's premiums to the Deposit Insurance Fund administered by the FDIC, are expected to be higher than they would have been than if the Bank were not operating under the Order.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 10 - SHAREHOLDERS' EQUITY AND REGULATORY MATTERS (continued)

As of December 31, 2010, according to the most recent notification from the FDIC, the Bank was categorized as adequately capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since the notification that management believes have changed the Bank's category. The Corporation's and the Bank's actual capital amounts and ratios at December 31 are also presented in the following table:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2010						
Total capital (to risk-weighted assets)						
Consolidated	\$ 15,159,000	11.88%	\$ 10,207,360	≥ 8.00%	NA	NA
The Bank of Washington	\$ 18,168,000	14.24%	\$ 10,207,360	≥ 8.00%	\$ 12,759,200	≥ 10.00%
Tier I capital (to risk-weighted assets)						
Consolidated	\$ 13,545,000	10.62%	\$ 10,207,360	≥ 8.00%	NA	NA
The Bank of Washington	\$ 16,554,000	12.97%	\$ 5,103,680	≥ 4.00%	\$ 7,655,520	≥ 6.00%
Tier I capital (to average assets)						
Consolidated	\$ 13,545,000	8.20%	\$ 13,212,880	≥ 8.00%	NA	NA
The Bank of Washington	\$ 16,554,000	10.02%	\$ 6,606,440	≥ 4.00%	\$ 8,258,050	≥ 5.00%
2009						
Total capital (to risk-weighted assets)						
Consolidated	\$ 14,509,000	8.76%	\$ 13,255,600	≥ 8.00%	NA	NA
The Bank of Washington	\$ 17,462,000	10.54%	\$ 13,255,600	≥ 8.00%	\$ 16,569,500	≥ 10.00%
Tier I capital (to risk-weighted assets)						
Consolidated	\$ 12,409,000	7.49%	\$ 13,255,600	≥ 8.00%	NA	NA
The Bank of Washington	\$ 15,362,000	9.27%	\$ 6,627,800	≥ 4.00%	\$ 9,941,700	≥ 6.00%
Tier I capital (to average assets)						
Consolidated	\$ 12,409,000	7.49%	\$ 15,541,680	≥ 8.00%	NA	NA
The Bank of Washington	\$ 15,362,000	7.88%	\$ 7,778,840	≥ 4.00%	\$ 9,713,550	≥ 5.00%

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 10 - SHAREHOLDERS' EQUITY AND REGULATORY MATTERS (continued)

Federal Reserve Board regulations require maintenance of certain minimum reserve balances on deposit with the Federal Reserve Bank. The amounts of such balances on deposit were approximately \$25,000 at December 31, 2010 and 2009. Also, under Washington State law, approval from the state banking regulators is required prior to declaring cash dividends.

NOTE 11 - EMPLOYEE BENEFITS

Incentive stock option plan - The shareholders of the Corporation approved an incentive stock option plan (the Plan) to promote the best interest of the Corporation and its shareholders by providing an incentive to employees and directors. The Plan permits the grant of incentive stock options, nonqualified options, and restricted stock. The compensation cost charged against income for the Plan was \$126,280 for 2010, of which \$3,638 related to stock options and \$122,642 related to restricted stock. The compensation cost charged against income for the Plan was \$96,534 for 2009, of which \$4,450 related to stock options and \$92,084 related to restricted stock. The maximum number of shares that may be issued under the Plan is 425,537 shares (as adjusted by stock dividends and stock splits) of common stock of the Corporation.

Option awards are generally granted with an exercise price equal to the market price of the Corporation's stock at the date of grant; those option awards generally vest and become exercisable in incremental percentages over 5 years of continuous service from the grant date and expire after 10 years. Restricted stock awards generally vest over a 5-year period. Certain option and share awards provide for accelerated vesting if there is a change in control (as defined in the Plan).

A summary of stock option transactions were:

	Granted Options for Common Stock	Weighted- Average Exercise Price of Shares Under Plan	Weighted- Average Remaining Contractual Term
Outstanding at January 1, 2010	51,194	\$ 6.28	
Granted	-	-	
Exercised	-	-	
Expired/forfeited	<u>(36,406)</u>	<u>5.81</u>	
Outstanding at December 31, 2010	<u>14,788</u>	<u>\$ 7.44</u>	<u>3.44</u>
Options vested or expected to vest at December 31, 2010	<u>14,265</u>	<u>\$ 7.29</u>	<u>3.36</u>
Options exercisable at December 31, 2010	<u>14,265</u>	<u>\$ 7.29</u>	<u>3.36</u>

The total intrinsic value of options exercised was \$0 for the years ended December 31, 2010 and 2009. As of December 31, 2010, there was no unrecognized compensation cost related to stock options.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 11 - EMPLOYEE BENEFITS (continued)

Restricted stock plan - A summary of the status of the Corporation's restricted stock as of December 31, 2010, and changes during the year ended December 31, 2010, is presented below:

	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2010	27,122	10.57
Granted	164,000	2.00
Vested	(9,506)	2.00
Forfeited	(8,638)	10.57
Nonvested at December 31, 2010	172,978	3.50

As of December 31, 2010, there was \$605,326 of total unrecognized compensation cost related to restricted stock. That cost is expected to be recognized over a weighted-average period of 2.02 years. The total fair value of shares vested during the year ended December 31, 2010, was \$19,012.

There was no cash received from option exercise under all share-based payment arrangements for the years ended December 31, 2010 and 2009. There was no tax benefit realized for the tax deductions from option exercise of the share-based payment arrangements for the years ended December 31, 2010 and 2009.

401(k) plan - The Bank sponsors an employee investment plan that allows qualified employees, at their option, to make contributions of certain percentages of pre-tax base salary through salary deductions under Section 401(k) of the Internal Revenue Code. Employee contributions are invested, at the employees' direction, among a variety of investment alternatives. The Bank pays administrative expenses related to the plan, and the Bank began to match a portion of employee contributions in 1999 up to 6% of eligible compensation. Contributions are at the Bank's discretion. There was no contribution in 2010 or 2009.

Employee stock purchase plan - During 2001, the Bank implemented an employee stock purchase plan (Stock Plan) for all eligible employees. The maximum number of shares that may be issued under the Stock Plan is 88,653, and the Stock Plan expires after 10 years. Under the Stock Plan, shares of the Bank's common stock may be purchased at six-month intervals at the fair market value on the last day of each six-month period. Purchases may not exceed \$25,000 of the fair market value of such stock per calendar year. Employees may purchase shares having a value not exceeding 10% of their gross compensation during an offering period. There were no employee purchased shares during 2010. During 2009, employees purchased 2,999 shares at an average price of \$7.25 per share.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 12 - OPERATING LEASE COMMITMENTS

The Bank leases space for branches and operations located in Lynnwood and Issaquah, Washington. These leases run for a period ranging from 2 to 10 years and allow for established rent increases each year. The Lynnwood branch is leased from a related party (Note 13). All leases require the Bank to pay all taxes and maintenance and utility costs, as well as maintaining certain types of insurance. The annual lease commitment is as follows:

<u>YEAR ENDING DECEMBER 31,</u>	<u>AMOUNT</u>
2011	\$ 157,487
2012	157,487
2013	157,487
2014	157,487
2015	80,247
Thereafter	<u>48,600</u>
	<u><u>\$ 758,795</u></u>

Rental expense charged to operations was approximately \$204,800 and \$219,400 for the years ended December 31, 2010 and 2009, respectively.

NOTE 13 - RELATED PARTY TRANSACTIONS

Certain directors, executive officers, and principal shareholders are customers of, and have had banking transactions with, the Bank. The Bank expects to have such transactions in the future. All loans and commitments included in such transactions were made in compliance with applicable laws on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons and do not involve more than the normal risk of collectibility or present any other unfavorable features. The activity in loans to directors, executive officers, principal shareholders, and companies with which they are associated was as follows for the years ended:

	<u>2010</u>	<u>2009</u>
Beginning balance	\$ 8,934,993	\$ 8,744,908
New loans	100	392,339
Repayments	<u>(3,060,529)</u>	<u>(202,254)</u>
Ending balance	<u><u>\$ 5,874,564</u></u>	<u><u>\$ 8,934,993</u></u>

Loan commitments to these same parties were approximately \$629,400 and \$602,500 at December 31, 2010 and 2009, respectively.

The Bank paid a member of management, who is also a director, approximately \$101,500 and \$94,700 in 2010 and 2009, respectively, for use of its Lynnwood branch. Payments to related parties are deemed to be at fair market value.

The Bank held deposits of approximately \$1,493,400 and \$2,037,800 for related parties at December 31, 2010 and 2009, respectively.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 14 - SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK

The Bank's business activity is primarily with customers located within Snohomish and King Counties. The Bank originates commercial, real estate, and consumer loans. Generally, loans are secured by accounts receivable, inventory, deposit accounts, personal property, or real estate. Rights to collateral vary and are legally documented to the extent practicable. Loans totaling approximately 79% of the loan portfolio are collateralized by real estate, and local economic conditions have affected some borrowers' ability to meet the stated repayment terms.

The distribution of commitments to extend credit approximates the distribution of loans outstanding. The Bank, as a matter of policy, does not extend credit to new borrowers in excess of \$2,250,000, or existing borrowers in excess of \$3,000,000, without prior approval from the board of directors.

The Bank's interest-bearing deposits with banks are primarily held with the FHLB in short-term, interest-bearing accounts. Its federal funds sold are generally purchased and sold for one-day periods with other banks.

NOTE 15 - OFF-BALANCE-SHEET ACTIVITIES

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amount of the instrument reflects the extent of the Bank's involvement in the particular financial instrument.

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, standby letters of credit, and financial guarantees written is represented by the contractual notional amount of the instrument. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of the notional amount of the Bank's financial instruments with off-balance-sheet risk at December 31, 2010 and 2009, follows:

	Contract Amount	
	2010	2009
Commitments to extend credit	\$ 7,019,889	\$ 12,179,670
Unfunded commitments under lines of credit and credit card arrangements	\$ 2,253,497	\$ 2,434,775

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

Unfunded commitments under commercial lines of credit and revolving credit lines are commitments for possible future extensions of credit to existing customers. These lines of credit are generally uncollateralized and usually do not contain a specific maturity date and may not be drawn upon to the total extent to which the Bank is committed.

The Bank has not entered into any standby letters of credit or financial guarantees.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 16 - FAIR VALUE MEASUREMENTS

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities are considered to be fair valued on a recurring basis if fair value is measured regularly. The following table shows the Corporation's assets and liabilities measured at fair value on a recurring basis (there were no transfers between Level 1 and Level 2 fair value measurements).

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
December 31, 2010				
U.S. Treasury and obligations of				
U.S government agencies	\$ -	\$ 4,454,715	\$ -	\$ 4,454,715
Corporate bonds	\$ -	\$ 1,575,679	\$ -	\$ 1,575,679
December 31, 2009				
Corporate bonds	\$ -	\$ 1,044,142	\$ -	\$ 1,044,142

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Assets and liabilities are considered to be fair valued on a nonrecurring basis if the fair value measurement of the instrument does not necessarily result in a change in the amount recorded on the balance sheet. Generally, nonrecurring valuation is the result of the application of other accounting pronouncements that require assets or liabilities to be assessed for impairment or recorded at the lower of cost or fair value. The following table presents the Corporation's assets measured at fair value on a nonrecurring basis.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>	<u>Total Loss</u>
December 31, 2010					
Impaired loans ⁽¹⁾	\$ -	\$ -	\$ 23,582,036	\$ 23,582,036	\$ -
Other real estate owned ⁽²⁾	\$ -	\$ -	\$ 16,131,273	\$ 16,131,273	\$ 109,965
December 31, 2009					
Impaired loans ⁽¹⁾	\$ -	\$ -	\$ 44,201,424	\$ 44,201,424	\$ 547,791
Other real estate owned ⁽²⁾	\$ -	\$ -	\$ 5,377,662	\$ 5,377,662	\$ 563,585

⁽¹⁾ The loss represents the specific reserve on impaired loans at December 31, 2010 and 2009.

⁽²⁾ This loss represents the loss on impairment and sale of other real estate owned during the year

The impaired loans amount above represents impaired, collateral-dependent loans that have been adjusted to fair value. When the Bank identified a collateral-dependent loan as impaired, it measured the impairment using the current fair value of the collateral, less selling costs. Depending on the characteristics of a loan, the fair value of collateral is estimated by obtaining external appraisals. If the Bank determines that the value of the impaired loan is less than the recorded investment in the loan, it recognizes this impairment and adjusts the carrying value of the loan to fair value through the allowance for loan losses.

Other real estate owned, in the preceding table, represents real estate that has been foreclosed and adjusted to fair value. At the time of foreclosure, these assets are recorded at the lower of the carrying amount of the loan or fair value less costs to sell, which becomes the asset's new basis. Any write-downs based on the asset's fair value at the date of foreclosure are charged to the allowance for loan losses. Management periodically performs valuations to determine if the asset's fair value has further declined. Fair value adjustments are recorded as a noninterest expense.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 16 - FAIR VALUE MEASUREMENTS (continued)

The table below presents the carrying value and fair value of the Corporation's financial instruments:

	December 31, 2010	
	Carrying Amount	Estimated Fair Value
Assets		
Cash and due from banks	\$ 9,250,207	\$ 9,250,000
Interest-bearing deposits	\$ 8,586,626	\$ 8,587,000
Available-for-sale securities	\$ 6,030,394	\$ 6,030,000
Loans receivable, net	\$ 108,595,078	\$ 97,281,000
FHLB stock	\$ 559,000	\$ 559,000
Bank-owned life insurance	\$ 3,196,909	\$ 3,196,700
Liabilities		
Demand deposits, money markets, and savings accounts	\$ 59,241,219	\$ 59,241,000
Time deposits	\$ 79,040,722	\$ 79,438,000
Other borrowings	\$ 4,495,161	\$ 4,656,000
Junior subordinated debentures payable	\$ 3,093,000	\$ 1,376,000
	December 31, 2009	
	Carrying Amount	Estimated Fair Value
Assets		
Cash and due from banks	\$ 14,244,851	\$ 14,245,000
Interest-bearing deposits	\$ 7,707,878	\$ 7,708,000
Available-for-sale securities	\$ 1,044,142	\$ 1,044,000
Held-to-maturity securities	\$ 252,852	\$ 267,000
Loans receivable, net	\$ 151,950,712	\$ 145,933,000
FHLB stock	\$ 559,000	\$ 559,000
Bank-owned life insurance	\$ 3,105,682	\$ 3,106,000
Liabilities		
Demand deposits, money markets, and savings accounts	\$ 58,242,291	\$ 58,242,000
Time deposits	\$ 112,245,921	\$ 112,249,000
Other borrowings	\$ 8,607,661	\$ 9,005,000
Junior subordinated debentures payable	\$ 3,093,000	\$ 1,351,000

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

Cash and due from banks, interest-bearing deposits, and bank-owned life insurance - The carrying amount of these items is a reasonable estimate of their fair value.

Available-for-sale and held-to-maturity securities - The fair value is based on quoted market prices, matrix pricing models, or dealer estimates.

Loans receivable - The fair value is estimated by discounting the future cash flows and estimated prepayments using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining term. Some loan types were valued at carrying value because of their floating rate or expected maturity characteristics.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Years Ended December 31, 2010 and 2009

NOTE 16 - FAIR VALUE MEASUREMENTS (continued)

FHLB stock - The fair value is based upon the redemption value of the stock, which equates to its carrying value.

Customer accounts - The fair value of demand deposits, savings accounts, and money market accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates is estimated by discounting the estimated future cash flows using the rates currently offered for deposits with similar remaining maturities.

Other borrowings - The fair value of other borrowings is estimated by discounting the estimated future cash flows using rates currently available to the Bank for debt with similar remaining maturities.

Junior subordinated debentures payable - The fair value is calculated based on the discounted cash flow method, adjusted for market interest rates and terms to maturity.

Off-balance-sheet commitments - The Bank's financial off-balance-sheet instruments include unfunded commitments to extend credit and borrowing facilities available to the Bank. The fair value of these instruments is not considered practicable to estimate because of the lack of quoted market price and the inability to estimate fair value without incurring excessive costs.

WASHINGTON BANCORP, INC. AND SUBSIDIARIES

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Elizabeth F. Copstead	Erik S. Nelson
Robert J. Drewel	William R. Sanden
Robert G. Wolfe	Gary C. Jones
Michael D. Echelbarger	Mark J. Trumper
Bruce A. Clawson	

MANAGEMENT AND STAFF

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Bruce Clawson, *President & COO*
Jeanne Hansen, *Senior Vice President & CCO*
Joseph Runte, *Senior Vice President & CFO*
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