

Ottawa Savings Bancorp, Inc.  
Form 10-K  
March 25, 2014

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

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**FORM 10-K**

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**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2013**

**or**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934**

**For transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 0-51367**

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**OTTAWA SAVINGS BANCORP, INC.**

**(Exact Name of Registrant as Specified in Charter)**

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**United States**                      **20-3074627**  
**(State or other Jurisdiction (I.R.S. Employer**  
**of Incorporation)                      Identification No.)**

**925 LaSalle Street, Ottawa, Illinois**              **61350**  
**(Address of Principal Executive Offices) (Zip Code)**

**Registrant's telephone number, including area code: (815) 433-2525**

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**Securities registered pursuant to Section 12(b) of the Act: None**

**Securities registered pursuant to Section 12(g) of the Act:**

**Common Stock, Par Value \$0.01 per share**

**(Title of Class)**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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Indicate by check mark whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No .

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No .

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated  
Filer

Accelerated Filer

Non-Accelerated filer (do not check if a smaller reporting company)

Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No .

As of June 30, 2013, the aggregate market value of the voting common equity held by non-affiliates of the registrant was approximately \$6,817,113 (based on the last sale price of the common stock on the OTC Bulletin Board of \$9.00 per share).

The number of shares of Common Stock of the registrant issued and outstanding as of March 25, 2014 was 2,117,979.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

None

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**OTTAWA SAVINGS BANCORP, INC.**

**Form 10-K for Fiscal Year Ended**

**December 31, 2013**

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## **PART I**

### **Forward-Looking Statements**

*This report includes forward-looking statements, including statements regarding our strategy, effectiveness of investment programs, evaluations of future interest rate trends and liquidity, expectations as to growth in assets, deposits and results of operations, future operations, market position, financial position, and prospects, plans and objectives of management. These forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, can generally be identified by use of the words “believe,” “expect,” “intend,” “anticipate,” “estimate,” “project,” or similar expressions. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain and actual results may differ materially from those predicted in such forward-looking statements. A number of factors, some of which are beyond our ability to predict or control, could cause future results to differ materially from those contemplated. These factors include but are not limited to: recent and future bail out actions by the government; a further slowdown in the national and Illinois economies; a further deterioration in asset values locally and nationwide; volatility of rate sensitive deposits; changes in the regulatory environment; increasing competitive pressure in the banking industry; operational risks; asset/liability matching risks and liquidity risks; continued access to liquidity sources; changes in the securities markets; changes in our borrowers’ performance on loans; changes in critical accounting policies and judgments; changes in accounting policies or procedures as may be required by the Financial Accounting Standards Board or other regulatory agencies; changes in the equity and debt securities markets; effect of additional provision for loan losses; fluctuations of our stock price; success of any acquisition or expansion strategies that we may undertake; impact of reputation risk created by these developments on such matters as business generation and retention, funding and liquidity; and political developments, wars or other hostilities that may disrupt or increase volatility in securities or otherwise affect economic conditions. The consequences of these factors, any of which could hurt our business, could include, among others: increased loan delinquencies; an escalation in problem assets and foreclosures; a decline in demand for our products and services; a reduction in the value of the collateral for loans made by us, especially real estate, which, in turn would likely reduce our customers’ borrowing power and the value of assets and collateral associated with our existing loans; a reduction in the value of certain assets held by our company; an inability to meet our liquidity needs and an inability to engage in certain lines of business. These risks and uncertainties should be considered in evaluating forward-looking statements, and undue reliance should not be placed on such statements. Except to the extent required by applicable law or regulation the Company does not undertake any obligation to update any forward-looking statement to reflect circumstances or events that occur after the date the forward-looking statements are made. See also “Item 1A. Risk Factors” and other risk factors discussed elsewhere in this Annual Report.*

## **ITEM 1. BUSINESS**

### **General**

Ottawa Savings Bancorp, Inc. (the “Company”) was incorporated under the laws of the United States on July 11, 2005, for the purpose of serving as the holding company of Ottawa Savings Bank (the “Bank”), as part of the Bank’s



conversion from a mutual to a stock form of organization. The Company is a publicly traded banking company with assets of \$170.6 million at year-end 2013 and is headquartered in Ottawa, Illinois.

In 2005, the Board of Directors of the Bank unanimously adopted a plan of conversion providing for the conversion of the Bank from an Illinois chartered mutual savings bank to a federally chartered stock savings bank and the purchase of all of the common stock of the Bank by the Company. The depositors of the Bank approved the plan at a meeting held in 2005.

In adopting the plan, the Board of Directors of the Bank determined that the conversion was advisable and in the best interests of its depositors and the Bank. The conversion was completed in 2005 when the Company issued 1,223,701 shares of common stock to Ottawa Savings Bancorp MHC (a mutual holding company), and 1,001,210 shares of common stock to the public. As of December 31, 2013, Ottawa Savings Bancorp MHC holds 1,223,701 shares of common stock, representing 57.8% of the Company's common shares outstanding.

The Bank's business is to attract deposits from the general public and use those funds to originate and purchase one-to-four family, multi-family and non-residential real estate, construction, commercial and consumer loans, which the Bank primarily holds for investment. The Bank has continually diversified its products to meet the needs of the community.

## **Business Strategy**

The Company's business strategy is to operate as a well-capitalized and profitable community savings bank dedicated to providing quality customer service and innovative new products. The Bank operates in a building with 21,000 square feet of office space, five drive-up lanes, and a separate ATM drive-up to provide quality customer service to customers in the community.

Highlights of our business strategy are as follows:

- Continue to emphasize the origination of one-to four-family mortgage loans;
- Aggressively market core deposits;
- Offer a broad range of financial products and services to both retail and commercial customers in the Bank's market area;
- Pursue opportunities to increase non-residential real estate and multi-family lending in the Bank's market area;
- Continue to utilize conservative underwriting guidelines to limit credit risk in the Bank's loan portfolio to achieve a high level of asset quality; and
- Consider expanding into new market areas to grow the Bank's business through the addition of new branch locations and/or through possible acquisitions.

## **Market Area and Competition**

The Company is headquartered in Ottawa, Illinois, which is located in north-central Illinois approximately 80 miles southwest of Chicago. Its market area, which benefits from its proximity to Chicago, includes all of LaSalle County.

The Bank faces significant competition for the attraction of deposits and origination of loans. Our most direct competition for deposits and loans has historically come from the several financial institutions operating in our market area and, to a lesser extent, from other financial service companies, such as brokerage firms, credit unions, mortgage companies and mortgage brokers. Our main competitors include a number of significant independent banks. In addition, the Bank faces competition for investors' funds from money market funds and other corporate and government securities. Competition for loans also comes from the increasing number of non-depository financial service companies entering the mortgage and consumer credit market, such as securities companies and specialty finance companies. The Bank believes that its long-standing presence in Ottawa, Illinois and its personal service philosophy enhances its ability to compete favorably in attracting and retaining individual and business customers. The Company actively solicits deposit-related customers and competes for deposits by offering customers personal attention, professional service and competitive interest rates.

## **Lending Activities**

*General.* Our loan portfolio consists primarily of one-to-four family residential mortgage loans. To a lesser extent, our loan portfolio includes multi-family and non-residential real estate, commercial, construction and consumer loans. Substantially all of our loans are made within our local market, excluding our purchased loan portfolio.

*Loan Portfolio Composition.* The following table sets forth the composition of our loan portfolio by type of loan as of the dates indicated, including a reconciliation of gross loans receivable after consideration of the undisbursed portion of construction loan funds, the allowance for loan losses and net deferred costs (fees).

	<b>At December 31,</b>											
	2013		2012		2011		2010		2009			
	<b>(Dollars in Thousands)</b>											
	Amount	Percent Of Total	Amount	Percent Of Total	Amount	Percent Of Total	Amount	Percent Of Total	Amount	Percent Of Total	Amount	Percent Of Total
One-to-four family	\$71,314	61.83 %	\$75,609	60.24 %	\$80,334	60.41 %	\$82,442	58.75 %	\$89,595	58.76 %		
Multi-family	2,507	2.17 %	4,629	3.69 %	5,580	4.20 %	6,237	4.44 %	5,512	3.62 %		
Lines of credit	10,941	9.49 %	13,209	10.52 %	14,219	10.69 %	15,325	10.92 %	14,540	9.54 %		
Non-residential real estate	15,842	13.73 %	18,897	15.06 %	20,058	15.08 %	20,362	14.51 %	21,841	14.33 %		
Commercial	4,075	3.53 %	4,717	3.76 %	5,965	4.49 %	9,795	6.98 %	10,528	6.90 %		
Construction	2,111	1.83 %	105	0.08 %	982	0.74 %	531	0.38 %	3,858	2.53 %		
Consumer	8,554	7.42 %	8,353	6.65 %	5,832	4.39 %	5,637	4.02 %	6,592	4.32 %		
Total loans, gross	115,344	100.00 %	125,519	100.00 %	132,970	100.00 %	140,329	100.00 %	152,466	100.00 %		
Undisbursed portion of loan funds	(1,696 )		(56 )		(171 )		(178 )		(152 )			
Allowance for loan losses	(2,910 )		(3,381 )		(4,747 )		(4,703 )		(3,515 )			
Deferred loan costs (fees), net	(65 )		(87 )		(80 )		(97 )		(99 )			
Total loans, net	\$110,673		\$121,995		\$127,972		\$135,351		\$148,700			

Listed below are the outstanding balances of purchased loans, which have been included in the table above.

	<b>At December 31,</b>				
	2013	2012	2011	2010	2009
	<b>(In Thousands)</b>				
One-to-four family	\$648	\$697	\$754	\$796	\$668
Multi-family	645	2,332	2,405	2,465	1,797
Non-residential real estate	680	2,020	3,353	5,399	6,717
Purchased auto loans (included in consumer loans above)	8,162	7,810	5,179	4,658	5,017

Total	\$10,135	\$12,859	\$11,691	\$13,318	\$14,199
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*Maturity of Loan Portfolio.* The following tables show the remaining contractual maturity of our loans at December 31, 2013. The tables do not include the effect of possible prepayments or due on sale clause payments.

<b>At December 31, 2013</b>								
	<b>One-to-</b>		<b>Lines of Non-residential</b>		<b>Commercial</b>	<b>Construction</b>	<b>Consumer</b>	<b>Total</b>
	<b>four</b>	<b>Multi-family</b>	<b>credit</b>	<b>real estate</b>				
	<b>family</b>							
	<b>(In Thousands)</b>							
Amounts due one year or less	\$ 945	\$ 645	\$ 4,302	\$ 917	\$ 168	\$ 2,111	\$ 128	\$ 9,216
After one year								
More than one year to three years	740	-	685	2,077	1,736	-	1,338	6,576
More than three years to five years	1,225	470	889	377	992	-	4,413	8,366
More than five years to ten years	5,598	-	3,872	2,894	870	-	2,632	15,866
More than ten years to twenty years	25,826	1,298	1,142	5,637	309	-	43	34,255
More than twenty years	36,980	94	51	3,940	-	-	-	41,065
Total due after December 31, 2014	70,369	1,862	6,639	14,925	3,907	-	8,426	106,128
Gross loans receivable	\$ 71,314	\$ 2,507	\$ 10,941	\$ 15,842	\$ 4,075	\$ 2,111	\$ 8,554	\$ 115,344
Less:								
Undisbursed portion of loan funds								(1,696 )
Allowance for loan losses								(2,910 )
Deferred loan costs (fees), net								(65 )
Total loans, net								\$ 110,673

<b>Due After December 31, 2014</b>		
	<b>Fixed</b>	<b>Adjustable Total</b>
	<b>(In Thousands)</b>	
One-to-four family	\$ 38,713	\$ 31,656
Multi-family	733	1,129
Lines of credit	270	6,369
Non-residential real estate	4,510	10,415
Commercial	3,598	309
Consumer	8,426	-
Total	\$ 56,250	\$ 49,878



*Asset Quality.* Within our investment portfolio we have no subprime or Alt-A backed instruments among our securities. Historically, our lending activity has promoted home ownership in the communities we serve. Our consumer and residential mortgage loans are originated consistent with the underwriting approach described herein. This includes an assessment of each borrower's personal financial condition, including a review of credit reports and related FICO scores as well as verification of income and assets. The Company does not conduct lending programs that target the subprime market. During the ordinary course of business to achieve our goal of being a community bank, we originate and manage loans in our portfolio to some borrowers with a risk of default higher than customers considered prime. Thus, the extended economic downturn may affect us indirectly, albeit to a lesser extent than it will likely impact those banks and thrifts that produced and retained significant portfolios that targeted such loans and securities. While we believed that the nature of our one-to-four family lending niche and our underwriting standards would limit the impact of the downward turn in the credit cycle on the quality of our assets—particularly in comparison with those institutions that were directly targeting subprime and Alt-A lending—the downturn in the credit cycle resulted in our experiencing higher levels of charge-offs and/or provisions for loan losses, which impacted our results of operations.

*One- to-Four Family Residential Loans.* Our primary lending activity is the origination of mortgage loans to enable borrowers to purchase or refinance existing homes or to construct new residential dwellings in our market area. We offer fixed-rate and adjustable-rate mortgage loans with terms up to 30 years. Borrower demand for adjustable-rate loans versus fixed-rate loans is a function of the level of interest rates, the expectations of changes in the level of interest rates, the difference between the interest rates and loan fees offered for fixed-rate mortgage loans and the initial period interest rates and loan fees for adjustable-rate loans. The relative amount of fixed-rate mortgage loans and adjustable-rate mortgage loans that can be originated or purchased at any time is largely determined by the demand for each in a competitive environment and the effect each has on our interest rate risk. The loan fees charged, interest rates, and other provisions of mortgage loans are determined by us on the basis of our own pricing criteria and competitive market conditions.

We offer fixed rate loans with terms of either 15, 20 or up to 30 years. We traditionally sell 30-year fixed rate loans into the secondary market, resulting in a fixed rate loan portfolio primarily composed of loans with less than 15 to 20 year terms. Our adjustable-rate mortgage loans are based on either a 15, 20 or up to 30 year amortization schedule and interest rates and payments on our adjustable-rate mortgage loans adjust every one, three or five years. Interest rates and payments on our adjustable-rate loans generally are adjusted to a rate that is based on the respective one, three, and five year monthly Constant Maturity Treasury indices (CMT). The maximum amount by which the interest rate may be increased or decreased is generally 1% to 2% per adjustment period, depending on the type of loan, and the lifetime interest rate ceiling is generally 5% over the initial interest rate of the loan. The initial and floor rates for owner occupied properties are 1.875%, 2.875% and 3.875% for the one, three and five year adjustable rate loans, respectively, and 2.875%, 3.875% and 4.875% for non-owner occupied one-to-four family properties, respectively, at this time.

Due to historically low interest rate levels, borrowers generally have preferred fixed-rate loans in recent years. While we anticipate that our adjustable-rate loans will better offset the adverse effects on our net interest income of an increase in interest rates as compared to fixed-rate mortgages, the increased mortgage payments required of adjustable-rate loans in a rising interest rate environment could cause an increase in delinquencies and defaults. The



marketability of the underlying property also may be adversely affected in a high interest rate environment. In addition, although adjustable-rate mortgage loans help make our asset base more responsive to changes in interest rates, the extent of this interest rate sensitivity is limited by the annual and lifetime interest rate adjustment limits.

While one-to-four family residential real estate loans are normally originated with up to 30-year terms, such loans typically remain outstanding for substantially shorter periods because borrowers often prepay their loans in full upon sale of the property pledged as security or upon refinancing the original loan. Therefore, average loan maturity is a function of, among other factors, the level of purchase and sale activity in the real estate market, prevailing interest rates and the interest rates payable on outstanding loans.

We originate loans to individuals and purchase loans that finance the construction of residential dwellings for personal use. Our construction loans generally provide for the payment of interest only during the construction phase, which is usually ten months. At the end of the construction phase, most of our loans automatically convert to permanent mortgage loans. Construction loans generally can be made with a maximum loan to value ratio of 80% of the appraised value with maximum terms of 30 years. The largest outstanding residential construction loan at December 31, 2013 was \$990,000, of which \$237,000 was disbursed. We also require periodic inspections of the property during the term of the construction.

We generally do not make conventional loans with loan-to-value ratios exceeding 80%. Loans with loan-to-value ratios in excess of 80% generally require private mortgage insurance, government guarantee or additional collateral. We require all properties securing mortgage loans to be appraised by an independent appraiser approved by our Board of Directors and licensed by the State of Illinois. We require title insurance on all first mortgage loans. Borrowers must obtain hazard insurance, or flood insurance for loans on property located in a flood zone, before closing the loan.

We participate with the USDA Rural Development Company to offer loans to qualifying customers. Loans are granted up to 100% of appraised value and the USDA guarantees up to 80% of the loan. These loans require no down payment but are subject to maximum income limitations.

*Lines of Credit.* We offer lines of credit, principally home equity lines of credit, which have adjustable rates of interest that are indexed to the prime rate as published in *The Wall Street Journal* for terms of up to 20 years. These loans are originated with maximum loan-to-value ratios of 80% of the appraised value of the property, and we require that we have a second lien position on the property. We also offer secured and unsecured lines of credit for well-qualified individuals and small businesses. Management includes these loans based on the collateral supporting the line of credit in either the non-residential, multi-family, commercial or one-to-four family categories for the purposes of monitoring and evaluating the portfolio.

*Multi-Family and Non-Residential Real Estate Loans.* We offer fixed rate balloon and adjustable-rate mortgage loans secured by multi-family and non-residential real estate. Our multi-family and non-residential real estate loans are generally secured by condominiums, apartment buildings, single-family subdivisions and owner-occupied properties used for businesses.

We originate and purchase multi-family and non-residential real estate loans with terms generally up to 25 years. Interest rates and payments on adjustable-rate loans adjust every one, three and five years. Interest rates and payments on our adjustable rate loans generally are adjusted to a rate typically equal to the interest rate used for one- to- four family loan products, plus 50 basis points to 100 basis points based on credit-worthiness and risk. The adjustment per period is 1% to 2% based on the loan contract, to a lifetime cap of 5%. Loan amounts generally do not exceed 70% of the appraised value for well-qualified borrowers.

We originate and purchase land loans to individuals on approved residential building lots for personal use for terms of up to 15 years and to a maximum loan to value ratio of 80% of the appraisal value. Our land loans are adjustable loans with adjustments occurring every one, three and five years, based on the original contract. Interest rate adjustments are based on the CMT plus a spread. For adjustable loans in this class, the loans generally have a floor ranging from the initial rate up to 4.875%.

We also make non-residential loans for commercial development projects including condominiums, apartment buildings, single-family subdivisions, single-family speculation loans, as well as owner-occupied properties used for business. These loans provide for payment of interest only during the construction phase and may, in the case of an apartment or commercial building, convert to a permanent mortgage loan. In the case of a single family subdivision or construction or builder loan, as individual lots are sold, the principal balance is reduced by a minimum of 80% of the net lot sales price. In the case of a commercial construction loan, the construction period may be from nine months to two years. Loans are generally made to a maximum of 70% of the appraised value as determined by an appraisal of the property made by an independent licensed appraiser. We also require periodic inspections of the property during

the term of the construction loan. The largest non-residential loan at December 31, 2013 was a troubled debt restructured loan from 2012 with a restructured balance of \$1.8 million, of which \$1.7 million is outstanding. This loan has been performing in accordance with its modified terms since it was restructured in December 2012 and will be returned to a performing status once scheduled principal payments begin. For adjustable loans in this category, there generally is an interest rate floor ranging from 3.75% to 6.00%.

Loans secured by multi-family and non-residential real estate generally have larger balances and involve a greater degree of risk than one-to-four family residential mortgage loans. Of primary concern in multi-family and non-residential real estate lending is the borrower's credit-worthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income producing properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject, to a greater extent than residential real estate loans, to adverse conditions in the real estate market or the economy. In reaching a decision on whether to make a multi-family or non-residential real estate loan, we consider the net operating income of the property, the borrower's expertise, credit history and profitability, and the value of the underlying property.

*Commercial Loans.* These loans consist of operating lines of credit secured by general business assets and equipment. We loan primarily to businesses with less than \$5,000,000 in annual revenues. The operating lines of credit are generally short term in nature with interest rates tied to short term rates and adjustments occurring daily, monthly, or quarterly based on the original contract. For adjustable loans, there is an interest rate floor built in to them ranging from 3.75% to 6.00%. The equipment loans are typically made with maturities of less than five years and are priced with a fixed interest rate. The Bank has originated commercial loans from Bankers Healthcare Group in prior years. Bankers Healthcare Group specializes in loans to healthcare professionals of all specialties throughout the United States. These loans are primarily comprised of working capital and equipment loans. We underwrite these loans based on our criteria and service the loans in-house.

*Consumer Loans.* We offer a variety of consumer loans, which include auto, share loans and personal unsecured loans to our customer base and related individuals. Unsecured loans generally have a maximum borrowing limit of \$25,000 and a maximum term of four years.

The procedures for underwriting consumer loans include an assessment of the applicant's payment history on other debts and ability to meet existing obligations and payments on the proposed loans. Although the applicant's credit-worthiness is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, to the proposed loan amount.

Consumer loans may entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly. In such cases, repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan and the remaining deficiency often does not warrant further substantial collection efforts against the borrower. In addition, consumer loan collections depend on the borrower's continuing financial stability, and therefore are more likely to be adversely affected by job loss, divorce, illness, or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws may limit the amount which can be recovered on such loans.

*Purchased Auto Loans.* The Bank purchases auto loans from regulated financial institutions. At December 31, 2013 and 2012, we had \$8.2 million and \$7.8 million of loans outstanding, respectively. These types of loans are primarily low balance individual auto loans. We have the opportunity to review the loans at least three days prior to our purchase and we have a right to refuse any specific loan within thirty days of the purchase of any given loan pool. During 2013, we purchased \$4.0 million of auto loans.

*Loan Origination, Purchases and Sales.* Loan originations come from a number of sources. The primary source of loan originations are our in-house loan originators, and to a lesser extent, advertising and referrals from customers. We occasionally purchase loans or participation interests in loans. As of December 31, 2013, we had an aggregate of \$10.1 million in purchased loan participations outstanding, including the auto loans purchased as discussed in the previous paragraph. The largest outstanding loan participation as of December 31, 2013 was a non-residential real estate loan for \$0.7 million. This loan is performing in accordance with its terms.

We sell some of the longer-term fixed-rate one-to-four family mortgage loans that we originate in the secondary market based on prevailing market interest rate conditions, an analysis of the composition and risk of the loan portfolio, liquidity needs and interest rate risk management goals. Generally, loans are sold without recourse and with servicing retained. We sold \$5.4 million and \$8.4 million of loans in the years ended December 31, 2013 and 2012, respectively. We occasionally sell participation interests in loans and may sell loan participations in the future.



The following table shows our loan originations, purchases, sales and repayment activities for the periods indicated.

	<b>For The Years Ended</b>				
	<b>December 31,</b>				
	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
	<b>(In Thousands)</b>				
Beginning balance, net	\$121,995	\$127,972	\$135,351	\$148,700	\$156,444
Loans originated					
One-to-four family	9,686	12,924	5,666	19,872	25,587
Multi-family	19	77	129	562	2,245
Lines of credit	987	381	1,799	530	5,315
Non-residential real estate	3,182	3,888	4,015	1,085	2,196
Commercial	458	285	335	8,287	7,738
Construction	2,111	105	982	668	710
Consumer	248	265	190	481	961
Total loans originated	16,691	17,925	13,116	31,485	44,752
Loans purchased					
One-to-four family	-	-	-	-	-
Multi-family	-	-	-	-	4
Non-residential real estate	-	-	-	-	895
Commercial	-	-	-	-	-
Consumer	4,048	5,847	3,050	2,003	-
Total loans purchased	4,048	5,847	3,050	2,003	899
Loan sales(1)	(5,324 )	(8,333 )	(598 )	(8,713 )	(14,772 )
Principal payments	(25,590 )	(22,890 )	(22,927 )	(36,912 )	(37,658 )
Change in allowance for loan losses	471	1,366	(44 )	(1,188 )	(1,910 )
Change in undisbursed loan funds	(1,640 )	115	7	(26 )	962
Change in deferred loan costs (fees), net	22	(7 )	17	2	(17 )
Ending balance, net	\$110,673	\$121,995	\$127,972	\$135,351	\$148,700

(1) All loan sales were one-to-four family loans.

*Loan Approval Procedures and Authority.* Our lending activities follow written, non-discriminatory underwriting standards and loan origination procedures established by our Board of Directors and management.

For one-to-four family loans and owner occupied residential loans, our President may approve loans up to \$400,000 and two members of our Board of Directors must approve loans over \$400,000. Residential loans and all commercial loans above \$400,000 up to \$1 million in the aggregate to any borrower(s) must be approved by a majority of our inside loan committee. This committee consists of our President, Vice President and our Commercial Banking Officer. For loans to any borrower(s) in the aggregate of more than \$1 million up to \$2 million, approval is

required by a majority of our level two loan committee, which consists of the inside loan committee, one designated outside director and our Chairman of the Board. For loan requests above \$2 million in the aggregate to any borrower(s), approval is required by a majority of the Board of Directors level loan committee, which consists of the inside loan committee and the Bank's Board of Directors as a whole.

*Loans to One Borrower.* The maximum amount that we may lend to one borrower and the borrower's related entities is limited by regulation to generally 15% of our stated capital and reserves. At December 31, 2013, our regulatory maximum was \$3.3 million.

*Loan Commitments.* We issue commitments for fixed-rate and adjustable-rate mortgage loans conditioned upon the occurrence of certain events. Commitments to originate mortgage loans are legally binding agreements to lend to our customers and generally expire in 45 days.

*Delinquencies.* When a borrower fails to make a required loan payment, we take a number of steps to have the borrower cure the delinquency and restore the loan to current status. We make initial contact with the borrower when the loan becomes 10 days past due. If payment is not then received by the 30<sup>th</sup> day of delinquency, additional letters are sent and phone calls generally are made to the customer by the Vice President or President. When the loan becomes 60 days past due, we generally commence foreclosure proceedings against any real property that secures the loan or attempt to repossess any personal property that secures a consumer loan. If a foreclosure action is instituted and the loan is not brought current, paid in full, or refinanced before the foreclosure sale, the real property securing the loan generally is sold at foreclosure. We may consider loan workout arrangements with certain borrowers under certain circumstances.

Management informs the Board of Directors on a monthly basis of the amount of loans delinquent more than 60 days, all loans in foreclosure and all foreclosed and repossessed property that we own.

### Delinquent Loans

The following table presents information with respect to the delinquent loans at the dates indicated.

	<b>December 31, 2013</b>		<b>90 Days or</b>		<b>Total</b>	
	<b>60-89 Days</b>		<b>More</b>			
	<b>(Dollars in Thousands)</b>					
	<b>Number</b>	<b>Principal</b>	<b>Number</b>	<b>Principal</b>	<b>Number</b>	<b>Principal</b>
	<b>of</b>	<b>of</b>	<b>of</b>	<b>of</b>	<b>of</b>	<b>of</b>
	<b>Balance</b>	<b>Balance</b>	<b>Balance</b>	<b>Balance</b>	<b>Balance</b>	<b>Balance</b>
	<b>Loans</b>	<b>Loans</b>	<b>Loans</b>	<b>Loans</b>	<b>Loans</b>	<b>Loans</b>
One-to-four family	5	\$ 429	10	\$ 1,451	15	\$ 1,880
Multi-family	-	-	-	-	-	-
Lines of credit	2	64	2	162	4	226
Non-residential real estate	2	428	2	319	4	747
Construction	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
<b>Total</b>	<b>9</b>	<b>\$ 921</b>	<b>14</b>	<b>\$ 1,932</b>	<b>23</b>	<b>\$ 2,853</b>

	<b>December 31, 2012</b>		<b>90 Days or</b>		<b>Total</b>	
	<b>60-89 Days</b>		<b>More</b>			
	<b>(Dollars in Thousands)</b>					
	<b>Number</b>	<b>Principal</b>	<b>Number</b>	<b>Principal</b>	<b>Number</b>	<b>Principal</b>
	<b>of</b>	<b>of</b>	<b>of</b>	<b>of</b>	<b>of</b>	<b>of</b>
	<b>Balance</b>	<b>Balance</b>	<b>Balance</b>	<b>Balance</b>	<b>Balance</b>	<b>Balance</b>
	<b>Loans</b>	<b>Loans</b>	<b>Loans</b>	<b>Loans</b>	<b>Loans</b>	<b>Loans</b>
One-to-four family	5	\$ 616	8	\$ 613	13	\$ 1,229
Multi-family	-	-	-	-	-	-
Lines of credit	-	-	3	1,009	3	1,009
Non-residential real estate	1	335	3	516	4	851
Construction	-	-	-	-	-	-
Commercial	-	-	-	-	-	-
Consumer	1	19	-	-	1	19



Total 7 \$ 970 14 \$ 2,138 21 \$ 3,108

**December 31, 2011**

	<b>60-89 Days</b>		<b>90 Days or More</b>		<b>Total</b>	
	<b>(Dollars in Thousands)</b>					
	<b>Number of</b>		<b>Number of</b>		<b>Number of</b>	
	<b>Principal Balance</b>		<b>Principal Balance</b>		<b>Principal Balance</b>	
	<b>Loans</b>		<b>Loans</b>		<b>Loans</b>	
One-to-four family	3	\$ 849	25	\$ 2,459	28	\$ 3,308
Multi-family	-	-	1	305	1	305
Lines of credit	-	-	7	1,980	7	1,980
Non-residential real estate	1	57	5	709	6	766
Construction	-	-	-	-	-	-
Commercial	-	-	1	7	1	7
Consumer	2	43	2	5	4	48
<b>Total</b>	<b>6</b>	<b>\$ 949</b>	<b>41</b>	<b>\$ 5,465</b>	<b>47</b>	<b>\$ 6,414</b>

<b>December 31, 2010</b>						
	<b>60-89 Days</b>		<b>90 Days or More</b>		<b>Total</b>	
	<b>(Dollars in Thousands)</b>					
	<b>Number</b>		<b>Number</b>		<b>Number</b>	
	<b>Principal</b>		<b>Principal</b>		<b>Principal</b>	
	<b>of</b>		<b>of</b>		<b>of</b>	
	<b>Balance</b>		<b>Balance</b>		<b>Balance</b>	
	<b>Loans</b>		<b>Loans</b>		<b>Loans</b>	
One-to-four family	9	\$ 1,948	31	\$ 3,622	40	\$ 5,570
Multi-family	-	-	-	-	-	-
Lines of credit	4	228	6	401	10	629
Non-residential real estate	2	184	8	1,248	10	1,432
Construction	-	-	-	-	-	-
Commercial	-	-	1	20	1	20
Consumer	3	23	-	-	3	23
<b>Total</b>	<b>18</b>	<b>\$ 2,383</b>	<b>46</b>	<b>\$ 5,291</b>	<b>64</b>	<b>\$ 7,674</b>

<b>December 31, 2009</b>						
	<b>60-89 Days</b>		<b>90 Days or More</b>		<b>Total</b>	
	<b>(Dollars in Thousands)</b>					
	<b>Number</b>		<b>Number</b>		<b>Number</b>	
	<b>Principal</b>		<b>Principal</b>		<b>Principal</b>	
	<b>of</b>		<b>of</b>		<b>of</b>	
	<b>Balance</b>		<b>Balance</b>		<b>Balance</b>	
	<b>Loans</b>		<b>Loans</b>		<b>Loans</b>	
One-to-four family	11	\$ 777	26	\$ 3,856	37	\$ 4,633
Multi-family	-	-	-	-	-	-
Lines of credit	2	139	6	248	8	387
Non-residential real estate	2	153	7	2,020	9	2,173
Construction	-	-	-	-	-	-
Consumer	2	1	3	25	5	26
<b>Total</b>	<b>17</b>	<b>\$ 1,070</b>	<b>42</b>	<b>\$ 6,149</b>	<b>59</b>	<b>\$ 7,219</b>

*Classified Assets.* Federal Deposit Insurance Corporation regulations and our Asset Classification Policy provide that loans and other assets considered to be of lesser quality be classified as “substandard,” “doubtful” or “loss” assets. An asset is considered “substandard” if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. “Substandard” assets include those characterized by the “distinct possibility” that the institution will sustain “some loss” if the deficiencies are not corrected. Assets classified as “doubtful” have all of the weaknesses inherent in those classified “substandard,” with the added characteristic that the weaknesses present make “collection or liquidation in full,” on the basis of currently existing facts, conditions and values, “highly questionable and improbable.” Assets classified as “loss” are those considered “uncollectible” and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. We classify an asset as “special mention”

if the asset has a potential weakness that warrants management's close attention. While such assets are not impaired, management has concluded that if the potential weakness in the asset is not addressed, the value of the asset may deteriorate, adversely affecting the repayment of the asset. Loans classified as impaired for financial reporting purposes are generally those loans classified as substandard or doubtful for regulatory reporting purposes.

An insured institution is required to establish allowances for loan losses in an amount deemed prudent by management for loans classified substandard or doubtful, as well as for other problem loans. General allowances represent loss allowances which have been established to recognize the inherent losses associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies problem assets as "loss," it is required to charge off such amounts. An institution's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the Office of the Comptroller of the Currency ("OCC").

On the basis of management's review of its assets, at December 31, 2013 and 2012, we had classified \$3.4 million and \$4.4 million, respectively, of our assets as special mention and \$5.8 million and \$5.6 million, respectively, of our assets as substandard. We had classified none of our assets as doubtful at December 31, 2013 and December 31, 2012. There were no assets classified as loss for the years ended December 31, 2013 or 2012. The loan portfolio is reviewed on a regular basis to determine whether any loans require classification in accordance with applicable regulations. Not all classified assets constitute non-performing assets.

As the economic downturn continued in our market during 2013 and foreclosures and liquidations as a manner of reducing non-performing assets proved costly, the Company continued its restructuring process with respect to certain non-performing loans that provided for restructuring of the terms of the loan due to economic or legal reasons related to the borrower's financial difficulties. We occasionally modify loans to help a borrower stay current on his or her loan and to avoid foreclosure. We consider modifications only after analyzing the borrower's current repayment capacity, evaluating the strength of any guarantors based on documented current financial information, and assessing the current value of any collateral pledged. We generally do not forgive principal or interest on loans, but may do so if it is in our best interest and increases the likelihood that we can collect the remaining principal balance. We may modify the terms of loans to lower interest rates (which may be at below market rates) to provide for fixed interest rates on loans where fixed rates are otherwise not available, or to provide for interest-only terms. These modifications are made only when there is a reasonable and attainable workout plan that has been agreed to by the borrower and that is in our best interest. Troubled debt restructurings (TDRs) are considered to be non-performing, except for those that have established a sufficient performance history (generally a minimum of six consecutive months of performance) under the terms of the restructured loan. At December 31, 2013, nine loans totaling \$3.1 million of our 38 substandard loans totaling \$5.8 million were considered TDRs and were included in non-accrual loans. At December 31, 2012, seven loans totaling \$3.1 million of our 23 substandard loans totaling \$5.6 million that were considered TDRs and were included in non-accrual loans. Five of the 2012 TDRs less approximately \$0.3 million in payments and write-downs remain included in non-accrual loans at December 31, 2013. During the year ended December 31, 2013, there were five loan modifications classified as TDRs due to A/B note restructurings which involved principal reductions. One of the new modifications paid-off two existing TDRs of \$0.1 million with a new performing A note at a market rate and the associated B note was charged off. The borrower remains responsible for the full principal amount of the B note. Another new modification involved a loan relationship comprised of seven impaired loans with the same borrower. These loans were combined into an A/B note structure with the new performing A note at a market rate and associated B note that was charged off. The third loan relationship involved the restructuring of three impaired loans for the same borrower. These loans were restructured using the A/B note structure. From these loans, three new A notes were originated, totaling approximately \$0.3 million at market rates, but still considered non-performing, with the associated B notes charged off. Additionally, one of our previously performing TDRs from 2011 with a balance of \$0.1 million at December 31, 2013 was returned to non-performing status in January of 2013. Of the nine remaining TDRs at December 31, 2013, seven were one-to-four family residential loans and two were non-residential real estate loans.

The following table shows the amounts and relevant ratios of nonperforming assets for the periods indicated:

	<b>December 31,</b>				
	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
	<b>(In Thousands)</b>				
Non-accrual:					
One-to-four family	\$3,549	\$3,067	\$6,755	\$4,023	\$3,856
Multi-family	-	-	305	-	-
Non-residential real estate	2,332	2,986	1,566	1,248	2,020
Commercial	-	-	7	20	-
Consumer	-	-	14	-	25
Total non-accrual loans	5,881	6,053	8,647	5,291	5,901
Past due greater than 90 days and still accruing:					
One-to-four family	-	92	36	-	-

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Lines of credit	-	15	-	-	248
Non-residential real estate	-	164	-	-	-
Total nonperforming loans	5,881	6,324	8,683	5,291	6,149
Foreclosed real estate	585	1,297	542	1,334	833
Other repossessed assets	13	9	40	28	21
Total nonperforming assets	\$6,479	\$7,630	\$9,265	\$6,653	\$7,003

**Ratios**

	<b>December 31,</b>				
	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
Allowance for loan losses as a percent of gross loans receivable	2.52 %	2.69 %	3.57 %	3.35 %	2.31 %
Allowance for loan losses as a percent of total nonperforming loans	49.48%	53.46%	54.67%	88.89%	57.16%
Nonperforming loans as a percent of gross loans receivable	5.10 %	5.04 %	6.53 %	3.77 %	4.03 %
Nonperforming loans as a percent of total assets	3.45 %	3.53 %	4.75 %	2.71 %	3.06 %
Nonperforming assets as a percent of total assets	3.80 %	4.26 %	5.06 %	3.40 %	3.48 %

The total amount of non-accrual loans decreased to \$5.9 million from \$6.1 million for the years ended December 31, 2013 and 2012, respectively. Total non-performing loans consist of 39 loans to 28 borrowers for the year ended December 31, 2013, as compared to 29 loans to 23 borrowers for the year ended December 31, 2012. For the years ended December 31, 2013 and 2012, gross interest income of \$289,000 and \$246,000, respectively, would have been recorded had the non-accrual loans at the end of the period been on accrual status throughout the period. We recognized no interest income on these loans.

### **Allowance for Loan Losses**

Our allowance for loan losses is maintained at a level necessary to absorb loan losses which are both probable and reasonably estimable. Management, in determining the allowance for loan losses, considers the losses inherent in its loan portfolio and changes in the nature and volume of loan activities, along with the general economic and real estate market conditions. We utilize a two-tier approach: (1) identification of impaired loans and establishment of specific loss allowances on such loans; and (2) establishment of general valuation allowances on the remainder of our loan portfolio. We maintain a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. Specific loan loss allowances are established for identified losses based on a review of such information. A loan evaluated for impairment is considered to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. We do not aggregate such loans for evaluation purposes. Loan impairment is 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. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Should full collection of principal be expected, cash collected on nonaccrual loans can be recognized as interest income.

General loan loss allowances are based upon a combination of factors including, but not limited to management's judgment and losses which are probable and reasonably estimable. Due to changing economic conditions which resulted in reduced charge-offs through June 30, 2013, management evaluated and changed the historical loss period used in the allowance for loan losses calculation during the quarter ended June 30, 2013. Through March 31, 2013, management used the most recent eight quarters of loss history to calculate historical loss rates. The weighting applied to the quarters was graduated, with heavier weightings applied to the most recent quarters of loss history. Beginning with the quarter ended June 30, 2013, management expanded the loss period and began using the most recent twelve quarters of loss history to calculate historical loss rates. The weighting applied to the quarters is still graduated, with heavier weightings applied to the most recent quarters of loss history; however, the weighting applied has a lesser graduation than the previous methodology. The new weighting applies 40% to each of the most recent four quarters and 30% to each of the next eight quarters. Management evaluated the impact of the change in methodology by calculating the allowance for loan losses using both the old methodology and the new methodology at June 30, 2013, and determined that the change in methodology did not have a material impact on the allowance for loan losses as of June 30, 2013.

The allowance is increased through provisions charged against current earnings, and offset by recoveries of previously charged-off loans. Loans which are determined to be uncollectible are charged against the allowance. Management uses available information to recognize probable and reasonably estimable loan losses, but future loss provisions may be necessary based on changing economic conditions. The allowance for loan losses as of December 31, 2013 is maintained at a level that represents management's best estimate of losses inherent in the loan portfolio, and such losses were both probable and reasonably estimable. In addition, the OCC, as an integral part of its examination process, periodically reviews our allowance for loan losses.

*Allowance for Loan Losses.* The following table analyzes changes in the allowance for the periods indicated.

	<b>Year Ended December 31,</b>				
	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
	<b>(Dollars in Thousands)</b>				
Balance at beginning of year	\$3,381	\$4,747	\$4,703	\$3,515	\$1,605
Chargeoffs:					
One-to-four family	1,136	2,352	1,666	821	360
Multi-family	282	133	250	-	-
Non-residential real estate	84	772	3,224	952	773
Commercial	-	52	-	321	-
Consumer	17	27	43	48	69
	1,519	3,336	5,183	2,142	1,202
Recoveries:					
One-to-four family	14	49	1	3	35
Multi-family	15	-	-	-	148
Non-residential real estate	136	-	35	-	-
Consumer	8	9	11	18	18
	173	58	47	21	201
Net charge-offs	1,346	3,278	5,136	2,121	1,001
Additions charged to operations	875	1,912	5,180	3,309	2,911
Balance at end of year	\$2,910	\$3,381	\$4,747	\$4,703	\$3,515
Net charge-offs to average gross loans outstanding	1.12 %	2.52 %	3.79 %	1.45 %	0.64 %

*Allocation of Allowance for Loan Losses.* The following table presents an analysis of the allocation of the allowance for loan losses at the dates indicated. The allocation of the allowance to each category is not necessarily indicative of future loss in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

	<b>2013</b>				
	<b>Percent Of</b>	<b>Allowance</b>	<b>Percent</b>	<b>Of Gross</b>	
	<b>Amount To</b>	<b>Total</b>	<b>Of Gross</b>	<b>Loans In</b>	
	<b>Allowance</b>	<b>Allowance</b>	<b>Each</b>	<b>Category</b>	
	<b>Total</b>	<b>Allowance</b>	<b>To Total</b>	<b>To Total</b>	
	<b>Allowance</b>	<b>Allowance</b>	<b>Gross</b>	<b>Loans</b>	
	<b>(Dollars in Thousands)</b>				
One-to-four family	\$2,277	78.25	%	61.83	%
Multi-family	141	4.85	%	2.17	%
Lines of credit (1)	-	-	%	9.49	%



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Non-residential real estate	388	13.33	%	13.73	%
Commercial	30	1.03	%	3.53	%
Construction (1)	-	-	%	1.83	%
Consumer	74	2.54	%	7.42	%
Total allowance for loan losses	\$2,910	100.00	%	100.00	%

**2012**

**(Dollars in Thousands)**

One-to-four family	\$2,057	60.84	%	60.24	%
Multi-family	162	4.79	%	3.69	%
Lines of credit (1)	-	-	%	10.52	%
Non-residential real estate	1,012	29.93	%	15.06	%
Commercial	75	2.22	%	3.76	%
Construction (1)	-	-	%	0.08	%
Consumer	75	2.22	%	6.65	%
Total allowance for loan losses	\$3,381	100.00	%	100.00	%

**2011****(Dollars in Thousands)**

One-to-four family	\$3,113	65.58	%	60.41	%
Multi-family	438	9.23	%	4.20	%
Lines of credit (1)	-	-	%	10.69	%
Non-residential real estate	1,146	24.14	%	15.08	%
Commercial	11	0.23	%	4.49	%
Construction (1)	-	-	%	0.74	%
Consumer	39	0.82	%	4.39	%
Total allowance for loan losses	\$4,747	100.00	%	100.00	%

**2010****(Dollars in Thousands)**

One-to-four family	\$2,425	51.56	%	58.75	%
Multi-family	106	2.25	%	4.44	%
Lines of credit (1)	-	-	%	10.92	%
Non-residential real estate	1,880	39.98	%	14.51	%
Commercial	227	4.83	%	6.98	%
Construction (1)	-	0.00	%	0.38	%
Consumer	65	1.38	%	4.02	%
Total allowance for loan losses	\$4,703	100.00	%	100.00	%

**2009**

	<b>Percent Of</b>	<b>Percent</b>	<b>Of Gross</b>	<b>Loans In</b>	
	<b>Allowance</b>	<b>Each</b>	<b>Category</b>	<b>To Total</b>	
	<b>Amount To</b>	<b>Total</b>	<b>Allowance</b>	<b>Gross</b>	
		<b>Allowance</b>	<b>Loans</b>		

**(Dollars in Thousands)**

One-to-four family	\$2,059	58.58	%	58.76	%
Multi-family	55	1.57	%	3.62	%
Lines of credit (1)	-	-	%	9.54	%
Non-residential real estate	1,193	33.94	%	14.33	%
Commercial	120	3.41	%	6.90	%
Construction (1)	-	-	%	2.53	%
Consumer	88	2.50	%	4.32	%
Total allowance for loan losses	\$3,515	100.00	%	100.00	%

(1) Allowances applicable to Lines of Credit and Construction loans are maintained in the related category of the underlying collateral.

Each quarter, management evaluates the total balance of the allowance for loan losses based on several factors that are not loan specific, but are reflective of the inherent losses in the loan portfolio. This process includes, but is not limited to, a periodic review of loan collectability in light of historical experience, the nature and volume of loan activity, conditions that may affect the ability of the borrower to repay, underlying value of collateral, if applicable, and economic conditions in our immediate market area. First, we group loans by delinquency status. All loans 90 days or more delinquent and all loans classified as substandard or doubtful are evaluated individually, based primarily on the value of the collateral securing the loan. Specific loss allowances are established as required by this analysis. All loans for which a specific loss allowance has not been assigned are segregated by type and delinquency status and a loss allowance is established by using loss experience data and management's judgment concerning other matters it considers significant. The allowance is allocated to each category of loan based on the results of the above analysis.

Total allowance for loan losses decreased \$0.5 million to \$2.9 million at December 31, 2013 from \$3.4 million at December 31, 2012. The decrease in the allowances for loan losses was primarily due to a decrease of \$0.6 million in the general portion of the reserve. The decrease in the general portion was due primarily to the reduction in the size of the loan portfolio as well as the stabilization of the nonperforming assets levels having a favorable impact on the historical loss factors. The historical loss factor for non-residential property declined the most due to the historical loss percentage improving as well as decreases in the qualitative factors as risks in this segment continue to lessen. The historical loss factors increased slightly for the other categories. Additionally, management increased the qualitative factors for the one-to-four family segment to reflect the continued degradation of this segment as the issues facing our borrowers related to the local economic conditions continue to be challenging as unemployment levels remain elevated in comparison to the state and national levels. Offsetting this decrease was an increase of \$87,000 of specific reserves on impaired loans. Impaired loans were \$5.8 million with a valuation allowance of \$265,000 at December 31, 2013, as compared to \$5.6 million of impaired loans with a valuation allowance of \$178,000 at December 31, 2012.

This analysis process is inherently subjective, as it requires us to make estimates that are susceptible to revisions as more information becomes available. Although we believe that we have established the allowance at a level to absorb probable and estimable losses, additions may be necessary if economic or other conditions in the future differ from the current environment.

## Investment Activities

We have legal authority to invest in various types of liquid assets, including U.S. Treasury obligations, securities of various federal agencies and of state and municipal governments, mortgage-backed securities and certificates of deposit of federally insured institutions.

At December 31, 2013, our investment portfolio consisted primarily of municipal securities with maturities of five to more than ten years and residential mortgage-backed securities issued by Fannie Mae, Freddie Mac, and Ginnie Mae with stated final maturities of 30 years or less.

Our investment objectives are to provide and maintain liquidity, to maintain a balance of high quality, diversified investments to minimize risk, to provide collateral for pledging requirements, to establish an acceptable level of interest rate risk, to provide an alternate source of low-risk investments when demand for loans is weak, and to generate a favorable return. Our Board of Directors has the overall responsibility for our investment portfolio, including approval of our investment policy and appointment of our Investment Committee. The Investment Committee is responsible for approval of investment strategies and monitoring of investment performance. Our President is the designated investment officer and the CFO and the President are responsible for the daily investment activities and are authorized to make investment decisions consistent with our investment policy. The Investment Committee, consisting of five external Board of Director members, meets regularly with the President and CFO to review and determine investment strategies and transactions.

The following table sets forth the carrying value of our investment portfolio at the dates indicated.

	<b>December 31, 2013</b>		<b>2012</b>		<b>2011</b>	
	<b>Carrying Fair</b>		<b>Carrying Fair</b>		<b>Carrying Fair</b>	
	<b>Amount</b>	<b>Value</b>	<b>Amount</b>	<b>Value</b>	<b>Amount</b>	<b>Value</b>
	<b>(In Thousands)</b>					
<b>Available-for-sale</b>						
US agency securities	\$-	\$-	\$-	\$-	\$3,031	\$3,031

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State and municipal securities	8,444	8,444	7,121	7,121	3,706	3,706
Residential mortgage-backed securities	26,103	26,103	21,743	21,743	26,270	26,270
Total available-for-sale	\$34,547	\$34,547	\$28,864	\$28,864	\$33,007	\$33,007

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*Portfolio Maturities and Yields.* The composition and maturities of the investment securities portfolio at December 31, 2013 are summarized in the following table. Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur. Certain mortgage-backed securities have interest rates that are adjustable and will re-price annually within the various maturity ranges. These re-pricing schedules are not reflected in the table below.

	At December 31, 2013											
	One Year or Less		More than One Year Through Five Years		More than Five Years Through Ten Years		More than Ten Years		Total Securities			
	Weighted Carrying Value	Weighted Average Yield	Weighted Carrying Value	Weighted Average Yield	Weighted Carrying Value	Weighted Average Yield	Weighted Carrying Value	Weighted Average Yield	Weighted Carrying Value	Weighted Average Yield	Weighted Carrying Value	Weighted Average Yield
	(Dollars in Thousands)											
Available-for-sale securities:												
State and municipal securities	\$-	0.00 %	\$-	0.00 %	\$3,285	4.44 %	\$5,159	4.71 %	\$8,444	4.60 %		
Residential mortgage-backed securities	497	2.33 %	23,079	2.35 %	2,527	1.43 %	-	0.00 %	26,103	2.26 %		
Total securities available-for-sale	\$497	2.33 %	\$23,079	2.35 %	\$5,812	3.13 %	\$5,159	4.71 %	\$34,547	2.83 %		

### Deposit Activities and Other Sources of Funds

*General.* Deposits and loan repayments are the major sources of our funds for lending and other investment purposes. Loan repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are significantly influenced by general interest rates and money market conditions.

*Deposit Accounts.* The vast majority of our depositors are residents of LaSalle County. Deposits are raised primarily from within our primary market area through the offering of a broad selection of deposit instruments, including checking accounts, money market accounts, regular savings accounts, club savings accounts, certificate accounts and various retirement accounts. The Bank also is a member of the Certificate of Deposit Registry Service (CDARS), which allows the Bank to retain high deposit relationships with its depository customer base, while still

allowing the customer to enjoy FDIC deposit insurance on amounts in excess of the current limit of \$250,000. Other than our relationship with CDARS, we do not utilize brokered funds. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit, and the interest rate among other factors. In determining the terms of our deposit accounts, we consider the rates offered by our competition, profitability to us, matching deposit and loan products and customer preferences and concerns. We generally review our deposit mix and pricing weekly. Our current strategy is to offer competitive rates, but not be the market leader in every type and maturity.

The following table sets forth the dollar amount of deposits by type as of the dates indicated.

	December 31, 2013			2012			2011		
	Amount	Percent Of Total	(Dollars In Thousands)	Amount	Percent Of Total	(Dollars In Thousands)	Amount	Percent Of Total	(Dollars In Thousands)
Non-Interest Bearing Checking	\$ 5,219	3.58 %		\$ 4,314	2.78 %		\$ 4,039	2.53 %	
Interest Bearing Checking	14,382	9.87 %		12,425	8.01 %		12,124	7.58 %	
Money Market accounts	21,795	14.95 %		20,666	13.33 %		18,875	11.80 %	
Savings accounts	16,941	11.62 %		15,218	9.81 %		13,595	8.50 %	
Certificates of Deposit accounts	87,432	59.98 %		102,452	66.07 %		111,315	69.59 %	
Total deposit accounts	\$ 145,769	100.00 %		\$ 155,075	100.00 %		\$ 159,948	100.00 %	
Certificate Accounts, by rate									
Less than 1.00%	\$ 41,752	47.75 %		\$ 35,118	34.28 %		\$ 32,522	29.22 %	
1.00% to 1.99 %	28,584	32.69 %		24,781	24.19 %		22,700	20.39 %	
2.00% to 2.99 %	13,565	15.52 %		32,124	31.35 %		34,830	31.29 %	
3.00% to 3.99 %	3,531	4.04 %		9,571	9.34 %		17,264	15.51 %	
4.00% to 4.99 %	-	0.00 %		858	0.84 %		3,463	3.11 %	
5.00% to 5.99 %	-	0.00 %		-	0.00 %		536	0.48 %	
Total Certificate Accounts	\$ 87,432	100.00 %		\$ 102,452	100.00 %		\$ 111,315	100.00 %	

The following table sets forth the distribution of average deposit accounts, by account type, at the dates indicated.

	<b>Years Ended December 31,</b>					
	<b>2013</b>		<b>2012</b>		<b>2011</b>	
	<b>Weighted Average</b>	<b>Amount</b>	<b>Weighted Average</b>	<b>Amount</b>	<b>Weighted Average</b>	<b>Amount</b>
	<b>Avg. Rate</b>	<b>Amount</b>	<b>Avg. Rate</b>	<b>Amount</b>	<b>Avg. Rate</b>	<b>Amount</b>
	<b>(Dollars In Thousands)</b>					
Non-Interest Bearing Checking	0.00 %	\$4,187	0.00 %	\$3,882	0.00 %	\$3,539
Interest Bearing Checking	0.05 %	13,465	0.06 %	12,493	0.11 %	11,282
Money Market accounts	0.24 %	20,837	0.29 %	20,369	0.56 %	20,544
Passbook accounts	0.06 %	16,642	0.08 %	15,026	0.10 %	13,444
Certificate of Deposit accounts	1.20 %	95,916	1.70 %	107,805	2.03 %	114,205
Total	0.80 %	\$151,047	1.21 %	\$159,575	1.53 %	\$163,014

*Deposit Activity.* The following table sets forth the deposit activities for the periods indicated.

	<b>Years Ended December 31,</b>					
	<b>2013</b>		<b>2012</b>		<b>2011</b>	
	<b>(In Thousands)</b>					
Beginning of period	\$155,075	\$159,948	\$170,831			
Net deposits (withdrawals)	(10,672 )	(6,916 )	(13,267 )			
Interest credited on deposit accounts	1,366	2,043	2,384			
End of period	\$145,769	\$155,075	\$159,948			
Percent change	-6.00 %	-3.05 %	-6.37 %			

The following table indicates the amount of certificates of deposit as of December 31, 2013, by time remaining until maturity.

	<b>Three</b>	<b>Over Three</b>	<b>Over Six</b>	<b>Over</b>	<b>Total</b>
	<b>Months</b>	<b>To Six</b>	<b>To Twelve</b>	<b>Twelve</b>	
	<b>Or Less</b>	<b>Months</b>	<b>Months</b>	<b>Months</b>	
	<b>(In Thousands)</b>				
Less than \$100,000	\$ 6,551	\$ 6,494	\$ 9,382	\$ 29,202	\$ 51,629
\$100,000-\$250,000	3,354	2,700	4,740	17,403	28,197
Over \$250,000	1,018	1,740	2,517	2,331	7,606
Total	\$ 10,923	\$ 10,934	\$ 16,639	\$ 48,936	\$ 87,432



	<b>Less than</b>	<b>1 to 2</b>	<b>2 to 3</b>	<b>3 to 4</b>	<b>4 to 5</b>	<b>Total</b>
	<b>1 year</b>	<b>years</b>	<b>years</b>	<b>years</b>	<b>years</b>	
	<b>(In Thousands)</b>					
Less than 1.00%	\$ 19,163	\$ 14,255	\$ 5,289	\$ 2,985	\$ 60	\$ 41,752
1.00% to 1.99 %	9,000	567	2,447	5,586	10,984	28,584
2.00% to 2.99 %	8,666	4,289	610	-	-	13,565
3.00% to 3.99 %	1,668	1,863	-	-	-	3,531
4.00% to 4.99 %	-	-	-	-	-	-
5.00% to 5.99 %	-	-	-	-	-	-
<b>Total</b>	<b>\$ 38,497</b>	<b>\$ 20,974</b>	<b>\$ 8,346</b>	<b>\$ 8,571</b>	<b>\$ 11,044</b>	<b>\$ 87,432</b>

*Borrowings.* If necessary, we borrow from the Federal Home Loan Bank of Chicago to supplement our supply of lendable funds and to meet deposit withdrawal requirements. The Federal Home Loan Bank functions as a central reserve bank providing credit for member financial institutions. As a member, we are required to own capital stock in the Federal Home Loan Bank of Chicago and are authorized to apply for advances on the security of such stock and certain of our mortgage loans and other assets (principally securities that are obligations of, or guaranteed by, the United States), provided certain standards related to credit-worthiness have been met. Advances are made under several different programs, each having its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based either on a fixed percentage of an institution's net worth or on the Federal Home Loan Bank's assessment of the institution's credit-worthiness. Under its current credit policies, the Federal Home Loan Bank generally limits advances to 25% of a member's assets, and short-term borrowings of less than one year may not exceed 10% of the institution's assets. The Federal Home Loan Bank determines specific lines of credit for each member institution. There were no Federal Home Loan Bank advances outstanding at December 31, 2013. At December 31, 2013, we had the ability to borrow \$50.4 million from the Federal Home Loan Bank of Chicago. In addition, as of December 31, 2013, the Bank had \$5.0 million of available credit from Bankers Bank of Wisconsin to purchase federal funds.

## **Personnel**

At December 31, 2013, we had 19 full-time employees and 5 part-time employees, none of whom is represented by a collective bargaining unit. We believe our relationship with our employees is good.

## **Subsidiaries**

The Company's only subsidiary is Ottawa Savings Bank.

## **REGULATION AND SUPERVISION**

### **General**

Ottawa Savings Bank as an insured federal savings bank is subject to extensive regulation, examination and supervision by the Office of the Comptroller of the Currency ("OCC"), as its primary federal regulator, and the Federal Deposit Insurance Corporation, as the insurer of its deposits. Ottawa Savings Bank is a member of the Federal Home Loan Bank System and its deposit accounts are insured up to applicable limits by the Deposit Insurance Fund ("DIF") managed by the Federal Deposit Insurance Corporation. Ottawa Savings Bank must file reports with the OCC and the Federal Deposit Insurance Corporation concerning its activities and financial condition in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with, or acquisitions of, other financial institutions. There are periodic examinations by the OCC and, under certain circumstances, the Federal Deposit Insurance Corporation to evaluate Ottawa Savings Bank's safety and soundness and compliance with various regulatory requirements. This regulatory structure is intended primarily for the protection of the insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such policies, whether by the OCC, the Federal Deposit Insurance Corporation or Congress, could have a material adverse impact on Ottawa Savings Bancorp, Inc., Ottawa Savings Bancorp MHC (see page 22 for discussion of the mutual holding company) and Ottawa Savings Bank and their operations.

Ottawa Savings Bancorp, Inc. and Ottawa Savings Bancorp MHC, as savings and loan holding companies, are required to file certain reports with, are subject to examination by, and otherwise must comply with the rules and regulations of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"). Ottawa Savings Bancorp, Inc. is also subject to the rules and regulations of the Securities and Exchange Commission under the federal

securities laws.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) made extensive changes to the regulation and supervision of financial institutions, including the Bank. Under the Dodd-Frank Act, the Office Thrift Supervision (“OTS”) was eliminated and responsibility for the supervision and regulation of federal savings associations was transferred to the OCC on July 21, 2011. The OCC is the agency that is primarily responsible for the regulation and supervision of national banks. At the same time, the responsibility for supervising and regulating the savings and loan holding companies like Ottawa Savings Bancorp, Inc. and Ottawa Savings Bancorp MHC was transferred to the Federal Reserve Board. In addition, the Dodd-Frank Act created a new agency, the Consumer Financial Protection Bureau which assumed responsibility for the implementation of the federal financial consumer protection and fair lending laws and regulations and has authority to impose new requirements. However, institutions of \$10.0 billion or less in assets will continue to be examined for compliance with consumer protection and fair lending laws and regulations by, and be subject to the enforcement authority of, their prudential regulator rather than the Consumer Financial Protection Bureau. Many of the provisions of the Dodd-Frank Act require the issuance of regulations before their impact on operations can be fully assessed by management. However, there is a significant possibility that the Dodd-Frank Act will, at a minimum, result in increased regulatory burden and compliance costs for Ottawa Savings Bank, Ottawa Savings Bancorp, Inc. and Ottawa Savings Bancorp MHC.

Certain of the regulatory requirements that are applicable to Ottawa Savings Bank, Ottawa Savings Bancorp, Inc. and Ottawa Savings Bancorp MHC are described below. This description of statutes and regulations is not intended to be a complete explanation of such statutes and regulations and their effects on Ottawa Savings Bank, Ottawa Savings Bancorp, Inc. and Ottawa Savings Bancorp MHC and is qualified in its entirety by reference to the actual statutes and regulations.

## Regulation of Federal Savings Banks

*Business Activities.* Federal laws and regulations govern the activities of federal savings banks, such as the Ottawa Savings Bank. These laws and regulations delineate the nature and extent of the activities in which federal savings banks may engage. In particular, certain lending authority for federal savings banks, e.g., commercial, non-residential real property loans and consumer loans, is limited to a specified percentage of the institution's capital or assets.

The Dodd-Frank Act authorizes depository institutions to pay interest on commercial demand deposits effective July 21, 2011.

*Capital Requirements.* The applicable capital regulations require federal savings banks to meet three minimum capital standards: a 1.5% tangible capital to total assets ratio; a 4% Tier 1 capital to total assets leverage ratio (3% for institutions receiving the highest rating on the CAMELS examination rating system) and an 8% risk-based capital ratio. In addition, the prompt corrective action standards discussed below also establish, in effect, a minimum 2% tangible capital standard, a 4% leverage ratio (3% for institutions receiving the highest rating on the CAMELS system) and, together with the risk-based capital standard itself, a 4% Tier 1 risk-based capital standard. The regulations also require that, in meeting the tangible, leverage and risk-based capital standards, banks must generally deduct investments in and loans to subsidiaries engaged in activities as principal that are not permissible for a national bank.

The risk-based capital standard requires federal savings banks to maintain Tier 1 (core) and total capital (which is defined as core capital and supplementary capital, less certain specified deductions from total capital such as reciprocal holdings of depository institution capital, instruments and equity investments) to risk-weighted assets of at least 4% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, recourse obligations, residual interests and direct credit substitutes, are multiplied by a risk-weight factor of 0% to 100%, as assigned by the capital regulation based on the risks believed inherent in the type of asset. Core (Tier 1) capital is generally defined as common stockholders' equity (including retained earnings), certain non-cumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries, less intangibles other than certain mortgage servicing rights and credit card relationships. The components of supplementary (Tier 2) capital currently include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock, the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and up to 45% of unrealized gains on available-for-sale equity securities with readily determinable fair market values. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital.

The OCC also has authority to establish individual minimum capital requirements in appropriate cases upon a determination that an institution's capital level is or may become inadequate in light of the particular circumstances. At December 31, 2013, the Bank met each of its capital requirements.

In July 2013, the OCC and the other federal bank regulatory agencies issued a final rule that will revise their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. The final rule applies to all depository institutions, top-tier bank holding companies with total consolidated assets of \$500 million or more and top-tier savings and loan holding companies. Among other things, the rule establishes a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk weighted assets) and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also requires unrealized gains and losses on certain “available-for-sale” securities holdings to be included for purposes of calculating regulatory capital unless a one-time opt-out is exercised. Additional constraints will also be imposed on the inclusion in regulatory capital of mortgage-servicing assets, defined tax assets and minority interests will. The rule limits a banking organization’s capital distributions and certain discretionary bonus payments if the banking organization does not hold a “capital conservation buffer” consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The final rule becomes effective for Ottawa Savings Bank on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective.

*Prompt Corrective Regulatory Action.* The OCC is required to take certain supervisory actions against undercapitalized institutions, the severity of which depends upon the institution’s degree of undercapitalization. Generally, a savings bank that has a ratio of total capital to risk weighted assets of less than 8%, a ratio of Tier 1 (core) capital to risk-weighted assets of less than 4% or a ratio of core capital to total assets of less than 4% (3% or less for institutions with the highest examination rating) is considered to be “undercapitalized.” A savings bank that has a total risk-based capital ratio less than 6%, a Tier 1 capital ratio of less than 3% or a leverage ratio that is less than 3% is considered to be “significantly undercapitalized” and a savings bank that has a tangible capital to assets ratio equal to or less than 2% is deemed to be “critically undercapitalized.” Subject to a narrow exception, the OCC is required to appoint a receiver or conservator within specified time frames for an institution that is “critically undercapitalized.” An institution must file a capital restoration plan with the OCC within 45 days of the date it receives notice that it is “undercapitalized,” “significantly undercapitalized” or “critically undercapitalized.” Compliance with the plan must be guaranteed by any parent holding company. In addition, numerous mandatory supervisory actions become immediately applicable to an undercapitalized institution, including, but not limited to, increased monitoring by regulators and restrictions on growth, capital distributions and expansion. “Significantly undercapitalized” and “critically undercapitalized” institutions are subject to more extensive mandatory regulatory actions. The OCC could also take any one of a number of discretionary supervisory actions, including the issuance of a capital directive and the replacement of senior executive officers and directors.

In addition to the increase in capital requirements set forth in the Dodd-Frank Act, federal banking agencies have the authority to impose higher capital requirements on an individual bank basis. These requirements may be greater than those set forth in the Dodd-Frank Act or that would qualify a bank as being “well capitalized” under the FDIC’s prompt corrective action regulations.

*Loans to One Borrower.* Federal law provides that savings banks are generally subject to the limits on loans to one borrower applicable to national banks. Generally, subject to certain exceptions, savings banks may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of its unimpaired capital and surplus. An additional amount may be lent, equal to 10% of unimpaired capital and surplus, if secured by specified readily-marketable collateral.

*Standards for Safety and Soundness.* The federal banking agencies have adopted Interagency Guidelines prescribing Standards for Safety and Soundness in various areas such as internal controls and information systems, internal audit, loan documentation and credit underwriting, interest rate exposure, asset growth and quality, earnings and compensation, fees and benefits. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If the OCC determines that a savings bank fails to meet any standard prescribed by the guidelines, the OCC may require the savings bank to submit an acceptable plan to achieve compliance with the standard.

*Limitation on Capital Distributions.* Federal regulations impose limitations upon all capital distributions by a savings bank, including cash dividends, payments to repurchase its shares and payments to stockholders of another institution in a cash-out merger. Under the regulations, an application to and the prior approval of the OCC is required before any capital distribution if the savings bank does not meet the criteria for “expedited treatment” of applications under OCC regulations (i.e., generally, examination and Community Reinvestment Act ratings in the two top categories), the total capital distributions for the calendar year exceed net income for that year plus the amount of retained net income for the preceding two years, the savings bank would be undercapitalized following the distribution or the distribution would otherwise be contrary to a statute, regulation or agreement with the OCC. If an application is not required, the savings bank must still provide 30 days prior written notice to the Federal Reserve Board of the capital distribution if, like Ottawa Savings Bank, it is a subsidiary of a holding company, as well as a written notice filing with the OCC. If Ottawa Savings Bank’s capital were ever to fall below its regulatory requirements or the OCC notified it that it was in need of increased supervision, its ability to make capital distributions could be restricted. In addition, the OCC could prohibit a proposed capital distribution that would otherwise be permitted by the regulation, if the agency determines that such distribution would constitute an unsafe or unsound practice.

*Qualified Thrift Lender Test.* Federal law requires savings banks to meet a qualified thrift lender test. Under the test, a savings bank is required to either qualify as a “domestic building and loan association” under the Internal Revenue Code or maintain at least 65% of its “portfolio assets” (total assets less: (i) specified liquid assets up to 20% of total assets; (ii) intangibles, including goodwill; and (iii) the value of property used to conduct business) in certain “qualified thrift investments” (primarily multi-family residential mortgages and related investments, including certain mortgage-backed securities but also including education, credit card and small business loans) in at least 9 months out of each 12 month

period.

A savings bank that fails the qualified thrift lender test is subject to certain operating restrictions. The Dodd-Frank Act also specifies that failing the qualified thrift lender test is a violation of law that could result in an enforcement action and dividend limitations. As of December 31, 2013, Ottawa Savings Bank maintained 90.5% of its portfolio assets in qualified thrift investments and, therefore, met the qualified thrift lender test.

*Transactions with Related Parties.* Federal law limits Ottawa Savings Bank's authority to lend to, and engage in certain transactions (collectively, "covered transactions") with "affiliates" (e.g., any company that controls or is under common control with an institution), including Ottawa Savings Bancorp, Inc. and Ottawa Savings Bancorp MHC). The aggregate amount of covered transactions with any individual affiliate is limited to 10% of the capital and surplus of the savings institution. The aggregate amount of covered transactions with all affiliates is limited to 20% of the savings institution's capital and surplus. Loans and other specified transactions with affiliates are required to be secured by collateral in an amount and of a type described in federal law. The purchase of low quality assets from affiliates is generally prohibited. Transactions with affiliates must be on terms and under circumstances that are at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated companies. In addition, savings banks are prohibited from lending to any affiliate that is engaged in activities that are not permissible for bank holding companies and no savings bank may purchase the securities of any affiliate other than a subsidiary.

The Sarbanes-Oxley Act of 2002 generally prohibits loans by the Company to its executive officers and directors. However, the Sarbanes-Oxley Act contains a specific exemption from such prohibition for loans by Ottawa Savings Bank to its executive officers and directors in compliance with federal banking regulations. Federal regulations require that all loans or extensions of credit to executive officers and directors of insured institutions and 10% stockholders (“insiders”), as well as entities such persons control, must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons and must not involve more than the normal risk of repayment or present other unfavorable features. The law restricts both the individual and aggregate amount of loans Ottawa Savings Bank may make to insiders based, in part, on Ottawa Savings Bank’s capital position and requires certain board approval procedures to be followed. There is an exception for loans made pursuant to a benefit or compensation program that is widely available to all employees of the institution and does not give preference to insiders over other employees. Additional restrictions apply to loans to executive officers.

*Enforcement.* The OCC has primary enforcement responsibility over federal savings banks and has the authority to bring actions against the institution and all institution-affiliated parties, including stockholders, and any attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an insured institution. Formal enforcement action may range from the issuance of a capital directive or cease and desist order, to removal of officers and/or directors, to institution of receivership, conservatorship or termination of deposit insurance. Civil penalties cover a wide range of violations and can amount to \$25,000 per day, or even \$1 million per day in especially egregious cases subject to adjustments for inflation. The Federal Deposit Insurance Corporation (“FDIC”) has authority to recommend to the OCC that enforcement action be taken with respect to a particular savings institution. If action is not taken by the OCC, the FDIC has authority to take such action under certain circumstances. Federal law also establishes criminal penalties for certain violations.

*Assessments.* Federal savings banks are required to pay assessments to the OCC to fund its operations. The general assessments, paid on a semi-annual basis, are based upon the savings bank’s total assets, including consolidated subsidiaries, as reported in the institution’s latest quarterly thrift financial report or call report, its financial condition and the complexity of its portfolio. The OCC assessments paid by Ottawa Savings Bank for the year ended December 31, 2013 was approximately \$86,000.

*Insurance of Deposit Accounts.* The Bank’s deposits are insured up to applicable limits, which are \$250,000 per depositor by the Deposit Insurance Fund (“DIF”) of the FDIC.

Under the FDIC’s risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors, with less risky institutions paying lower assessments. An institution’s assessment rate depends upon the category to which it is assigned. Effective April 1, 2009, assessment rates range from seven to 77.5 basis points. The FDIC may adjust the scale uniformly from one quarter to the next, except that no adjustment can deviate more than three basis points from the base scale without notice and comment. No institution may pay a dividend if in default of the federal deposit insurance assessment.



On February 7, 2011, the FDIC approved a final rule that implemented changes to the deposit insurance assessment system mandated by the Dodd-Frank Act. The final rule, which took effect for the quarter beginning April 1, 2011, requires that the base on which deposit insurance assessments are charged be revised from one that is based on domestic deposits to one that is based on average consolidated total assets minus average tangible equity. Under the final rule, insured depository institutions are required to report their average consolidated total assets on a daily basis, using the regulatory accounting methodology established for reporting total assets. For purposes of the final rule, tangible equity is defined as Tier 1 capital.

In addition to the assessment for deposit insurance, institutions are required to make payments on bonds issued in the late 1980s by the Financing Corporation to recapitalize a predecessor deposit insurance fund. That payment is established quarterly and during the four quarters ended December 31, 2013 averaged 0.16 basis points of assessable deposits.

The Dodd-Frank Act increased the minimum Deposit Insurance Fund ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The FDIC must seek to achieve the 1.35% ratio by September 30, 2020. Insured institution with assets of \$10.0 billion or more are supposed to fund the increase. The Dodd-Frank Act eliminated the 1.5% maximum fund ratio, instead leaving it to the discretion of the FDIC and the FDIC has recently exercised that discretion by establishing a long range fund of 2%.

The FDIC has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of Ottawa Savings Bank. Management cannot predict what insurance assessment rates will be in the future.

Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or the OCC. The management of Ottawa Savings Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

*Federal Reserve System.* The Federal Reserve Board regulations require savings associations to maintain noninterest-earning reserves against their transaction accounts (primarily Negotiable Order of Withdrawal “NOW” and regular checking accounts). The amounts are adjusted annually and, for 2013, the regulations provide that reserves be maintained against aggregate transaction accounts as follows: a 3% reserve ratio is assessed on net transaction accounts up to and including \$79.5 million; a 10% reserve ratio is applied above \$79.5 million. The first \$12.4 million of otherwise reservable balances are exempted from the reserve requirements. The Bank complies with the foregoing requirements.

*Federal Home Loan Bank System.* Ottawa Savings Bank is a member of the Federal Home Loan Bank System, which consists of twelve regional Federal Home Loan Banks. The Federal Home Loan Bank provides a central credit facility primarily for member institutions. Ottawa Savings Bank, as a member of the Federal Home Loan Bank of Chicago, is required to acquire and hold shares of capital stock in that Federal Home Loan Bank. Ottawa Savings Bank had an investment in Federal Home Loan Bank of Chicago stock at December 31, 2013 of \$1.0 million.

The Federal Home Loan Banks are required to provide funds for the resolution of insolvent thrifts in the late 1980s and to contribute funds for affordable housing programs. These requirements, as well as general financial results, could reduce the amount of dividends that the Federal Home Loan Banks pay to their members and could also result in the Federal Home Loan Banks imposing a higher rate of interest on advances to their members. If dividends were reduced, or interest on future Federal Home Loan Bank advances increased, our net interest income would likely also be reduced.

*Community Reinvestment Act.* Under the Community Reinvestment Act, as implemented by OCC regulations, a savings bank has a continuing and affirmative obligation consistent with its safe and sound operations to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The Community Reinvestment Act does not establish specific lending requirements or programs for financial institutions nor does it limit an institution’s discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the Community Reinvestment Act. The Community Reinvestment Act requires the OCC, in connection with its examination of a savings bank, to assess the institution’s record of compliance with the Community Reinvestment Act. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit

lenders from discriminating in their lending practices on the basis of characteristics specified in those statutes. A savings bank's failure to comply with the provisions of the Community Reinvestment Act could result in denial of certain corporate applications, such as branches or mergers, or restrictions on its activities. Responsibility for administering the Community Reinvestment Act, unlike other fair lending laws, is not being transferred to the Consumer Financial Protection Bureau. The Bank's most recent Community Reinvestment Act rating was "satisfactory."

## **Holding Company Regulation**

*General.* Ottawa Savings Bancorp, Inc. and Ottawa Savings Bancorp MHC are savings and loan holding companies within the meaning of federal law. As part of such, they are subject to Federal Reserve Board regulations, examinations, supervision, reporting requirements and regulations concerning corporate governance and activities. In addition, the Federal Reserve Board has enforcement authority over Ottawa Savings Bancorp, Inc. and Ottawa Savings Bancorp MHC. Among other things, this authority permits the Federal Reserve Board to restrict or prohibit activities that are determined to be a serious risk to Ottawa Savings Bank.

As part of the Dodd-Frank Act regulatory restructuring, the responsibilities of the OTS as to savings and loan holding companies were transferred to the Federal Reserve Board on July 21, 2011. The Federal Reserve Board is the agency that regulates bank holding companies.

*Restrictions Applicable to Mutual Holding Companies.* According to federal law and Federal Reserve Board regulations, a mutual holding company, such as Ottawa Savings Bancorp MHC, may generally engage in the following activities: (1) investing in the stock of a savings association; (2) acquiring a mutual association through the merger of such association into a savings association subsidiary of such holding company or an interim savings association subsidiary of such holding company; (3) merging with or acquiring another holding company, one of whose subsidiaries is a savings association; and (4) any activity approved by the Federal Reserve Board for a bank holding company or financial holding company or previously approved by the Federal Reserve Board for multiple savings and loan holding companies. In addition, mutual holding companies may engage in activities permitted for financial holding companies, expanded the authorized activities. Financial holding companies may engage in a broad array of financial service activities including insurance and securities.

Federal law prohibits a savings and loan holding company, including a federal mutual holding company, from directly or indirectly, or through one or more subsidiaries, acquiring more than 5% of the voting stock of another savings institution, or its holding company, without prior written approval of the Federal Reserve Board. Federal law also prohibits a savings and loan holding company from acquiring more than 5% of a company engaged in activities other than those authorized for savings and loan holding companies by federal law; or acquiring or retaining control of a depository institution that is not insured by the Federal Deposit Insurance Corporation. In evaluating applications by holding companies to acquire savings institutions, the Federal Reserve Board must consider the financial and managerial resources and future prospects of the company and institution involved, the effect of the acquisition on the risk to the insurance funds, the convenience and needs of the community and competitive factors.

The Federal Reserve Board is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, except: (1) the approval of interstate supervisory acquisitions by savings and loan holding companies; and (2) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

If the savings institution subsidiary of a savings and loan holding company fails to meet the qualified thrift lender test, the holding company must register with the Federal Reserve Board as a bank holding company within one year of the savings institution's failure to so qualify.

*Capital Requirements.* The Federal Reserve Board has adopted capital adequacy guidelines for bank holding companies on a consolidated basis substantially similar to those of the OCC for Ottawa Savings Bank. As of December 31, 2013, Ottawa Savings Bancorp, Inc.'s total capital and Tier 1 capital ratios exceeded these minimum capital requirements. The Dodd-Frank Act requires the Federal Reserve Board to promulgate consolidated capital requirements for depository institution holding companies that are no less stringent, both quantitatively and in terms of components of capital, than those applicable to institutions themselves. This will eliminate the inclusion of certain instruments from Tier 1 capital, such as trust preferred securities, that are currently includable for bank holding companies.

*Source of Strength.* The Dodd-Frank Act also extends the "source of strength" doctrine to savings and loan holding companies. The regulatory agencies must issue regulations requiring that all banks and savings and loan holding companies serve as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial stress.

*Dividends and Stock Repurchases.* The Federal Reserve Board has issued a policy statement regarding the payment of dividends and the repurchase of shares of common stock by bank holding companies that it has made applicable to savings and loan holding companies as well. In general, the policy provides that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the holding company appears

consistent with the organization's capital needs, asset quality and overall financial condition. Regulatory guidance provides for prior regulatory review of capital distributions in certain circumstances such as where the company's net income for the past four quarters, net of dividends previously paid over that period, is insufficient to fully fund the dividend or the company's overall rate of earnings retention is not consistent with the company's capital needs and overall financial condition. The ability of a holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. Moreover, a company should inform the Federal Reserve Board reasonably in advance of declaring or paying a dividend that exceeds earnings for the period for which the dividend is being paid. The policy statement also provides for regulatory review prior to a holding company redeeming or repurchasing regulatory capital instruments when the holding company is experiencing financial weaknesses or redeeming or repurchasing common stock or perpetual preferred stock that would result in a net reduction as of the end of a quarter in the amount of such equity instruments outstanding compared with the beginning of the quarter in which the redemption or repurchase occurred. These regulatory policies could affect the ability of the Company to pay dividends, repurchase shares of common stock or otherwise engage in capital distributions.

*Stock Holding Company Subsidiary Regulation.* The Federal Reserve Board has adopted regulations governing the two-tier mutual holding company form of organization and subsidiary stock holding companies that are controlled by mutual holding companies. Ottawa Savings Bancorp, Inc. is the stock holding company subsidiary of Ottawa Savings Bancorp MHC. Ottawa Savings Bancorp, Inc. is permitted to engage in activities that are permitted for Ottawa Savings Bancorp MHC subject to the same restrictions and conditions.

*Waivers of Dividends.* Federal Reserve Board regulations currently require mutual holding companies to notify them if they propose to waive receipt of dividends from their stock holding company subsidiary. In addition, the regulations require that the mutual holding company obtain the approval of a majority of the eligible votes of members of the mutual holding company (generally Bank depositors) before it can waive dividends. The Federal Reserve Board reviews dividend waiver notices on a case-by-case basis, and, in general, does not object to a waiver if: (i) the waiver would not be detrimental to the safe and sound operation of the savings association; and (ii) the mutual holding company's board of directors determines that their waiver is consistent with such directors' fiduciary duties to the mutual holding company's members. Subject to the non-objection or approval of the Federal Reserve Board, we anticipate that Ottawa Savings Bancorp MHC will waive dividends that Ottawa Savings Bancorp, Inc. may pay, if any.

*Conversion to Stock Form.* Federal Reserve Board regulations permit Ottawa Savings Bancorp MHC to convert from the mutual form of organization to the capital stock form of organization. In a conversion transaction, a new holding company would be formed as the successor to Ottawa Savings Bancorp MHC and Ottawa Savings Bancorp, Inc., Ottawa Savings Bancorp MHC's corporate existence would end and certain depositors in the Bank would receive a right to subscribe for shares of a new holding company. In a conversion transaction, each share of common stock of Ottawa Savings Bancorp, Inc. held by stockholders other than Ottawa Savings Bancorp MHC would be automatically converted into a number of shares of common stock of the new holding company based on an exchange ratio designed to ensure that stockholders other than Ottawa Savings Bancorp MHC own the same percentage of common stock in the new holding company as they owned in Ottawa Savings Bancorp, Inc. immediately before conversion. The total number of shares held by stockholders other than Ottawa Savings Bancorp MHC after a conversion transaction would be increased by any purchases by such stockholders in the stock offering conducted as part of the conversion transaction.

*Acquisition of Control.* Under the federal Change in Bank Control Act, a notice must be submitted to the Federal Reserve Board if any person (including a company), or group acting in concert, seeks to acquire direct or indirect "control" of a savings and loan holding company or savings bank. Under certain circumstances, a change of "control" may occur, and prior notice is required, upon the acquisition of 10% or more of the voting stock of a savings and loan holding company or savings institution, unless the Federal Reserve Board has found that the acquisition will not result in a change of control. Under the Change in Bank Control Act, the Federal Reserve Board has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the anti-trust effects of the acquisition. Any company that so acquires control would then be subject to regulation as a savings and loan holding company.

## **Federal Securities Laws**

Ottawa Savings Bancorp, Inc. common stock is registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934. Ottawa Savings Bancorp, Inc. is subject to the information, proxy solicitation, insider trading restrictions and other requirements under the Securities Exchange Act of 1934.

The registration, under the Securities Act of 1933, of the shares of common stock does not cover the resale of those shares. Shares of common stock purchased by persons who are not affiliates of Ottawa Savings Bancorp, Inc. may be resold without registration. Shares purchased by an affiliate of Ottawa Savings Bancorp, Inc. will be subject to the resale restrictions of Rule 144 under the Securities Act of 1933. If Ottawa Savings Bancorp, Inc. meets the current public information requirements of Rule 144, each affiliate of Ottawa Savings Bancorp, Inc. that complies with the other conditions of Rule 144, including those that require the affiliate's sale to be aggregated with those of other persons, would be able to sell in the public market, without registration, a number of shares not to exceed, in any three-month period, the greater of 1% of the outstanding shares of Ottawa Savings Bancorp, Inc., or the average weekly volume of trading in the shares during the preceding four calendar weeks. In the future, Ottawa Savings Bancorp, Inc. may permit affiliates to have their shares registered for sale under the Securities Act of 1933.

## **FEDERAL AND STATE TAXATION**

### **Federal Income Taxation**

*General.* We report our income on a fiscal year basis using the accrual method of accounting. The federal income tax laws apply to us in the same manner as to other corporations with some exceptions, including particularly our reserve for bad debts discussed below. The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to us. Our federal income tax returns have been either audited or closed under the statute of limitations through tax year 2009. Ottawa Savings Bank's maximum federal income tax rate was 35% for both the 2013 and 2012 tax year.

Ottawa Savings Bancorp, Inc. has filed a consolidated federal income tax return with Ottawa Savings Bank. Accordingly, it is anticipated that any cash distributions made by Ottawa Savings Bancorp, Inc. to its stockholders would be treated as cash dividends and not as a non-taxable return of capital to stockholders for federal and state tax purposes.

*Bad Debt Reserves.* For fiscal years beginning before June 30, 1996, thrift institutions that qualified under certain definitional tests and other conditions of the Internal Revenue Code were permitted to use certain favorable provisions to calculate their deductions from taxable income for annual additions to their bad debt reserve. A reserve could be established for bad debts on qualifying real property loans, generally secured by interests in real property improved or to be improved, under the percentage of taxable income method or the experience method. The reserve for non-qualifying loans was computed using the experience method. Federal legislation enacted in 1996 repealed the reserve method of accounting for bad debts for institutions with assets in excess of \$500 million and the percentage of taxable income method for all institutions for tax years beginning after 1995 and requires savings institutions to recapture or take into income certain portions of their accumulated bad debt reserves. Approximately \$1.2 million of our accumulated bad debt reserves would not be recaptured into taxable income unless Ottawa Savings Bank makes a “non-dividend distribution” to Ottawa Savings Bancorp, Inc. as described below.

*Distributions.* If Ottawa Savings Bank makes “non-dividend distributions” to Ottawa Savings Bancorp, Inc., the distributions will be considered to have been made from Ottawa Savings Bank’s un-recaptured tax bad debt reserves, to the extent of the “non-dividend distributions,” and then from Ottawa Savings Bank’s supplemental reserve for losses on loans, to the extent of those reserves, and an amount based on the amount distributed, but not more than the amount of those reserves, will be included in Ottawa Savings Bank’s taxable income. Non-dividend distributions include distributions in excess of Ottawa Savings Bank’s current and accumulated earnings and profits, as calculated for federal income tax purposes, distributions in redemption of stock, and distributions in partial or complete liquidation. Dividends paid out of Ottawa Savings Bank’s current or accumulated earnings and profits will not be so included in Ottawa Savings Bank’s taxable income.

The amount of additional taxable income triggered by a non-dividend is an amount that, when reduced by the tax attributable to the income, is equal to the amount of the distribution. Therefore, if Ottawa Savings Bank makes a non-dividend distribution to Ottawa Savings Bancorp, Inc., approximately one and one-half times the amount of the distribution not in excess of the amount of the reserves would be includable in income for federal income tax purposes, assuming a 34% federal corporate income tax rate. Ottawa Savings Bank does not intend to pay dividends that would result in a recapture of any portion of its bad debt reserves.

*Tax Allocation Agreement.* Ottawa Savings Bancorp, Inc. and Ottawa Savings Bank have executed a Tax Allocation Agreement. The purpose of this agreement is to set forth the rights and obligations of Ottawa Savings Bancorp, Inc. and Ottawa Savings Bank for purposes of filing consolidated federal and state combined income tax returns.

Under the Tax Allocation Agreement, Ottawa Savings Bancorp, Inc. and Ottawa Savings Bank calculate their federal and state income tax liabilities as if they were filing a separate tax return. If there is tax liability calculated on this separate entity basis, Ottawa Savings Bank pays that tax liability to Ottawa Savings Bancorp, Inc. Payments are made no earlier than five days prior to the time that Ottawa Savings Bancorp, Inc. is required to make either estimated or final tax payments for the consolidated or combined return. If Ottawa Savings Bank has a taxable loss for a year on a separate entity basis, and if that loss could have been carried back to obtain a refund, Ottawa Savings Bancorp, Inc.



pays an amount equal to such refund to Ottawa Savings Bank, whether or not any such refund is actually received on a consolidated or combined basis. If that taxable loss would not have resulted in a refund on a separate entity basis because there was no carry-back available, but that loss is used on the consolidated or combined return to reduce tax liability on a consolidated or combined basis, Ottawa Savings Bancorp, Inc. pays Ottawa Savings Bank an amount equal to the tax savings from using that loss.

Ottawa Savings Bank is required to contribute to Ottawa Savings Bancorp, Inc. its share of any required estimated tax payments. When the consolidated or combined return is actually filed, if the estimated payments by Ottawa Savings Bank to Ottawa Savings Bancorp, Inc. exceed the amount of Ottawa Savings Bank's tax liability on a separate entity basis, Ottawa Savings Bancorp, Inc. will refund the excess to Ottawa Savings Bank. If Ottawa Savings Bank's tax liability on a separate entity basis exceeds the estimated payments it has paid to Ottawa Savings Bancorp, Inc., Ottawa Savings Bank will pay the deficiency to Ottawa Savings Bancorp, Inc.

### **State Taxation**

Ottawa Savings Bancorp, Inc. is subject to the Illinois Income Tax and the Illinois Personal Property Tax Replacement Income Tax, at the rates of 7.0% and 2.5%, respectively, for fiscal year 2013. These amounts remained unchanged from 2012 levels. These taxes are imposed on our federal taxable income, with certain adjustments.

## **ITEM 1A. RISK FACTORS**

### **Our allowance for loan losses may prove to be insufficient to absorb potential losses in our loan portfolio.**

We established our allowance for loan losses and maintain it at a level considered adequate by management to absorb loan losses that are inherent in the portfolio. The amount of future loan losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, which may be beyond our control, and such losses may exceed current estimates. At December 31, 2013, our allowance for loan losses as a percentage of total gross loans was 2.52% and as a percentage of total non-performing loans was approximately 49.48%. Because of the concentration of one-to-four family, non-residential and commercial loans in our loan portfolio, the movement of a small number of loans to non-performing status can have a significant impact on this ratio. Although management believes that the allowance for loan losses as of December 31, 2013 was adequate to absorb losses on any existing loans that may become uncollectible, in light of the current economic environment, we cannot predict loan losses with certainty, and we cannot assure you that our allowance for loan losses will prove sufficient to cover actual loan losses in the future, particularly if economic conditions worsen beyond what management currently expects. Additional provisions to the allowance for loan losses and loan losses in excess of our allowance for loan losses may adversely affect our business, financial condition and results of operations. For additional details, see “Management’s Discussion and Analysis of Financial Condition and Results of Operation -- Comparison of Financial Condition at December 31, 2013 and December 31, 2012-- Provision for Loan Losses.”

### **Our origination or purchase of non-residential real estate, multi-family, commercial or construction loans may expose us to increased lending risks.**

Our loan portfolio includes non-residential real estate, multi-family, commercial and construction loans. We intend to continue to underwrite loans of this nature when it is prudent to do so from a business standpoint as long as the loans fall within internal policy limits and enable us to remain in compliance with regulatory guidelines and limits. These types of loans generally expose a lender to greater risk of non-payment and loss than one-to-four family residential mortgage loans because repayment of the loans often depends on the successful operation of the property and the income stream of the borrowers. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one-to-four family residential mortgage loans. Also, many of these types of borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan.

### **Fiscal challenges facing the U.S government could negatively impact financial markets which in turn could have an adverse effect on our financial position or results of operations.**

Many of our investment securities are issued by the U.S. government and government agencies and sponsored entities. As a result of uncertain domestic political conditions, including the recent federal government shutdown and potential future federal government shutdowns, the possibility of the federal government defaulting on its obligations for a period of time due to debt ceiling limitations or other unresolved political issues could pose liquidity risks due to investments in financial instruments issued or guaranteed by the federal government becoming less liquid. In 2011, Standard & Poor's lowered its long term sovereign credit rating on the U.S. from AAA to AA+. A further downgrade or a downgrade by other rating agencies, as well as sovereign debt issues facing the governments of other countries, could have a material adverse impact on financial markets and economic conditions in the U.S. and worldwide. Additionally, the U.S. government and the governments of other countries took steps to stabilize the financial system, including investing in financial institutions, and implementing programs to improve general economic conditions, but there can be no assurances that these efforts will restore long-term stability and that they will not result in adverse unintended consequences.

**FDIC deposit insurance premiums might increase, which will adversely affect our earnings.**

The recent economic recession has caused a high level of bank failures, which has dramatically increased FDIC resolution costs and led to a significant reduction in the balance of the Deposit Insurance Fund. During 2011, the FDIC modified its calculation for assessing premiums and shifted the responsibility for shoring up the shortfall in the DIF. The decrease in the base assessment rate that occurred in 2011 has decreased our deposit insurance costs from 2011 levels and positively impacted our earnings. In lieu of imposing an additional special assessment, the FDIC required all institutions to prepay their assessments for all of 2010, 2011 and 2012, which for us totaled \$1.1 million. During June 2013, our remaining balance of \$112,000 was returned. Any future increases in the base assessment rate or additional special assessments would negatively impact our earnings.

**Fluctuations in interest rates could reduce our profitability and affect the value of our assets.**

Short-term market interest rates (which we use as a guide to price our deposits) remain near historically low levels, and longer-term market interest rates (which we use as a guide to price our longer-term loans) have risen during the latter part of 2013 from historically low levels. The fact that the market yield curve had minimal movement on short-term market interest rates had a positive impact on our cost of funds. For the year ended December 31, 2013, our interest rate spread was 3.38% compared to 3.36% for the year ended December 31, 2012. If short-term interest rates rise, and if rates on our deposits re-price upwards faster than the rates on our long-term loans and investments, we would experience compression of our interest rate spread and net interest margin, which would have a negative effect on our profitability. Decreases in interest rates can result in increased prepayments of loans and mortgage-related securities, as borrowers refinance to reduce their borrowing costs. Under these circumstances, we are subject to reinvestment risk as we may have to re-deploy such loan or securities proceeds into lower-yielding assets, which might also negatively impact our income.

**Strong competition within our market area could hurt our profits and slow growth.**

We face intense competition both in making loans and attracting deposits. This competition has made it more difficult for us to make new loans and at times has forced us to offer higher deposit rates. Price competition for loans and deposits might result in us earning less on our loans and paying more on our deposits, which reduces net interest income. According to data obtained from the FDIC, as of June 30, 2013, we held approximately 5.9% of all bank and thrift deposits in LaSalle County, which was the 6<sup>th</sup> largest market share of deposits out of 24 financial institutions (excluding credit unions) in LaSalle County. Notwithstanding our market share, we face substantial competition from the other financial institutions that operate in our market area, most of which have substantially greater resources and lending limits than we have and may offer services that we do not provide. We expect competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Our profitability depends upon our continued ability to compete successfully in our market area.

**Our expansion strategy may negatively impact our earnings.**

We consider our primary market area to consist of LaSalle County, Illinois. We currently operate from our headquarters located in Ottawa, Illinois. We may expand our presence throughout our market area and pursue further expansion through the establishment of one or more branches. The profitability of any expansion policy will depend on whether the income that we generate from the additional branches we may establish will offset the increased expenses resulting from operating new branches. It may take a period of time before any new branches would become profitable, especially in areas in which we do not have an established presence. During this period, operating any new branches would likely have a negative impact on our net income.

**The loss of any one of our senior executive officers could hurt our operations.**

We rely heavily on our senior executive officers. The loss of any one of these officers could have an adverse effect on us because, as a small community bank, each of these officers has more responsibilities than would be typical at a larger financial institution with more employees. In addition, as a small community bank, we have fewer management level personnel who are in a position to assume the responsibilities of such officers' positions with us should we need to find replacements for any of these senior members of management. We do not have key-man life insurance on any of these officers.

**Our geographic concentration means that our performance may be affected by economic, regulatory and demographic conditions in our market area.**

As of December 31, 2013, most of our total loans were to individuals and/or secured by properties located in our primary market area of LaSalle County in Illinois. As a result, our revenues and profitability are subject to prevailing economic, regulatory, demographic and other conditions in LaSalle County. Because our business is concentrated in this area, adverse economic, regulatory, demographic or other developments that are limited to this area may have a disproportionately greater effect on us than they would have if we did business in markets outside that particular geographic area.

**If the value of real estate in LaSalle County, Illinois were to decline materially, a significant portion of our loan portfolio could become under-collateralized, which could have a material adverse effect on us.**

With most of our loans concentrated in LaSalle County, Illinois, a continued decline in local economic conditions could adversely affect the value of the real estate collateral securing our loans. A further decline in property values would further diminish our ability to recover on defaulted loans by selling the real estate collateral, making it more likely that we would suffer losses on defaulted loans. Additionally, decreases in asset quality have required and may require further additions to our allowance for loan losses through increased provisions for loan losses, which would hurt our profits. Also, a continued decline in local economic conditions may have a greater effect on our earnings and capital than on the earnings and capital of larger financial institutions whose real estate loan portfolios are more geographically diverse. Real estate values are affected by various factors in addition to local economic conditions, including, among other things, changes in general or regional economic conditions, governmental rules or policies and natural disasters.

**We continually encounter technological change, and we may have fewer resources than our competitors to continue to invest in technological improvements.**

The financial services industry continues to undergo rapid technological changes, with frequent introductions of new technology-driven products and services. In addition to serving customers better, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success may depend, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We cannot assure you that we will be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.

**An interruption in or breach in security of our information systems may result in a loss of customer business.**

We rely heavily on communications and information systems to conduct our business, and while we have established policies and procedures to prevent or limit the impact of system failures, interruptions, or security breaches, there can be no guarantees that such events will not occur or that they will be adequately addressed if they do. In addition, we outsource certain aspects of our data processing and other operational functions to third-party providers. If our third-party providers encounter difficulties, or if we are unable to communicate with them, our ability to adequately process and account for transactions could be affected, and our business operations could be adversely impacted. The occurrence of any failures, interruptions, or security breaches to our systems or those of our third-party providers could result in a loss of customer business, additional regulatory scrutiny, and exposure to legal liability, which would have a material adverse effect on our business, financial condition, results of operations and cash flows.

**The trading history of our common stock is characterized by low trading volume. The value of your common stock may be subject to sudden decreases due to the volatility of the price of our common stock.**

Although our common stock trades on OTC Electronic Bulletin Board, it has not been regularly traded. We cannot predict the extent to which investor interest in us will lead to a more active trading market in our common stock or how liquid that market might become. A public trading market having the desired characteristics of depth, liquidity and orderliness depends upon the presence in the marketplace of willing buyers and sellers of our common stock at any given time, which presence is dependent upon the individual decisions of investors, over which we have no control.

The market price of our common stock may be highly volatile and subject to wide fluctuations in response to numerous factors, including, but not limited to, the factors discussed in other risk factors and the following:

actual or anticipated fluctuations in our operating results;  
changes in interest rates;  
changes in the legal or regulatory environment in which we operate;  
press releases, announcements or publicity relating to us or our competitors or relating to trends in our industry;  
changes in expectations as to our future financial performance, including financial estimates or recommendations by securities analysts and investors;  
future sales of our common stock;  
changes in economic conditions in our marketplace, general conditions in the U.S. economy, financial markets or the banking industry; and  
other developments affecting our competitors or us.

These factors may adversely affect the trading price of our common stock, regardless of our actual operating performance, and could prevent you from selling your common stock at or above the price at which you purchased shares. In addition, the stock markets, from time to time, experience extreme price and volume fluctuations that may be unrelated or disproportionate to the operating performance of companies. These broad fluctuations may adversely affect the market price of our common stock, regardless of our trading performance.

**We operate in a highly regulated environment and we may be adversely affected by changes in laws and regulations.**

We are subject to extensive regulation, supervision and examination by the OCC, our chartering authority and the FDIC, as insurer of our deposits. Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp, Inc. and Ottawa Savings Bank are all subject to regulation and supervision by the Federal Reserve Board. Such regulation and supervision governs the activities in which an institution and its holding company may engage, and are intended primarily for the protection of the insurance fund and depositors. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on our operations, the classification of our assets and determination of the level of our allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on our operations.

**Recently enacted financial regulatory reform may have a material impact on our operations.**

On July 21, 2010, the President signed into law the Dodd-Frank Act. The Dodd-Frank Act restructures the regulation of depository institutions. Under the Dodd-Frank Act, the OTS, which formerly regulated the Bank, was merged into the OCC. Savings and loan holding companies, including Ottawa Savings Bancorp MHC and Ottawa Savings Bancorp, are now regulated by the Federal Reserve Board. The Dodd-Frank Act also created a new federal agency to administer consumer protection and fair lending laws, a function that was formerly performed by the depository institution regulators. The federal preemption of state laws that was formerly accorded federally chartered depository institutions has been reduced as well and State Attorneys General now have greater authority to bring a suit against a federally chartered institution, such as Ottawa Savings Bank, for violations of certain state and federal consumer protection laws. The Dodd-Frank Act also imposes consolidated capital requirements on savings and loan holding companies effective in five years, which will limit our ability to borrow at the holding company and invest the proceeds from such borrowings as capital in Ottawa Savings Bank that could be leveraged to support additional growth. The Dodd-Frank Act contains various other provisions designed to enhance the regulation of depository institutions and prevent the recurrence of a financial crisis such as occurred in 2008-2009. The full impact of the Dodd-Frank Act on our business and operations will not be known for years until regulations implementing the statute are written and adopted. The Dodd-Frank Act may have a material impact on our operations, particularly through increased regulatory burden and compliance costs.

In addition to the enactment of the Dodd-Frank Act, the federal regulatory agencies recently have begun to take stronger supervisory actions against financial institutions that have experienced increased loan losses and other weaknesses as a result of the current economic crisis. The actions include the entering into of written agreements and cease and desist orders that place certain limitations on their operations. Federal bank regulators recently have also been using with more frequency their ability to impose individual minimal capital requirements on banks, which requirements may be higher than those imposed under the Dodd-Frank Act or which would otherwise qualify the bank as being “well capitalized” under the OCC’s prompt corrective action regulations. If we were to become subject to a supervisory agreement or higher individual capital requirements, such action may have a negative impact on our



ability to execute our business plans, as well as our ability to grow, pay dividends or engage in mergers and acquisitions and may result in restrictions in our operations. See “Regulation and Supervision – Federal Banking Regulation – Capital Requirements” for a discussion of regulatory capital requirements.

The Federal Reserve Board has adopted an interim final rule which requires Ottawa Savings Bancorp, MHC to notify the Federal Reserve Board if it proposes to waive receipt of dividends from the Company. In addition, the regulations also require that Ottawa Savings Bancorp, MHC obtain the approval of a majority of the eligible votes of members of the Ottawa Savings Bancorp, MHC (generally Bank depositors) before it can waive dividends. For a grandfathered company such as Ottawa Savings Bancorp, MHC that waived dividends prior to December 1, 2009, the Federal Reserve Board may not object to a dividend waiver request if the board of directors of the mutual holding company expressly determines that a waiver of the dividend is consistent with its fiduciary duties to members and the waiver would not be detrimental to the safe and sound operation of the savings association subsidiaries of the holding company. The Federal Reserve Board’s interim final rule regarding dividend waiver requests is subject to comment and there can be no assurances as to the timing of changes to the interim final rule, if any, the form of the final dividend waiver regulations or the effect of such regulations on Ottawa Savings Bancorp, MHC’s ability to waive dividends.

While Ottawa Savings Bancorp, MHC is grandfathered for purposes of the Federal Reserve Board dividend waiver regulations, we cannot assure that the Federal Reserve Board will grant dividend waiver requests in the future and, if granted, there can be no assurance as to the conditions, if any, the Federal Reserve Board will place on future dividend waiver requests. The denial of a dividend waiver request or the imposition of burdensome conditions on an approval of a waiver request may significantly limit the amount of dividends the Company pays in the future, if any.

**The Federal Reserve Board policy on remutualization transactions could prohibit acquisition of Ottawa Savings Bancorp, which may adversely affect our stock price.**

Current Federal Reserve Board regulations permit a mutual holding company to be acquired by a mutual institution in a remutualization transaction. However, Ottawa Savings Bancorp's former regulator, the OTS, had adopted a policy statement indicating that it viewed remutualization transactions as raising significant issues concerning disparate treatment of minority stockholders and mutual members of the target entity and raising issues concerning the effect on the mutual members of the acquiring entity. The Federal Reserve Board has not adopted a similar policy statement or issued on the matter and future Federal Reserve Board regulation may negatively affect Ottawa Savings Bancorp. Under certain circumstances, the Federal Reserve Board may give these issues special scrutiny and reject applications providing for the remutualization of a mutual holding company unless the applicant can clearly demonstrate that the Federal Reserve Board's concerns are not warranted in the particular case. Should the Federal Reserve Board prohibit or otherwise restrict these transactions in the future, our per share stock price may be adversely affected.

**There can be no assurance that enacted legislation or any proposed federal programs will stabilize the U.S. financial system and such legislation and programs may adversely affect us.**

There has been much legislative and regulatory action in response to the financial crisis affecting the banking system and financial markets and threats to investment banks and other financial institutions. There can be no assurance, however, as to the actual impact that the legislation and its implementing regulations or any other governmental program will have on the financial markets. The failure of the actions by the legislators, the regulatory bodies or the U.S. government to stabilize the financial markets and a continuation or worsening of current financial market conditions could materially and adversely affect our business, financial condition, results of operations, and access to credit or the trading price of our common shares.

**The fiscal and monetary policies of the federal government and its agencies could have a material adverse effect on our earnings.**

The Board of Governors of the Federal Reserve System regulates the supply of money and credit in the United States. Its policies determine in large part the cost of funds for lending and investing and the return earned on those loans and investments, both of which affect the net interest margin. The resultant changes in interest rates can also materially decrease the value of certain financial assets we hold, such as debt securities. Its policies can also adversely affect borrowers, potentially increasing the risk that they may fail to repay their loans. Changes in Federal Reserve Board policies are beyond our control and difficult to predict; consequently, the impact these changes on our activities and results of operations is difficult to predict.

**We may be subject to more stringent capital requirements.**

In July 2013, the OCC and the Federal Reserve Board approved a new rule that will substantially amend the regulatory risk-based capital rules applicable to Ottawa Savings Bank and Ottawa Savings Bancorp, Inc. The final rule implements the “Basel III” regulatory capital reforms and changes required by the Dodd-Frank Act.

The final rule includes new minimum risk-based capital and leverage ratios, which will be effective for Ottawa Savings Bank and Ottawa Savings Bancorp, Inc. on January 1, 2015, and refines the definition of what constitutes “capital” for purposes of calculating these ratios. The new minimum capital requirements will be: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 to risk-based assets capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4%. The final rule also establishes a “capital conservation” buffer of 2.5%, and will result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7%; (ii) a Tier 1 to risk-based assets capital ratio of 8.5%; and (iii) a total capital ratio of 10.5%. The new capital conservation buffer requirement will be phased in beginning in January 2016 at 0.625% of risk-weighted assets and will increase each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations will establish a maximum percentage of eligible retained income that can be utilized for such actions.

The application of more stringent capital requirements for Ottawa Savings Bank and Ottawa Savings Bancorp, Inc. could among other things, result in lower returns on equity, require the raising of additional capital, and result in regulatory actions constraining us from paying dividends or repurchasing shares if we were unable to comply with such requirements.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

The Company is located and conducts its business at the Bank’s main office at 925 LaSalle Street, Ottawa, Illinois 61350. The Company owns the building. The Company believes that the current facility is adequate to meet its present and immediately foreseeable needs.

The following table sets forth certain information relating to this facility at December 31, 2013.

<b>Location</b>	<b>Year Opened/ Acquired</b>	<b>Net Book</b>	<b>Square Footage</b>	<b>Owned/ Leased</b>	<b>Date of Lease Expiration</b>
		<b>Value at December 31, 2013</b>			
925 LaSalle Street, Ottawa, IL 61350	1958	\$6,332,000	21,000	Owned	N/A

**ITEM 3. LEGAL PROCEEDINGS**

The Company and the Bank are not involved in any pending proceedings other than legal proceedings occurring in the ordinary course of business. Such legal proceedings, in the aggregate, are believed by management to be immaterial to the Company’s business, financial condition, results of operations and cash flows.

**ITEM 4. MINE SAFETY PROCEEDINGS**

Not applicable.

**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

The Company's common stock is traded on the Over-the-Counter ("OTC") Bulletin Board under the symbol "OTTW". At December 31, 2013, the Company had 337 record holders of its common stock. The table below shows the reported high and low sale price of the common stock, as reported on the OTC Bulletin Board and dividends declared during the periods indicated in 2013 and 2012. Quotations reflect inter-dealer prices without mark-up, mark-down or commissions, and may not represent actual transactions.

	2013		2012			
	High	Low	Dividends Declared	High	Low	Dividends Declared
First quarter	\$6.90	\$5.55	\$ -	\$5.75	\$3.11	\$ -
Second quarter	\$9.00	\$6.00	\$ -	\$12.00	\$4.25	\$ -
Third quarter	\$9.50	\$7.55	\$ -	\$8.85	\$4.75	\$ -
Fourth quarter	\$10.00	\$8.00	\$ -	\$7.85	\$5.31	\$ -

**Dividend Policy**

The Company paid no cash dividends during 2013 or 2012. On August 18, 2011, the Company announced that the Board of Directors voted to suspend the equity cash dividend on the Company's common stock in an effort to conserve capital, and that the board intended to reevaluate the payment of a quarterly dividend on a quarter-by-quarter basis. The Board of Directors will declare dividends upon consideration of a number of factors, including capital requirements, the Company's and the Bank's financial condition and results of operations, tax considerations, statutory and regulatory limitations and general economic conditions. No assurances can be given that any dividends will be paid or that, if paid, will not be reduced or eliminated in future periods. Special cash dividends, stock dividends or returns of capital may, to the extent permitted by regulations, be paid in addition to, or in lieu of, regular cash dividends. The Company has filed consolidated tax returns with the Bank. Accordingly, it is anticipated that any future cash distributions made by the Company to its stockholders would be treated as cash dividends and not as a nontaxable return of capital for federal and state income tax purposes.

Dividends from the Company will depend, in large part, upon receipt of dividends from the Bank and ability of the MHC to waive the receipt of dividends paid by the Company to its shareholders. Federal and state law imposes certain limitations on dividends by savings banks and the waiver of receipt of dividends by mutual holding companies. See “*Item 1. Business.*” and “*Item 1A. Risk Factors.*”

### Issuer Purchases

There were no shares purchased by the Company during 2013.

### ITEM 6. SELECTED FINANCIAL DATA

The following tables set forth selected financial and other data of the Company for the periods and at the dates indicated. The information should be read in conjunction with the Consolidated Financial Statements and Notes beginning on page F-2.

	At December 31,		
	2013	2012	2011
	(In Thousands, except per share data)		
Financial Condition Data:			
Total Assets	\$ 170,610	\$ 179,046	\$ 182,950
Loans, net (1)	110,673	121,995	127,972
Securities available for sale	34,547	28,864	33,007
Deposits	145,769	155,075	159,948
Stockholders' Equity	21,486	21,046	20,413
Book Value per common share	\$ 10.14	\$ 9.94	\$ 9.64

(1) Net of loans in process, deferred loan (costs) fees, and allowance for loan losses.

	Years Ended December		
	31,	2012	2011
	2013	(In Thousands, except per share data)	
Operations Data:			
Total interest and dividend income	\$ 6,952	\$ 7,919	\$ 8,567
Total interest expense	1,452	2,170	2,570

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Net interest income	5,500	5,750	5,997
Provision for loan losses	875	1,912	5,180
Other income	659	642	758
Other expense	3,815	3,536	3,770
Income tax expense (benefit)	540	270	(921 )
Net income (loss)	\$929	\$674	\$(1,274)
Basic earnings (loss) per share	\$0.45	\$0.33	\$(0.62 )
Diluted earnings (loss) per share	\$0.45	\$0.32	\$(0.62 )

	At or for the Years Ended		
	December 31,		
	2013	2012	2011
<b>Performance Ratios:</b>			
Return on average assets	0.53 %	0.37 %	(0.68 )%
Return on average stockholders' equity	4.38	3.23	(5.97 )
Average stockholders' equity to average assets	12.06	11.39	11.45
Stockholders' equity to total assets at end of period	12.59	11.75	11.16
Net interest rate spread (1)	3.38	3.36	3.43
Net interest margin (2)	3.45	3.45	3.53
Average interest-earning assets to average interest-bearing liabilities	108.42	107.01	106.61
Other expense to average assets	2.17	1.93	2.02
Efficiency ratio (3)	61.94	55.31	55.81
Dividend payout ratio	-	-	(0.16 )
<b>Regulatory Capital Ratios:</b>			
Tangible capital (to average assets)	11.32	10.30	9.38
Tier 1 core capital (to average assets)	11.32	10.30	9.38
Total risk-based capital (to risk-weighted assets)	20.79	18.19	16.76
<b>Asset Quality Ratios:</b>			
Net charge-offs (recoveries) to average gross loans outstanding	1.12	2.52	3.79
Allowance for loan losses to gross loans outstanding	2.52	2.69	3.57
Non-performing loans to gross loans	5.10	5.04	6.53
Non-performing assets to total assets (4)	3.80	4.26	5.06
<b>Other Data:</b>			
Number of full-service offices	1	1	1

- (1) The net interest rate spread represents the difference between the weighted average yield on interest-earning assets and the weighted average cost of interest-bearing liabilities.
- (2) The net interest margin represents net interest income as a percent of average interest-earning assets.
- (3) The efficiency ratio represents other expense as a percent of net interest income before the provision for loan losses and other income.
- (4) Non-performing assets consist of non-performing loans and foreclosed real estate. Non-performing loans consist of all loans 90 days or more past due and all loans no longer accruing interest.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

### General



This discussion and analysis reflects the Company's consolidated financial statements and other relevant statistical data, and is intended to enhance your understanding of our financial condition and results of operations. The information in this section has been derived from and should be read in conjunction with the consolidated financial statements and notes to the consolidated financial statements, which appear beginning on page F-2.

Our results of operations depend primarily on our net interest income. Net interest income is the difference between the interest income we earn on our interest-earning assets, consisting primarily of loans, investment securities, mortgage-backed securities and other interest-earning assets (primarily cash and cash equivalents), and the interest we pay on our interest-bearing liabilities, consisting of money market accounts, passbook savings accounts, individual retirement accounts and certificates of deposit. Our results of operations also are affected by our provisions for loan losses, non-interest income and non-interest expense. Non-interest income currently consists primarily of fees, service charges, and gains on the sale of loans. Non-interest expense currently consists primarily of salaries and employee benefits, deposit insurance premiums, directors' fees, occupancy, data processing and professional fees. Our results of operations also may be affected significantly by general and local economic and competitive conditions, changes in market interest rates, governmental policies and actions of regulatory authorities.

## Critical Accounting Policies

We consider accounting policies involving significant judgments and assumptions by management that have, or could have, a material impact on the carrying value of certain assets or on income to be critical accounting policies. We consider the allowance for loan losses and deferred income taxes to be our critical accounting policy.

*Allowance for Loan Losses.* The allowance for loan losses is an amount necessary to absorb known or inherent losses that are both probable and reasonably estimable and is established through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect each borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. 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. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

*Deferred Income Taxes.* Deferred income tax assets and liabilities are computed for differences between the financial statement and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Deferred tax assets are also recognized for operating loss and tax credit carry-forwards. Accounting guidance requires that companies assess whether a valuation allowance should be established against their deferred tax assets based on the consideration of all available evidence using a "more likely than not" standard.

Per accounting guidance, the Company reviewed its deferred tax assets at December 31, 2013 and determined that no valuation allowance was necessary. Despite the challenging economic environment, the Company has a history of strong earnings, is well-capitalized, and has positive expectations regarding future taxable income.

The deferred tax asset will be analyzed quarterly to determine if a valuation allowance is warranted. However, there can be no guarantee that a valuation allowance will not be necessary in future periods. In making such judgments, significant weight is given to evidence that can be objectively verified. In making decisions regarding any valuation allowance, the Company considers both positive and negative evidence and analyzes changes in near-term market conditions as well as other factors which may impact future operating results.

### **Comparison of Financial Condition at December 31, 2013 and December 31, 2012**

The Company's total assets decreased \$8.4 million, or 4.7%, to \$170.6 million at December 31, 2013, from \$179.0 million at December 31, 2012 due primarily to a decrease in loans caused by a combination of normal attrition, pay-downs, loan charge-offs, reduced demand for new loans, strategic initiatives to reduce lending exposure and a decline in total cash and cash equivalents. Specifically, the decrease is the result of a decrease in loans of \$11.3 million, a decrease of \$4.2 million in cash and cash equivalents, a \$0.7 million decrease in foreclosed real estate, a decrease of \$0.1 million in non-marketable equity securities, a decrease in income tax refunds receivable of \$0.2 million, a decrease to prepaid FDIC insurance premiums of \$0.2 million, and a decrease in premises and equipment of \$0.2 million due to depreciation. The decreases were partially offset by a \$5.7 million increase in securities available for sale, an increase in the cash value of life insurance of \$0.5 million, an increase of \$2.0 million in federal funds sold, an increase of \$0.2 million in deferred tax assets, and an increase of \$0.2 million in other assets.

Cash and cash equivalents decreased \$4.2 million, or 38.8%, to \$6.6 million at December 31, 2013 from \$10.8 million at December 31, 2012 primarily as a result of cash used in financing activities exceeding the cash provided by investing and operating activities.

Federal funds sold increased \$2.0 million, or 117.9%, to \$3.6 million at December 31, 2013 from \$1.7 million at December 31, 2012 primarily to increase the yield on excess cash.

Securities available for sale increased \$5.7 million, or 19.7%, to \$34.5 million at December 31, 2013 from \$28.9 million at December 31, 2012. The increase was primarily the result of purchases of \$14.1 million offset by \$7.1 million in maturities and pay-downs.

Loans, net of the allowance for loan losses, decreased \$11.3 million, or 9.3%, to \$110.7 million at December 31, 2013, from \$122.0 million at December 31, 2012. The decrease in loans, net of the allowance for loan losses, was primarily due to normal attrition and pay-downs and principal reductions exceeding the level of originations in 2013. The Company is focusing its lending efforts on customers based primarily in its local market. Additionally, in this low rate environment our customers have been aggressively accelerating principal payments. Loan demand for 2013 decreased slightly from 2012 levels, remaining low, as rates have begun to rise and difficult economic conditions continue to impact our local market.

Foreclosed real estate decreased \$0.7 million, or 54.9%, to \$0.6 million at December 31, 2013, from \$1.3 million at December 31, 2012. The decrease was primarily due to the sale of properties and the reduced level of new foreclosures, compared to 2012 when the Bank foreclosed on a relationship that had 19 properties, of which 16 of the properties were sold during 2013.

Deferred tax assets increased \$0.2 million, or 9.2%, to \$2.4 million at December 31, 2013, from \$2.2 million at December 31, 2012. The increase was primarily due to an income tax benefit related to unrealized holding losses on available for sale securities slightly offset by decreases in deferred tax assets related to net operating loss carry forwards and other deferred tax asset items.

Cash value of life insurance increased \$0.5 million, or 32.1%, to \$2.1 million at December 31, 2013, from \$1.6 million at December 31, 2012. The increase is primarily due to the purchase of an additional \$0.5 million during 2013.

Total deposits decreased \$9.3 million, or 6.0%, to \$145.8 million at December 31, 2013, from \$155.1 million at December 31, 2012. The decrease is primarily due to decreases in certificates of deposit which declined \$15.0 million, as management strategically priced our rates to position the Bank for rising rates. Checking accounts and passbook savings increased \$4.6 million and money market accounts increased \$1.1 million from December 31, 2012 to December 31, 2013 due primarily to customers moving funds into non-term products as they wait for a better rate environment.

Other liabilities increased \$0.3 million, or 13.0%, to \$3.0 million at December 31, 2013, from \$2.7 million at December 31, 2012. The increase was primarily due to increases in the accrued SERP and deferred director compensation payables totaling \$0.3 million, an increase in FDIC premiums payable of \$38,000 due to the end of the prepaid assessment period resulting in the return of excess prepayments in June 2013, and an increase in accrued employee incentive payable of \$29,000 at December 31, 2013.

Equity increased approximately \$0.4 million, or 2.1%, to \$21.5 million at December 31, 2013, from \$21.0 million at December 31, 2012. The increase in equity is primarily related to the net income for the year ended December 31, 2013 of approximately \$0.9 million, offset by a decrease in other comprehensive income of \$0.5 million related to unrealized losses on securities available for sale.

### **Comparison of Results of Operations for the Years Ended December 31, 2013 and December 31, 2012**

*General.* Net income for the year ended December 31, 2013 was \$0.9 million compared to \$0.7 million for the year ended December 31, 2012.

*Net Interest Income.* The following table summarizes interest and dividend income and interest expense for the years ended December 31, 2013 and 2012.

	<b>Years Ended December 31,</b>			
	<b>2013</b>	<b>2012</b>	<b>\$</b>	<b>%</b>
			<b>change</b>	<b>change</b>
	<b>(Dollars in thousands)</b>			
Interest and dividend income:				
Interest and fees on loans	\$6,206	\$7,028	\$ (822 )	(11.70 )%
Securities:				
Mortgage-backed and related securities	469	633	(164 )	(25.91 )
U.S. agency securities	-	38	(38 )	(100.00)
State and municipal securities	266	211	55	26.07
Non-marketable equity securities	6	5	1	20.00
Interest-bearing deposits	5	4	1	25.00
<b>Total interest and dividend income</b>	<b>6,952</b>	<b>7,919</b>	<b>(967 )</b>	<b>(12.21 )</b>
Interest expense:				
Deposits	1,452	2,170	(718 )	(33.09 )
Borrowings	-	-	-	-
<b>Total interest expense</b>	<b>1,452</b>	<b>2,170</b>	<b>(718 )</b>	<b>(33.09 )</b>
<b>Net interest income</b>	<b>\$5,500</b>	<b>\$5,749</b>	<b>\$ (249 )</b>	<b>(4.33 )%</b>

Net interest income decreased \$0.2 million, or 4.3%, for the year ended December 31, 2013 compared to the year ended December 31, 2012. Interest and dividend income decreased due to the yield on interest earning assets decreasing from 4.75% to 4.37% and average interest earning assets declining by \$7.4 million. The decline in the loan portfolio contributed to a significant portion of the change in average interest earning assets. The yield on the investment portfolio and the loan portfolio continued to decline as the low rate environment continued during 2013. This decline in interest income was partially offset by a \$0.7 million or 33.1% reduction in interest expense. The cost of funds declined 40 basis points or 28.8% in 2013 due to the low rate environment. Additionally, the average balance of interest bearing liabilities declined by \$8.8 million or 5.7%.

*Provision for Loan Losses.* Management recorded a loss provision of \$0.9 million for the year ended December 31, 2013, compared to \$1.9 million for the year ended December 31, 2012. The loss provision decrease for the year ended December 31, 2013 was reflective of a decrease in charge-offs of \$1.8 million from 2012 to 2013, and management's assessment of the risk in the loan portfolio as compared to the allowance for loan losses. Based on a review of the loans that were in the loan portfolio at December 31, 2013, management believes that the allowance is maintained at a level that represents its best estimate of inherent losses in the loan portfolio that were both probable and reasonably estimable.

Management uses available information to establish the appropriate level of the allowance for loan losses. Future additions or reductions to the allowance may be necessary based on estimates that are susceptible to change as a result

of changes in economic conditions and other factors. As a result, our allowance for loan losses may not be sufficient to cover actual loan losses, and future provisions for loan losses could materially adversely affect the Company's operating results. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize adjustments to the allowance based on their judgments about information available to them at the time of their examination.

*Other Income.* The following table summarizes other income for the years ended December 31, 2013 and 2012.

	2013	2012	\$ change	% change
<b>(Dollars in thousands)</b>				
Other income:				
Gain on sale of securities	\$-	\$14	\$ (14 )	(100.00)%
Gain on sale of loans	66	109	(43 )	(39.45 )
Gain on sale of OREO, net	-	87	(87 )	(100.00)
Origination of mortgage servicing rights, net of amortization	5	(1 )	6	600.00
Customer service fees	299	290	9	3.10
Income on bank owned life insurance	9	30	(21 )	(70.00 )
Other	280	113	167	147.79
<b>Total other income</b>	<b>\$659</b>	<b>\$642</b>	<b>\$ 17</b>	<b>2.65 %</b>

The slight increase in other income was primarily a result of the receipt in 2013 of a \$0.1 million recovery of fraud losses on consumer loans related to frauds which occurred and were expensed during 2011 and 2012, recording of the 2013 TIF reimbursement, and rental income on OREO properties. The increase was partially offset by decreases in gains on the sales of OREO, securities, loans, and reduced income on bank owned life insurance. During 2013, the Company sold 28 of its OREO properties for a net loss and during 2012 the Company sold 18 of its OREO properties for a net gain of \$87,000. The decrease in gain on sale of securities is a result of there being no securities sold during 2013, while six securities were sold for a net gain of \$14,000 during 2012. The decrease in gain on sale of loans is a result of fewer loan originations and sales of loans during 2013 as compared to 2012.

*Other Expenses.* The following table summarizes other expenses for the years ended December 31, 2013 and 2012.

	<b>Years Ended December 31,</b>			
	2013	2012	\$ change	% change
<b>(Dollars in thousands)</b>				
Other expenses:				
Salaries and employee benefits	\$1,629	\$1,502	\$ 127	8.46 %
Directors fees	101	87	14	16.09
Occupancy	455	448	7	1.56
Deposit insurance premium	189	242	(53 )	(21.90 )
Legal and professional services	274	220	54	24.55
Data processing	290	320	(30 )	(9.38 )
Valuation adjustments and expenses on foreclosed real estate	335	152	183	120.39
Loss on sale OREO	4	-	4	100.00
Loss on sale of repossessed assets	8	19	(11 )	(57.89 )



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Loss on consumer loans	-	41	(41)	)	(100.00)
Other	530	505	25		4.95
<b>Total other expenses</b>	<b>\$3,815</b>	<b>\$3,536</b>	<b>\$ 279</b>		<b>7.89 %</b>

Efficiency ratio (1) 61.94% 55.31%

(1) Computed as other expenses divided by the sum of net interest income and other income.

Total other expenses increased in 2013 by \$0.3 million, or 7.9% due primarily to increases in valuation adjustments and expenses on foreclosed real estate and increased insurance expenses, both due to the number of OREO properties, increases in salaries and employee benefits, an increase in legal and professional services due to compliance related activities, and an increase in directors fees due to the addition of one new director in late 2012. The increases were offset by decreases in deposit insurance premiums due to lower deposits, decreases in data processing costs, the absence of losses on the sale of repossessed assets, and the absence of losses on consumer loans during the 2013 as compared to 2012. The efficiency ratio increased primarily due to higher costs for the period.

*Income Taxes.* The Company recorded an income tax expense of \$0.5 million for the year ended December 31, 2013, compared to \$0.3 million for the year ended December 31, 2012. The effective tax rates for the years ended December 31, 2013 and 2012 were 36.76% and 28.61%, respectively.

**Average Balance Sheet**

The following table presents for the periods indicated the total dollar amount of interest income from average interest earning assets and the resultant yields, as well as the interest expense on average interest bearing liabilities, expressed both in dollars and rates. No tax equivalent adjustments were made. All average balances are monthly average balances. Non-accruing loans have been included in the table as loans carrying a zero yield. The amortization of loan fees is included in computing interest income; however, such fees are not material.

	<b>Year Ended December 31,</b>											
	<b>2013</b>				<b>2012</b>				<b>2011</b>			
	<b>(Dollars in Thousands)</b>											
	<b>AVERAGE</b>			<b>AVERAGE</b>			<b>AVERAGE</b>			<b>AVERAGE</b>		
	<b>INTEREST/YIELD/</b>			<b>INTEREST/YIELD/</b>			<b>INTEREST/YIELD/</b>			<b>INTEREST/YIELD/</b>		
	<b>BALANCE</b>			<b>BALANCE</b>			<b>BALANCE</b>			<b>BALANCE</b>		
	<b>COST</b>			<b>COST</b>			<b>COST</b>			<b>COST</b>		
<b>ASSETS</b>												
Interest-earning assets												
Securities, net (1)	\$33,450	\$735	2.20 %	\$32,457	\$882	2.72 %	\$32,807	\$1,058	3.22 %			
Loans receivable, net (2)	115,587	6,206	5.37 %	125,478	7,028	5.60 %	130,283	7,503	5.76 %			
Non-marketable equity securities	1,267	6	0.47 %	1,689	5	0.30 %	2,535	3	0.12 %			
Other investments	8,916	5	0.06 %	6,977	4	0.06 %	4,394	3	0.07 %			
Total interest-earning assets	159,220	\$6,952	4.37 %	166,601	\$7,919	4.75 %	170,019	\$8,567	5.04 %			
Non-interest-earning assets	16,467			16,577			16,512					
<b>TOTAL ASSETS</b>	<b>\$175,687</b>			<b>\$183,178</b>			<b>\$186,531</b>					
<b>LIABILITIES AND EQUITY</b>												
Interest-bearing liabilities												
Money Market accounts	\$20,837	\$51	0.24 %	\$20,369	\$85	0.42 %	\$20,544	\$129	0.63 %			
Savings accounts	16,642	14	0.08 %	15,026	20	0.13 %	13,444	16	0.12 %			
Certificates of Deposit accounts	95,916	1,381	1.44 %	107,805	2,055	1.91 %	114,205	2,410	2.11 %			
Checking accounts	13,465	6	0.04 %	12,493	10	0.08 %	11,282	15	0.13 %			
Total interest-bearing liabilities	146,860	1,452	0.99 %	155,693	2,170	1.39 %	159,475	2,570	1.61 %			
Non-interest-bearing liabilities	7,638			6,612			5,699					
<b>TOTAL LIABILITIES</b>	<b>154,498</b>			<b>162,305</b>			<b>165,174</b>					
<b>EQUITY</b>	<b>21,189</b>			<b>20,873</b>			<b>21,357</b>					
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$175,687</b>			<b>\$183,178</b>			<b>\$186,531</b>					

<b>NET INTEREST INCOME</b>	\$5,500	\$5,749	\$5,997
<b>NET INTEREST RATE SPREAD (3)</b>	3.38 %	3.36 %	3.43 %
<b>NET INTEREST MARGIN (4)</b>	3.45 %	3.45 %	3.53 %
<b>RATIO OF AVERAGE INTEREST-EARNING ASSETS TO AVERAGE INTEREST-BEARING LIABILITIES</b>	108.42 %	107.01 %	106.61 %

(1)Includes unamortized discounts and premiums.

Amount is net of deferred loan origination (costs) fees, undisbursed loan funds, unamortized discounts and allowance for loan losses and includes non-performing loans. Loan fees included in interest income were \$135,000, \$189,000, and \$301,000 for 2013, 2012, and 2011, respectively.

(2)Net interest rate spread represents the difference between the yield on average interest-earning assets and the average cost of interest-bearing liabilities.

(3)Net interest margin represents net interest income divided by average interest-earning assets.

## Rate/Volume Analysis

The following table shows the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. It distinguishes between the changes related to changes in outstanding balances and those due to the changes in interest rates. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (i.e., changes in volume multiplied by old rate) and (ii) changes in rate (i.e., changes in rate multiplied by old volume). For purposes of this table, changes attributable to both rate and volume, which cannot be segregated, have been allocated proportionately to the change due to volume and the change due to rate.

	Year Ended December 31, 2013 COMPARED TO 2012		2012 COMPARED TO 2011		
	INCREASE (DECREASE) DUE TO		INCREASE (DECREASE) DUE TO		
	VOLUME		RATE		NET
	(Dollars in Thousands)				
Interest earned on					
Securities, net	\$22	\$(169 )	\$(147)	\$(10 )	\$(166 )
Loans receivable, net	(531)	(291 )	(822)	(269)	(475)
Non-marketable equity securities	(2 )	3	1	(3 )	2
Other investments	1	(0 )	1	2	(1 )
Total interest-earning assets	\$(510)	\$(457 )	\$(967)	\$(280)	\$(368 )
Interest expense on					
Money Market accounts	\$1	\$(35 )	\$(34 )	\$(1 )	\$(43 )
Passbook savings accounts	1	(7 )	(6 )	2	2
Certificates of Deposit accounts	(171)	(503 )	(674)	(122)	(233 )
Checking accounts	-	(4 )	(4 )	1	(6 )
Total interest-bearing liabilities	(169)	(549 )	(718)	(120)	(280 )
Change in net interest income	\$(341)	\$92	\$(249)	\$(160)	\$(88 )

## Management of Market Risk

*General.* The majority of our assets and liabilities are monetary in nature. Consequently, our most significant form of market risk is interest rate risk. Our assets, consisting primarily of residential mortgage loans, have longer maturities than our liabilities, consisting primarily of deposits. As a result, a principal part of our business strategy is to manage interest rate risk and reduce the exposure of our net interest income to changes in market interest rates. Accordingly,

our Board of Directors has established an Asset/Liability Management Committee which is responsible for evaluating the interest rate risk inherent in our assets and liabilities, for determining the level of risk that is appropriate given our business strategy, operating environment, capital, liquidity and performance objectives, and for managing this risk consistent with the guidelines approved by the Board of Directors. Senior management monitors the level of interest rate risk on a regular basis and the Asset/Liability Management Committee, which consists of senior management operating under a policy adopted by the Board of Directors, meets as needed to review our asset/liability policies and interest rate risk position.

We have sought to manage our interest rate risk in order to limit the exposure of our earnings and capital to changes in interest rates. In an attempt to accomplish this, we offer a variety of loan products, some of which are based on the prime rate and some loan products that adjust on one- to-five year intervals, based on various indices including the prime rate and U.S. Treasury securities. To shorten asset duration, we purchase auto loans, which are usually four to five years in length, as well as balance our investment purchases to ensure extension risk is minimized. In addition, we have attempted to lengthen the maturities of our deposit accounts by offering proportionately higher interest rates for longer terms, 3-5 year certificate accounts and by increasing our core deposits, in which the overall balances are generally less volatile to interest rate fluctuations than certificate accounts.

For additional information on our risk management strategy, see the sections entitled, “Item 1. Business – Delinquent Loans,” “Item 1. Business – Nonperforming Assets,” “Item 1. Business Ratios,” and “Item 1. Business - Allowance for Loan Losses.”

*Net Portfolio Value.* The net present value of an institution's cash flow from assets, liabilities and off balance sheet items (the institution's net portfolio value or "NPV") would change in the event of a range of assumed changes in market interest rates. For periods subsequent to December 31, 2011, institutions are responsible for valuing their own portfolios, or arranging to obtain the required information from a third-party provider. The model utilized by the Company's third-party provider utilizes a discounted cash flow analysis and an option-based pricing approach to measuring the interest rate sensitivity of net portfolio value. The model estimates the economic value of each type of asset, liability and off-balance sheet contract under the assumption that the United States Treasury yield curve increases by 100 to 300 basis points, or decreases by 100 basis points instantaneously. A basis point equals one-hundredth of one percent, and 100 basis points equals one percent. An increase in interest rates from 3% to 4% would mean, for example, a 100 basis point increase in the "Change in Interest Rates" column below.

The tables below set forth, as of the periods indicated, net portfolio value, the estimated changes in our net portfolio value that would result from the designated instantaneous changes in the United States Treasury yield curve.

**Year Ended December 31, 2013**

						<b>Net Portfolio Value As A</b>
						<b>Percentage Of Present Value Assets</b>
						<b>Net Portfolio Value</b>
						<b>Change In</b>
<b>Interest</b>	<b>Estimated</b>	<b>Amount</b>	<b>Percent</b>	<b>NPV</b>	<b>Change</b>	
<b>Rates</b>	<b>NPV</b>	<b>Of</b>	<b>Of</b>	<b>Ratio</b>	<b>Basis</b>	
<b>(Basis</b>		<b>Change</b>	<b>Change</b>		<b>Points</b>	
<b>Points)</b>						
<b>(Dollars In Thousands)</b>						
+300	\$14,254	\$(9,010 )	-38.73 %	9.18 %	(431 )	
+200	17,036	(6,228 )	-26.77 %	10.60 %	(289 )	
+100	20,341	(2,923 )	-12.56 %	12.20 %	(129 )	
0	23,264	-	-	13.49 %	-	
-100	25,797	2,533	10.89 %	14.60 %	111	

**Year Ended December 31, 2012**

		<b>Net Portfolio Value As A</b>
		<b>Percentage Of Present Value Assets</b>
		<b>Net Portfolio Value</b>

**Change In**

<b>Interest Rates</b> <b>(Basis Points)</b>	<b>Estimated NPV</b>	<b>Amount Of Change</b>	<b>Percent Of Change</b>	<b>NPV Ratio</b>	<b>Change In Basis Points</b>
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**Points)****(Dollars In Thousands)**

+300	\$12,481	\$ (9,666 )	-43.64 %	7.73 %	(467 )
+200	15,529	(6,618 )	-29.88 %	9.30 %	(310 )
+100	18,787	(3,360 )	-15.17 %	10.88 %	(152 )
0	22,147	-	-	12.40 %	-
-100	24,822	2,675	12.00 %	13.56 %	116

The table above indicates that at December 31, 2013, in the event of a 100 basis point increase in interest rates, we would experience a decrease of approximately 12.6% in net portfolio value. In the event of 200 basis point increase in interest rates, we would experience a decrease of approximately 26.8% in net portfolio value. For a 300 basis point increase in interest rates, we would experience a decrease value of approximately 38.7% in net portfolio value.

Certain shortcomings are inherent in the methodology used in the above interest rate risk measurement. Modeling changes in net portfolio value requires making certain assumptions that may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the net portfolio value table presented assumes that the composition of our interest-sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration or re-pricing of specific assets and liabilities. Accordingly, although the net portfolio value table provides an indication of our interest rate risk exposure at a particular point in time, such measurements are not intended to and do not provide a precise forecast of the effect of changes in market interest rates on our net interest income and will differ from actual results.

## Liquidity and Capital Resources

We maintain liquid assets at levels we believe are adequate to meet our liquidity needs. Our liquidity ratio averaged 7.2% for the year ended December 31, 2013 compared to 5.7% for the year ended December 31, 2012. We adjust our liquidity levels to fund deposit outflows, pay real estate taxes on mortgage loans, repay our borrowings, and to fund loan commitments. We also adjust liquidity as appropriate to meet asset and liability management objectives.

Our primary sources of liquidity are deposits, amortization and prepayment of loans and mortgage-backed securities, maturities of investment securities, other short-term investments, earnings, and funds provided from operations. While scheduled principal repayments on loans and mortgage-backed securities are a relatively predictable source of funds, deposit flows and loan prepayments are greatly influenced by market interest rates, economic conditions, and rates offered by our competition. We set the interest rates on our deposits to maintain a desired level of total deposits. In addition, we invest excess funds in short-term interest-earning assets, which provide liquidity to meet lending requirements.

Our cash flows are derived from operating activities, investing activities and financing activities as reported in our Consolidated Statements of Cash Flows included with the Consolidated Financial Statements which begin on page F-2 of this Form 10-K.

Our primary investing activities are the origination and purchase of one-to-four family, non-residential and multi-family real estate and other loans, including loans originated for sale, and the purchase of investment securities. For the years ended December 31, 2013 and 2012, our loan originations totaled \$16.7 million and \$17.9 million, respectively. For the years ended December 31, 2013 and 2012, we purchased loans totaling \$4.0 million and \$5.8 million, respectively. For the years ended December 31, 2013 and 2012, we received \$5.4 million and \$8.4 million, respectively, from the sale of loans, resulting in gains of \$66,000 and \$109,000, respectively. Cash received from the sales, calls, maturities and pay-downs on securities totaled \$7.1 million and \$12.1 million for the years ended December 31, 2013 and 2012 respectively. We purchased \$14.1 million and \$8.4 million in securities for the years ended December 31, 2013 and 2012, respectively. For a more detailed breakdown of our loan activity, see the section entitled "*Item 1. Business-Loan Origination, Purchase and Sales.*"

Deposit flows are generally affected by the level of interest rates, the interest rates and products offered by local competitors, and other factors. Deposits decreased \$9.3 million for the year ended December 31, 2013 and decreased \$4.9 million for the year ended December 31, 2012. For a more detailed breakdown of our deposit activity, see the section entitled "*Item 1. Business-Deposit Activities and Other Sources of Funds.*"



Liquidity management is both a daily and long-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the Federal Home Loan Bank of Chicago ("FHLBC") to provide advances and with Bankers Bank of Wisconsin to purchase Federal Funds. As a member of the FHLBC, we are required to own capital stock in the Federal Home Loan Bank of Chicago and are authorized to apply for advances on the security of such stock and certain of our mortgage loans and other assets (principally securities which are obligations of, or guaranteed by, the United States), provided certain standards related to credit-worthiness have been met. We had an available borrowing limit of \$50.4 million and \$53.0 million from the FHLBC as of December 31, 2013 and 2012, respectively. In addition, as of December 31, 2013, the Bank had \$5.0 million of available credit from Bankers Bank of Wisconsin to purchase Federal Funds. There were no Federal Home Loan Bank advances and no Federal Funds purchased outstanding at December 31, 2013 and 2012.

At December 31, 2013 we had outstanding commitments to originate loans of \$6.8 million, unfunded commitments under lines of credit of \$8.0 million, unfunded commitments on construction loans of \$1.7 million, and no unfunded standby letters of credit. At December 31, 2013, certificates of deposit scheduled to mature in less than one year totaled \$38.5 million. Based on prior experience, management believes that a significant portion of such deposits will remain with us, although there can be no assurance that this will be the case. In the event a significant portion of our deposits are not retained by us, we will have to utilize other funding sources, such as FHLBC advances, in order to maintain our level of assets. Alternatively, we could reduce our level of liquid assets, such as our cash and cash equivalents. In addition, the cost of such deposits may be significantly higher if market interest rates are higher at the time of renewal.

The Company is a separate legal entity from Ottawa Savings Bank and must provide for its own liquidity. In addition to its operating expenses, the Company is responsible for paying any dividends declared to its shareholders, and interest and principal on outstanding debt, if any. The Company also has repurchased shares of its common stock. The Company's primary source of income is dividends received from Ottawa Savings Bank. The amount of dividends that Ottawa Savings Bank may declare and pay to the Company in any calendar year, without the receipt of prior approval from the Federal Reserve Board, but with prior notice to the Federal Reserve Board, cannot exceed net income for that year to date plus retained net income (as defined) for the preceding two calendar years. At December 31, 2013, the Company had liquid assets of \$312,000.

## **Off-Balance Sheet Arrangements and Contractual Obligations**

For the year ended December 31, 2013, the Company did not engage in any off-balance sheet transactions reasonably likely to have a material adverse effect in its financial condition, results of operations or cash-flows.

## **Recent Accounting Pronouncements**

In February, 2013, the FASB issued ASU No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. The Update improves the reporting of reclassifications out of accumulated other comprehensive income by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP) to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. The adoption of ASU No. 2013-02 on January 1, 2013 did not have an impact on the Company's financial position, results of operation or cash flows.

In January 2014, the FASB issued ASU No. 2014-04, *Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. The update clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (i) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (ii) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar agreement. In addition, the update requires disclosure of both the amount of foreclosed residential real estate property held by the creditor and the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure in accordance with local requirements of the applicable jurisdiction. An entity can elect to adopt the amendments using either a modified retrospective method or a prospective transition method. The amendments are effective for annual and interim periods beginning after December 15, 2014, with early adoption permitted. The Company does not expect the adoption of this update to have a significant impact on its financial position, results of operation or cash flows.

## **Impact of Inflation and Changing Prices**

The consolidated financial statements and related notes of the Company have been prepared in accordance with GAAP, which generally requires the measurement of financial position and operating results in terms of historical dollars without consideration for changes in the relative purchasing power of money over time due to inflation. The

impact of inflation is reflected in the increased cost of our operations. Unlike industrial companies, our assets and liabilities are primarily monetary in nature. As a result, changes in market interest rates have a greater impact on performance than the effects of inflation.

#### **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information required by this item is incorporated herein by reference to Part II, Item 7, “*Management’s Discussion and Analysis of Financial Condition and Results of Operation.*”

#### **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The information required by this Item 8 is contained on pages F-2 through F-45 of this Form 10-K.

#### **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

## **ITEM 9A. CONTROLS AND PROCEDURES**

### **(a) Disclosure Controls and Procedures**

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision, and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our “disclosure controls and procedures” as contemplated by Exchange Act Rule 13a-15. Based upon their evaluation, and as of the end of the period covered by this report, the Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures are effective, in all material respects, in timely alerting them to material information relating to the Company (and its consolidated subsidiary) required to be included in the periodic reports the Company is required to file and submit to the SEC under the Exchange Act.

### **(b) Internal Controls Over Financial Reporting**

Management’s annual report on internal control over financial reporting is incorporated herein by reference to page 46 of this Annual Report on Form 10-K.

### **(c) Changes to Internal Controls Over Financial Reporting**

There were no changes in the Company's internal control over financial reporting identified in connection with the evaluation required by Exchange Act Rule 13a-15(d) that occurred during the fourth quarter of 2013 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **ITEM 9B. OTHER INFORMATION**

None.

## **PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE**

The Company's Board of Directors consists of six members and is divided into three classes with three-year staggered terms, with one-third of the directors elected each year.

Information regarding the directors of the Company is set forth below. Unless otherwise stated, each director has held his or her current occupation for the last five years. The age indicated for each individual is as of December 31, 2013. There are no family relationships among the directors or executive officers. The indicated period of service as a director includes service as a director of the Bank.

**Directors with Terms Ending in 2014:**

*John M. Armstrong* is a Principal at Armstrong & Associates, a registered investment advisory firm, in Ottawa, Illinois. Age 57. Director since 2012.

As a Certified Public Accountant and Certified Financial Planner, Mr. Armstrong provides the Board of Directors with experience regarding accounting and financial matters. Additionally, as a lifelong resident of Ottawa, Illinois, Mr. Armstrong has been actively involved in various community organizations, having served on the Board of the Ottawa Elementary School District and the Illinois Valley Fine Arts Trust and as a committee member with the United Way.

**Jon Kranov** has been employed with Ottawa Savings Bank since 1978 and has served as President of Ottawa Savings Bank, Ottawa Savings Bancorp and Ottawa Savings Bancorp MHC since May 2010. He is currently the Chairman of the Bank's Board of Directors and attends all committee meetings of the Board of Directors in his capacity as such. Mr. Kranov served as the Senior Vice President and Chief Financial Officer of the Bank from 1996 until May 2010 and 1996 until December 2011, respectively. He served in the positions of Senior Vice President and Chief Financial Officer of Ottawa Savings Bancorp and Ottawa Savings Bancorp MHC from 2005 until May 2010 and 2005 until December 2010, respectively. Mr. Kranov has an undergraduate degree in Accounting from Western Illinois University and has received a Masters Degree in Finance and Human Relations from Lewis University. Age 59. Director since May 2010.

Mr. Kranov's involvement in the Bank's and Company's local community affords the Board valuable insight regarding the business and operation of the Bank and the Company. Mr. Kranov's experience as Chief Financial Officer and knowledge of the various financial and accounting issues facing public companies in the banking sector, as well as his long history with the Bank and the Company, position him well as our President and Chief Executive Officer.

#### **Directors with Terms Ending in 2015:**

**Arthur C. Mueller** is the President of Mueller Funeral Homes, Inc. Age 60. Director since 1987.

As a lifelong and 6<sup>th</sup> generation resident of LaSalle County, Mr. Mueller has been actively involved in various community organizations, having served on the Board of Ottawa Regional Hospital and Healthcare Center and the Chamber of Commerce and as a member of Rotary International. With five funeral home locations in LaSalle County, Mr. Mueller has extensive ties to the Bank's and the Company's market area, as well as valuable leadership experience that he brings to the Board of Directors.

**Daniel J. Reynolds** is the co-owner of H.R. Imaging, Inc., a photography business in Ottawa, Illinois. Age 67. Director since 2003.

As a lifelong resident of Ottawa, Illinois who is actively involved in various community organizations, Mr. Reynolds has in-depth knowledge of the Bank's and the Company's market area. Additionally, Mr. Reynolds involvement in real estate development has given him knowledge of the local real estate industry, and his experience as a small business owner has given him organizational understanding and management expertise that he brings to the Board of Directors.

**Directors with Terms Ending in 2016:**

**James A. Ferrero** retired from LaSalle County Housing Authority as of December 31, 2005. He is the owner and president of a package store in Ottawa, Illinois. Age 64. Director since 2000. As a lifelong resident of Ottawa, Illinois who is actively involved in various community organizations, like the Chamber of Commerce, Mr. Ferrero has developed extensive ties to the market area in which the Bank and Company operate. Additionally, Mr. Ferrero's education in finance and experience as a small business owner have provided him with financial experience and expertise that is valuable to the Board of Directors.

**Keith F. Johnson** is the co-owner of Johnson Pattern and Machine Co. in Ottawa, Illinois. Age 60. Director since 2001. As a lifelong resident of Ottawa, Illinois who is actively involved in various community organizations, Mr. Johnson has in-depth knowledge of the market area in which the Bank and Company operate. Mr. Johnson's service as an elected Commissioner of our local government has provided him with leadership and managerial skills, which are valuable to the Board of Directors.

**Executive Officers Who are Not Also Directors:**

Below is information regarding our officers who are not also directors. Each officer has held his current position for at least the last five years, unless otherwise stated. Ages presented are as of December 31, 2013.

**Philip B. Devermann** has served as the Vice President of Ottawa Savings Bank since 1996. Mr. Devermann has served as the Vice President of Ottawa Savings Bancorp and Ottawa Savings Bancorp MHC since 2005. He has been employed with Ottawa Savings Bank since 1979. Mr. Devermann has an undergraduate degree in finance from Eastern Illinois University. Age 63.

**Marc N. Kingry** has served as the Chief Financial Officer of Ottawa Savings Bank, Ottawa Savings Bancorp and Ottawa Savings Bancorp MHC since December 2010. Prior to 2010, Mr. Kingry was Senior Vice President and Controller at a bank in Ottawa, Illinois since 2002. Mr. Kingry has an undergraduate degree in accountancy and has received a Masters Degree in Accounting from Illinois State University. He is a licensed Certified Public Accountant. Age 51.

### **Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's executive officers and directors, and persons who own more than 10% of any registered class of the Company's equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Executive officers, directors and greater than 10% shareholders are required by regulation to furnish the Company with copies of all Section 16(a) reports they file.

Based solely on its review of the copies of the reports it has received and written representations provided to the Company from the individuals required to file the reports, the Company believes that each of its executive officers and directors has complied with applicable reporting requirements for transactions in Ottawa Savings Bancorp common stock during the year ended December 31, 2013.

### **Code of Ethics**

The Company has adopted a Code of Ethics and Business Conduct that is designed to ensure that the Company's directors, executive officers and employees meet the highest standards of ethical conduct. The Code of Ethics and Business Conduct requires that the Company's directors, executive officers and employees avoid conflicts of interest, comply with all laws and other legal requirements, conduct business in an honest and ethical manner and otherwise act with integrity and in the Company's best interest. Under the terms of the Code of Ethics and Business Conduct, directors, executive officers and employees are required to report any conduct that they believe in good faith to be an actual or apparent violation of the Code.

As a mechanism to encourage compliance with the Code of Ethics and Business Conduct, the Company has established procedures to receive, retain and treat complaints received regarding accounting, internal accounting controls or auditing matters. These procedures ensure that individuals may submit concerns regarding questionable accounting or auditing matters in a confidential and anonymous manner. The Code of Ethics and Business Conduct also prohibits the Company from retaliating against any director, executive officer or employee who reports actual or apparent violations of the Code.

A copy of the Code of Ethics and Business Conduct is available without charge, upon written request to c/o Corporate Secretary, 925 LaSalle Street, Ottawa, Illinois 61350.

### **Corporate Governance**



The following table identifies our standing committees and their members as of December 31, 2013. All members of each committee are independent in accordance with the listing standards of the NASDAQ Stock Market.

<b>Director</b>	<b>Audit Committee</b>	<b>Nominating and Corporate Governance Committee</b>	<b>Compensation Committee</b>	<b>Assets and Liability Committee</b>
John M. Armstrong	X	X	X	X
James A. Ferrero	X*	X	X	X
Keith F. Johnson	X	X	X*	X*
Arthur C. Mueller	X	X	X	X
Jon Kranov				X
Daniel J. Reynolds	X	X*	X	X
<i>Number of Meetings in 2013</i>	5	1	6	4

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\* Chairman

**Audit Committee.** The Audit Committee meets periodically with the independent registered public accounting firm and management to review accounting, auditing, internal control structure and financial reporting matters. The board of directors has determined that James A. Ferrero is an “audit committee financial expert,” as such term is defined by the rules and regulations of the Securities and Exchange Commission. Mr. Ferrero is independent under the listing standards of the Nasdaq Stock Market. The Audit Committee acts under a written charter, a copy of which is available on the Company’s website at [www.ottawasavings.com](http://www.ottawasavings.com).

**Compensation Committee.** The Compensation Committee is responsible for human resource policies, salaries and benefits, incentive compensation, executive development and management succession planning. It also handles policies relating to nondiscriminatory employment practices, including those related to hiring, compensation and promotion. The Compensation Committee reviews all compensation components for the Company's President and Chief Executive Officer including annual salary, bonus, stock options, and other direct and indirect benefits, as well as reviews the Company's executive and employee compensation programs, and director compensation. The Committee considers the performance of the Company, shareholder return, competitive market values, and the compensation given to the President and Chief Executive Officer over recent years when determining appropriate compensation for the President and Chief Executive Officer. In setting executive compensation, the Committee ensures that a significant portion of compensation is connected to the long-term interest of shareholders. In its oversight of employee compensation programs, prior to making its recommendation to the Board, the Committee reviews recommendations from the President and Chief Executive Officer and Human Resources Manager. Decisions by the Compensation Committee with respect to the compensation levels are approved by the full Board of Directors. The Compensation Committee acts under a written charter. A copy of the Compensation Committee charter is not available on the Company's website. A copy of the Compensation Committee charter was attached as Appendix A to the Company's 2013 Proxy Statement and is publicly available on the Securities and Exchange Commission's website.

**Nominating and Corporate Governance Committee.** The Nominating and Corporate Governance Committee is responsible for the annual selection of the Board of Directors' nominees for election as directors and developing and implementing policies and practices relating to corporate governance, including implementation of and monitoring adherence to Ottawa Savings Bancorp's corporate governance policy. The Nominating and Corporate Governance Committee acts under a written charter adopted by the Board of Directors. A copy of the Nominating and Corporate Governance Committee charter is not available on the Company's website. A copy of the Nominating and Corporate Governance Committee charter was attached as Appendix B to the Company's 2013 Proxy Statement and is publicly available on the Securities and Exchange Commission's website.

## ITEM 11. EXECUTIVE COMPENSATION

### Summary Compensation Table

The following information is furnished for all individuals serving as the principal executive officer of the Company for the two most recently completed fiscal years and the next two most highly compensated executive officers of the Company whose total compensation for 2013 fiscal year exceeded \$100,000.

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards	Option Awards	Nonequity Incentive Plan	All Other Compensation	Total Compensation (\$)
--------------------------------	------	----------------	---------------	-----------------	------------------	-----------------------------	---------------------------	-------------------------------

									tion
									(\$)(2)
Jon Kranov									
<i>President and Chief</i>	2013	176,500	—	—	—	34,258		40,107	250,865
<i>Executive Officer</i>	2012	166,650	—	—	—	31,211		35,235	233,096
Philip B. Devermann									
<i>Vice President</i>	2013	124,500	—	—	—	18,124		15,753	158,377
	2012	120,848	—	—	—	16,998		13,050	150,896
Marc N. Kingry									
<i>Chief Financial Officer</i>	2013	101,145	—	—	—	16,013		12,417	129,575
	2012	93,425	—	—	—	13,143		7,891	114,459

(1) Represents payments made pursuant to the Employee Incentive Compensation Plan. Awards earned during 2013 were paid in March 2014.

(2) Details of the amounts reported in “All Other Compensation” for 2013 are provided in the table below. All perquisites, which, in the aggregate, were less than \$10,000 for an individual were excluded from “All Other Compensation.”

	Mr. Kranov	Mr. Devermann	Mr. Kingry
Board of Director fees	\$ 16,800	\$ —	\$ —
Employee stock ownership plan allocation	8,613	5,679	4,999
Fair market value of Employer contributions to 401(k) Plan	12,462	8,490	6,857
Dividends received on Stock Awards	105	—	—
Auto	1,095	—	—
Life insurance	1,032	1,584	561

### Salary Continuation Agreements

Ottawa Savings Bank has entered into a Salary Continuation Agreement with each of Jon Kranov and Philip B. Devermann.



Under the Salary Continuation Agreements, if Mr. Kranov's or Mr. Devermann's employment with the Bank terminates (1) on or after his 65<sup>th</sup> birthday; (2) subsequent to a change in control (as defined in each agreement); (3) on account of a disability; or (4) because of death, they will be entitled to receive \$25,258 and \$27,480, respectively, per year for 20 years commencing at the later of age 65 or the date of his termination of employment. The executive may elect, subject to the requirements of Section 409A of the Internal Revenue Code, to receive a lump sum payment that is actuarially equivalent to the normal retirement benefit. If the executive terminates employment before his 65<sup>th</sup> birthday for reasons other than cause, death or disability, and not subsequent to a change in control, he will receive a reduced benefit, which varies depending on the date of termination. The executive will forfeit his entitlement to all benefits under the Agreement if his employment with the Bank is terminated for cause as specified in his Agreement.

### Employee Incentive Compensation Plan

The Employee Incentive Compensation Plan (the "EIP") is an annual, variable compensation program designed to encourage participants to produce results that enable the Bank to reach targeted levels of performance for the fiscal year. The EIP is also meant to reward sound banking practices.

The cash incentive opportunities noted below are shown as a percentage of base salary. See "*Summary Compensation Table*" for the 2013 base salaries and the actual 2013 payouts under the EIP.

Role	2013 EIP Incentive Opportunities					
	Threshold (90% of Threshold Target)		Target (100%)	Stretch (110% of Target)		
Chief Executive Officer	0%	10.0	%	20.0	%	30.0 %
Chief Financial Officer	0	7.5		15.0		22.5
Vice President	0	7.5		15.0		22.5

For fiscal year 2013 the Chief Executive Officer and Compensation Committee Chairman identified a threshold level of earnings that must be achieved before any incentive funds are made available. The earnings are expressed as net income before taxes and before any incentive awards. A target, or planned, level is also determined. As fiscal performance exceeds the threshold level a percentage of the net income before taxes is allocated to the incentive pool. When fiscal performance reaches the target level, the incentive pool equals the sum of the target incentives. As fiscal performance exceeds the target level, additional allocations are made to the incentive pool to provide employees with continual motivation and reinforcement to exceed planned performance. Decisions are made by the Chief Executive Officer (for individuals other than himself) and the Compensation Committee to include or exclude certain items from the calculation of pre-tax, pre-incentive net income.

**Outstanding Equity Awards at Fiscal Year-End**

The following table provides information concerning unexercised options and stock awards that have not vested for each named executive officer outstanding as of December 31, 2013.

Name	Option Awards				Stock Awards	
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested	Value of Shares or Units of Stock That Have Not Vested (1)
Jon Kranovs	18,533	—	\$ 12.35	11/21/2016	—	—
	5,232	3,490	(2) \$ 6.00	11/17/2020	1,398(2)	\$ 11,883
Philip B. Devermann	17,443	—	\$ 12.35	11/21/2016	—	—
Marc N. Kingry	5,232	7,851	(3) \$ 4.25	11/16/2021	3,141(3)	\$ 26,698

(1) Market value is calculated on the basis of \$8.50 per share, which is the closing sales price for our common stock on December 31, 2013.

(2) Stock options and stock awards granted pursuant to the 2006 Equity Incentive Plan vest in five approximately equal installments commencing on November 17, 2011.

(3) Stock options and stock awards granted pursuant to the 2006 Equity Incentive Plan vest in five approximately equal installments commencing on November 19, 2012.

**Directors' Compensation**

The following table sets forth the compensation received by non-employee directors for their service on our Board of Directors during 2013.

<i>Name</i>	<i>Fees Earned or Paid in Cash (\$)</i>	<i>Nonqualified Deferred Compensation Earnings</i>	<i>Stock Awards (\$)</i>	<i>Option Awards</i>	<i>All Other Compensation (\$)</i>	<i>Total (\$)</i>
James A. Ferrero	16,800	—	—	—	—	16,800
Keith F. Johnson	16,800	—	—	—	—	16,800
Arthur C. Mueller	16,800	—	—	—	—	16,800
Daniel J. Reynolds	16,800	—	—	—	—	16,800
John M. Armstrong	16,800	—	—	—	—	16,800

The following tables set forth the applicable retainers and fees that are paid to non-employee directors for their service on the Boards of Directors. Directors do not receive fees for service on Board committees. Directors do not receive any compensation for their service on the Board of Directors of the MHC.

**Board of Directors of Bank:**

Monthly Retainer for all Board Members \$1,050

**Board of Directors of Company:**

Quarterly Retainer for all Board Members \$1,050

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

(a) The following table provides information as of December 31, 2013 about the persons known to the Company to be the beneficial owners of more than 5% of the Company's outstanding common stock. A person may be considered to beneficially own any shares of common stock over which he or she has, directly or indirectly, sole or shared voting or investment power.

Name and Address	Number of Shares Owned	Percent of Common Stock Outstanding(1)	
Ottawa Savings Bancorp MHC			
925 LaSalle Street	1,223,701	57.8	%
Ottawa, Illinois 61350			
Tyndall Capital Partners, LP			
599 Lexington Avenue	129,237	(2) 6.1	%
Suite 4100			
New York, New York 10022			

(1)Based on 2,117,979 shares of Company common stock outstanding and entitled to vote as of December 31, 2013.

(2)Based exclusively on a Schedule 13G/A filed with the Securities and Exchange Commission on February 14, 2013.

(b) The following table provides information as of December 31, 2013 about the shares of Ottawa Savings Bancorp common stock that may be considered to be beneficially owned by each director of the Company, by those named executive officers of the Company listed in the *Summary Compensation Table* and all directors and executive officers of the Company as a group. A person may be considered to beneficially own any shares of common stock over which he has directly or indirectly, sole or shared voting or investment power. Unless otherwise indicated, none of the shares listed are pledged as security and each of the listed individuals has sole voting and investment power with respect to the shares shown.

Name	Percent of
------	------------



	<b>Number of Shares Owned (Excluding Options) (1)</b>		<b>Number of Shares That May Be Acquired Within 60 Days By Exercising Options</b>	<b>Common Stock Outstanding (2)</b>	
<b>Directors:</b>					
John M. Armstrong	3,810		—	*	
James A. Ferrero	20,180	(3)	5,451	1.21	%
Keith F. Johnson	19,180	(4)	5,451	1.16	%
Jon Kranov	35,651		23,765	2.81	%
Arthur C. Mueller	12,180		5,451	*	
Daniel J. Reynolds	24,680	(5)	5,451	1.42	%

**Executive Officers Who Are Not Directors:**

Philip B. Devermann	16,429	17,443	1.60%
Marc N. Kingry	8,792	5,232	*
All directors and executive officers as a group (8 persons)	140,902	68,244	9.87%

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\*Represents less than 1% of the Company's outstanding shares.

(1) This column includes the following:

<u>Name</u>	Shares of Restricted Stock Awards Held in Trust	Shares Allocated Under the Ottawa Savings Bank ESOP	Shares Held in Trust in the Ottawa Savings Bank 401(k) Plan
John M. Armstrong	—	—	—
Philip Devermann	—	5,341	10,194
James A. Ferrero	—	—	—
Keith Johnson	—	—	—
Marc N. Kingry	3,141	1,657	—
Jon Kranov	1,398	6,535	5,373
Arthur C. Mueller	—	—	—
Daniel J. Reynolds	—	—	—

(2) Based on 2,117,979 shares of Company common stock outstanding and entitled to vote as of December 31, 2013.

(3) Includes 500 shares of which Mr. Ferrero may be deemed the beneficial owner as the trustee of his daughter's trust.

(4) Includes 17,000 shares pledged as security for a loan with an unrelated financial institution.

(5) Includes 8,500 shares held by Mr. Reynold's spouse.

### **(c) Changes in Control**

Management of the Company knows of no arrangements, including any pledge by any person of securities of the Company, the operation of which may at a subsequent date result in a change in control of the Company.

### **(d) Equity Compensation Plans**

The Company has adopted the Ottawa Savings Bancorp, Inc. 2006 Equity Incentive Plan, pursuant to which equity may be awarded to participants. The plan was approved by the Company's shareholders. The following table sets forth certain information with respect to the Company's equity compensation plan(s) as of December 31, 2013.

	<b>Number of Securities to be issued upon Exercise of Outstanding Options, Warrants and Rights</b>	<b>Weighted Average Exercise Price</b>	<b>Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding securities reflected in column a)</b>
	<b>(a)</b>	<b>(b)</b>	<b>(c)</b>
Equity Compensation Plans Approved by Stockholders	92,667	\$ 10.46	16,353
Equity Compensation Plans not Approved by Stockholders	--	--	--
Total	92,667	\$ 10.46	16,353

### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

#### **Certain Relationships and Material Transactions**

The Sarbanes-Oxley Act generally prohibits loans by the Bank to its executive officers and directors. However, the Sarbanes-Oxley Act contains a specific exemption from such prohibition for loans by the Bank to its executive officers and directors in compliance with federal banking regulations. Federal regulations require that all loans or extensions of credit to executive officers and directors of insured institutions must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons and must not involve more than the normal risk of repayment or present other unfavorable features. Ottawa Savings Bank is therefore prohibited from making any new loans or extensions of credit to executive officers and directors at different rates or terms than those offered to the general public. Notwithstanding this rule, federal regulations permit the Bank to make loans to executive officers and directors at reduced interest rates if the loan is

made under a benefit program generally available to all other employees and does not give preference to any executive officer or director over any other employee.

In accordance with banking regulations, the Board of Directors reviews all loans made to a director or executive officer in an amount that, when aggregated with the amount of all other loans to such person and his or her related interests, exceed the greater of \$25,000 or 5% of Ottawa Savings Bancorp's capital and surplus (up to a maximum of \$500,000) and such loan must be approved in advance by a majority of the disinterested members of the Board of Directors. Additionally, pursuant to the Company's Code of Ethics and Business Conduct, all executive officers and directors of the Company must disclose any existing or emerging conflicts of interest to the President and Chief Executive Officer of the Company. Such potential conflicts of interest include, but are not limited to, the following: (i) the Company conducting business with or competing against an organization in which a family member of an executive officer or director has an ownership or employment interest; and (ii) the ownership of more than 1% of the outstanding securities (or that represents more than 5% of the total assets of the employee and/or family member) of any business entity that does business with or is in competition with the Company.

### Director Independence

The Company's Board of Directors consists of six members, all of whom are independent under the current listing standards of the Nasdaq Stock Market, except for Mr. Kranov, who is the Company's and the Bank's President and Chief Executive Officer. In determining the independence of its directors, the Board considered transactions, relationships or arrangements between the Company, the Bank and its directors that are not required to be disclosed in Item 13 of this Annual Report on Form 10-K.

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table sets forth the fees billed to the Company for the fiscal years ended December 31, 2013 and December 31, 2012 for services provided by McGladrey LLP.

	2013	2012
Audit Fees (1)	\$113,800	\$108,500
Audit-Related Fees	—	—
Tax Fees (2)	11,600	11,995
All Other Fees	—	—

(1) For 2012 and 2013, includes fees for performance of the audit, review of financial statements for public filings and attendance at the annual meeting.

(2) For 2012 and 2013, represents fees for preparation of federal and state consolidated tax returns, claims for refunds and tax payment-planning services for tax compliance, tax planning and tax advice.

**Pre-Approval of Services by the Independent Registered Public Accounting Firm**

The Audit Committee is responsible for appointing, setting compensation and overseeing the work of the independent registered public accounting firm. In accordance with its charter, the Audit Committee approves, in advance, all audit and permissible non-audit services to be performed by the independent registered public accounting firm. Such approval process ensures that the independent registered public accounting firm does not provide any non-audit services to the Company that are prohibited by law or regulation.

In addition, the Audit Committee has established a policy regarding pre-approval of all audit and permissible non-audit services provided by the independent registered public accounting firm. Requests for services by the independent registered public accounting firm for compliance with the auditor services policy must be specific as to the particular services to be provided. The request may be made with respect to either specific services or a type of service for predictable or recurring services.

Any proposed specific engagement may be presented to the Audit Committee for consideration at its next regular meeting or, if earlier consideration is required, to the Audit Committee or one or more of its members. The member or members to whom such authority is delegated shall report any specific approval of services at the next regular meeting of the Audit Committee. The Audit Committee will regularly review summary reports detailing all services being provided to the Company by its independent registered public accounting firm.

During the year ended December 31, 2013, all services were approved, in advance, by the Audit Committee in compliance with these procedures.

## PART IV

### ITEM 15. EXHIBITS

<u>Exhibit No.</u>	<u>Description of Exhibits</u>
3.1	Certificate of Incorporation of Ottawa Savings Bancorp, Inc. (incorporated by reference to Exhibit 3.1 to Company's Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005, as amended)
3.2	Bylaws of Ottawa Savings Bancorp, Inc. (incorporated by reference to Exhibit 3.2 to Company's Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005, as amended)
4.1	Form of Stock Certificate of Ottawa Savings Bancorp, Inc. (incorporated by reference to Exhibit 4.1, to Company's Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005, as amended)
10.1	Ottawa Savings Bank Employee Stock Ownership Plan and Trust Agreement, (incorporated by reference to Exhibit 10.1 to Company's Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005, as amended)
10.2	ESOP Loan Documents, (incorporated by reference to Exhibit 10.2 to Company's Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005, as amended)
10.3	Ottawa Savings Bank Employees' Savings and Profit Sharing Plan and Trust, (incorporated by reference to Exhibit 10.7 to Company's Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005, as amended).
10.4	Ottawa Savings Bank Change in Control Severance Compensation Plan, (incorporated by reference to Exhibit 10.8 to Company's Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005,

as amended)

- 10.5 Ottawa Savings Bank Voluntary Deferred Compensation Plan (incorporated by reference to Exhibit 10.9 to Company's Registration Statement on Form SB-2, No. 333-123455, filed on May 16, 2005)
- 10.6 Amendment to Ottawa Savings Bank Voluntary Deferred Compensation Plan for Directors, (incorporated by reference to Exhibit 10.10 to Company's Registration Statement on Form SB-2, No. 333-123455, filed on May 16, 2005, as amended)
- 10.7 Ottawa Savings Bank Voluntary Deferred Compensation Plan for Directors (incorporated by reference to Exhibit 10.11 to Company's Registration Statement on Form SB-2, No. 333-123455, filed on May 16, 2005, as amended)
- 10.8 Salary Continuation Agreement between Ottawa Savings Bank and Jon L. Kranov, as amended (incorporated by reference to Exhibit 10.12 to Company's Annual Report on Form 10-K, No. 000-51367, filed on March 30, 2009)
- 10.9 Salary Continuation Agreement between Ottawa Savings Bank and Philip B. Devermann, as amended (incorporated by reference to Exhibit 10.13 to Company's Annual Report on Form 10-K, No. 000-51367, filed on March 30, 2009)
- 11.1 Computation of per share earnings (included in Note 1 to the Company's Consolidated Financial Statements)
- 14.1 Ottawa Savings Bancorp, Inc. Code of Ethics and Business Conduct (incorporated by reference to Exhibit 14.1 to Company's 2006 Annual Report on Form 10-KSB, No. 000-51367, filed on March 29, 2007)
- 21.1 List of Subsidiaries (incorporated by reference to Exhibit 21.1 to Company's 2005 Annual Report on Form 10-KSB, No. 000-51367, filed on March 29, 2006)



23.1 Consent of McGladrey LLP

31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer

31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer

32.1 Section 1350 Certifications

101 The following materials from the Ottawa Savings Bancorp, Inc. Annual Report on Form 10-K for the year ended December 31, 2013 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Financial Condition, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Cash Flows and (iv) related notes.

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## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The internal control process has been designed under our supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's consolidated financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America.

Management conducted an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2013, utilizing the framework established in Internal Control – Integrated Framework of 1992 issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the Company's internal control over financial reporting as of December 31, 2013 is effective.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that accurately and fairly reflect, in reasonable detail, transactions and dispositions of assets; and provide reasonable assurances that: (1) transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States; (2) receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and (3) unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the Company's financial statements are prevented or timely detected.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to the rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

**Ottawa Savings Bancorp, Inc. & Subsidiary**

Consolidated Financial Statements

12.31.13

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**Ottawa Savings Bancorp, Inc. & Subsidiary**

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors

Ottawa Savings Bancorp, Inc. and Subsidiary

We have audited the accompanying consolidated balance sheets of Ottawa Savings Bancorp, Inc. and Subsidiary (the Company) as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ McGLADREY LLP

Chicago, Illinois

March 25, 2014

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**Ottawa Savings Bancorp, Inc. & Subsidiary****Consolidated Balance Sheets****December 31, 2013 and 2012**

	<b>2013</b>	<b>2012</b>
<b>Assets</b>		
Cash and due from banks	\$2,174,979	\$1,439,637
Interest bearing deposits	4,430,861	9,348,352
<b>Total cash and cash equivalents</b>	<b>6,605,840</b>	<b>10,787,989</b>
Federal funds sold	3,630,000	1,666,000
Securities held to maturity (fair value of \$13 at December 31, 2012)	-	12
Securities available for sale	34,547,080	28,863,603
Non-marketable equity securities	1,233,536	1,334,436
Loans, net of allowance for loan losses of \$2,910,580 and \$3,381,441 at December 31, 2013 and December 31, 2012, respectively	110,672,618	121,994,851
Loans held for sale	-	171,095
Premises and equipment, net	6,451,409	6,629,794
Accrued interest receivable	652,693	696,638
Foreclosed real estate	584,786	1,297,214
Deferred tax assets	2,450,072	2,243,663
Cash value of life insurance	2,096,181	1,587,436
Prepaid FDIC premiums	-	163,999
Income tax refunds receivable	-	166,590
Other assets	1,686,107	1,442,841
<b>Total assets</b>	<b>\$170,610,322</b>	<b>\$179,046,161</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities</b>		
<b>Deposits:</b>		
Non-interest bearing	\$5,219,028	\$4,313,635
Interest bearing	140,549,623	150,761,010
<b>Total deposits</b>	<b>145,768,651</b>	<b>155,074,645</b>
Accrued interest payable	582	806
Other liabilities	3,035,707	2,686,620
<b>Total liabilities</b>	<b>148,804,940</b>	<b>157,762,071</b>
<b>Commitments and contingencies</b>		
Redeemable common stock held by ESOP plan	319,090	237,712
<b>Stockholders' Equity</b>		
Common stock, \$.01 par value, 12,000,000 shares authorized; 2,224,911 shares issued	22,249	22,249
Additional paid-in-capital	8,706,921	8,705,547
Retained earnings	14,619,095	13,689,967
Unallocated ESOP shares	(305,256 )	(356,132 )
Unearned management recognition plan shares	(21,024 )	(33,977 )
Accumulated other comprehensive (loss) income	(4,485 )	468,554
	23,017,500	22,496,208

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Less:

Treasury stock, at cost; 106,932 shares	(1,212,118 )	(1,212,118 )
Maximum cash obligation related to ESOP shares	(319,090 )	(237,712 )
<b>Total stockholders' equity</b>	21,486,292	21,046,378
<b>Total liabilities and stockholders' equity</b>	\$170,610,322	\$179,046,161

See Accompanying Notes to Consolidated Financial Statements.

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**Ottawa Savings Bancorp, Inc. & Subsidiary****Consolidated Statements of Operations****Years Ended December 31, 2013 and 2012**

	<b>2013</b>	<b>2012</b>
Interest and dividend income:		
Interest and fees on loans	\$6,205,611	\$7,028,299
Securities:		
Residential mortgage-backed and related securities	469,265	633,118
U.S. agency securities	-	38,297
State and municipal securities	266,135	210,311
Dividends on non-marketable equity securities	5,751	5,418
Interest-bearing deposits	5,460	3,792
<b>Total interest and dividend income</b>	<b>6,952,222</b>	<b>7,919,235</b>
Interest expense:		
Deposits	1,451,959	2,169,642
Borrowings	-	1
<b>Total interest expense</b>	<b>1,451,959</b>	<b>2,169,643</b>
<b>Net interest income</b>	<b>5,500,263</b>	<b>5,749,592</b>
Provision for loan losses	875,000	1,912,000
<b>Net interest income after provision for loan losses</b>	<b>4,625,263</b>	<b>3,837,592</b>
Other income:		
Gain on sale of securities	-	13,948
Gain on sale of loans	66,229	109,059
Gain on sale of OREO, net	-	86,984
Origination of mortgage servicing rights, net of amortization	5,157	(1,307 )
Customer service fees	299,148	289,815
Income on bank owned life insurance	8,745	30,330
Other	279,887	113,532
<b>Total other income</b>	<b>659,166</b>	<b>642,361</b>
Other expenses:		
Salaries and employee benefits	1,629,301	1,501,839
Directors fees	100,800	87,150
Occupancy	454,966	447,804
Deposit insurance premium	189,111	241,514
Legal and professional services	274,506	219,985
Data processing	289,599	320,034
Valuation adjustments and expenses on foreclosed real estate	335,208	152,088
Loss on sale of OREO, net	4,323	-
Loss on sale of repossessed assets	7,513	18,908
Loss on consumer loans	-	41,514
Other	529,982	504,725

<b>Total other expenses</b>	3,815,309	3,535,561
<b>Income before income tax expense</b>	1,469,120	944,392
Income tax expense	539,992	270,202
<b>Net income</b>	\$929,128	\$674,190
<b>Basic earnings per share</b>	\$0.45	\$0.33
<b>Diluted earnings per share</b>	\$0.45	\$0.32

See Accompanying Notes to Consolidated Financial Statements

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**Ottawa Savings Bancorp, Inc. & Subsidiary****Consolidated Statements of Comprehensive Income****Years Ended December 31, 2013 and 2012**

	<b>2013</b>	<b>2012</b>
Net income	\$929,128	\$674,190
Other comprehensive (loss) income, before tax:		
Securities available for sale:		
Unrealized holding (losses) gains arising during the period	(716,726)	74,198
Reclassification adjustment for (gains) included in net income	-	(13,948)
<b>Other comprehensive (loss) income, before tax</b>	<b>(716,726)</b>	<b>60,250</b>
Income tax (benefit) expense related to items of other comprehensive (loss) income	(243,687)	20,485
<b>Other comprehensive (loss) income, net of tax</b>	<b>(473,039)</b>	<b>39,765</b>
<b>Comprehensive income</b>	<b>\$456,089</b>	<b>\$713,955</b>

See Accompanying Notes to Consolidated Financial Statements.

## Ottawa Savings Bancorp, Inc. &amp; Subsidiary

## Consolidated Statements of Stockholders' Equity

## Years Ended December 31, 2013 and 2012

	Common Stock	Additional Paid-in Capital	Retained Earnings	Unallocated ESOP Shares	Unearned MRP Shares	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Maximum Cash Obligation Related to ESOP Shares	Total
Balance, December 31, 2011	\$22,249	\$8,715,905	\$13,015,777	\$(407,008)	\$(41,119)	\$428,789	\$(1,212,118)	\$(109,818)	\$20,412,676
Net income	-	-	674,190	-	-	-	-	-	674,190
Other comprehensive income	-	-	-	-	-	39,765	-	-	39,765
Allocation of 5,088 of ESOP shares	-	(21,291)	-	50,876	-	-	-	-	29,585
Compensation expense on MRP awards granted	-	-	-	-	7,142	-	-	-	7,142
Compensation expense on RRP options granted	-	10,933	-	-	-	-	-	-	10,933
Change related to ESOP shares cash obligation	-	-	-	-	-	-	-	(127,894)	(127,894)
Balance, December 31, 2012	22,249	8,705,547	13,689,967	(356,132)	(33,977)	468,554	(1,212,118)	(237,712)	21,046,498
Net income	-	-	929,128	-	-	-	-	-	929,128
Other comprehensive loss	-	-	-	-	-	(473,039)	-	-	(473,039)
Allocation of 5,087 of ESOP shares	-	(13,077)	-	50,876	-	-	-	-	37,799
	-	-	-	-	12,953	-	-	-	12,953

Compensation expense on MRP awards granted									
Compensation expense on RRP options granted	-	14,451	-	-	-	-	-	-	14,451
Change related to ESOP shares cash obligation	-	-	-	-	-	-	-	(81,378 )	(81,378 )
Balance, December 31, 2013	\$22,249	\$8,706,921	\$14,619,095	\$(305,256)	\$(21,024)	\$(4,485 )	\$(1,212,118)	\$(319,090)	\$21,486,000

See Accompanying Notes to Consolidated Financial Statements.

**Ottawa Savings Bancorp, Inc. & Subsidiary****Consolidated Statements of Cash Flows****Years Ended December 31, 2013 and 2012**

	<b>2013</b>	<b>2012</b>
Cash Flows from Operating Activities		
Net income	\$929,128	\$674,190
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	186,957	200,766
Provision for loan losses	875,000	1,912,000
Provision for deferred income taxes	37,278	426,474
Net amortization of premiums and discounts on securities	595,741	494,413
Gain on sale of securities	-	(13,948 )
Origination of mortgage loans held for sale	(5,152,718 )	(8,504,304 )
Proceeds from sale of mortgage loans held for sale	5,390,042	8,442,268
Gain on sale of loans, net	(66,229 )	(109,059 )
Origination of mortgage servicing rights, net of amortization	(5,157 )	1,307
Proceeds from sale of non-mortgage loans held for sale	268,634	-
Loss (gain) on sale of foreclosed real estate	4,323	(86,984 )
Write down of foreclosed real estate	161,284	36,798
Loss on sale of repossessed assets	7,513	18,908
Loss on consumer loans	-	41,514
ESOP compensation expense	37,799	29,585
MRP compensation expense	12,953	7,142
Compensation expense on RRP options granted	14,451	10,933
Increase in cash surrender value of life insurance	(8,745 )	(30,330 )
Change in assets and liabilities:		
Decrease in prepaid FDIC insurance premiums	163,999	230,798
Decrease (increase) in accrued interest receivable	43,945	(5,271 )
Increase in other assets	(230,109 )	(27,450 )
Decrease in income tax refunds receivable	166,590	572,068
Increase in accrued interest payable and other liabilities	348,863	208,146
<b>Net cash provided by operating activities</b>	<b>3,781,542</b>	<b>4,529,964</b>
Cash Flows from Investing Activities		
Securities available for sale:		
Purchases	(14,099,651)	(8,369,727 )
Sales, maturities and pay-downs	7,103,707	12,092,854
Securities held to maturity:		
Pay-downs	12	3
Purchase of bank-owned life insurance	(500,000 )	-
Net decrease in loans	9,578,957	1,957,242
Net increase in federal funds sold	(1,964,000 )	(39,000 )
Proceeds from sale of foreclosed real estate	1,093,963	1,326,687
Proceeds from sale of repossessed assets	36,987	46,974

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Purchase of premises and equipment	(8,572 )	(29,184 )
Proceeds from sale of non-marketable equity securities	100,900	1,200,516
<b>Net cash provided by investing activities</b>	<b>1,342,303</b>	<b>8,186,365</b>
Cash Flows from Financing Activities		
Net decrease in deposits	(9,305,994 )	(4,873,805 )
<b>Net cash used in financing activities</b>	<b>(9,305,994 )</b>	<b>(4,873,805 )</b>
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>(4,182,149 )</b>	<b>7,842,524</b>
Cash and cash equivalents:		
Beginning	10,787,989	2,945,465
Ending	\$6,605,840	\$10,787,989

(Continued)

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**Ottawa Savings Bancorp, Inc. & Subsidiary****Consolidated Statements of Cash Flows (continued)****Years Ended December 31, 2013 and 2012**

	<b>2013</b>	<b>2012</b>
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest paid to depositors	\$1,452,183	\$2,170,744
Interest paid on borrowings	-	1
Income taxes paid, net of (refunds) received	295,217	(794,787 )
Supplemental Schedule of Noncash Investing and Financing Activities		
Real estate acquired through or in lieu of foreclosure	599,642	2,429,291
Other assets acquired in settlement of loans	52,500	34,600
Sale of foreclosed real estate through loan origination	52,500	397,736
Transfer of non-mortgage loans to held for sale	268,634	-
Increase in ESOP put option liability	81,378	127,894

See Accompanying Notes to Consolidated Financial Statements.



## Ottawa Savings Bancorp, Inc. & Subsidiary

### Notes to Consolidated Financial Statements

#### Note 1. Summary of Significant Accounting Policies

##### *Principles of consolidation*

The accompanying consolidated financial statements include the accounts of Ottawa Savings Bancorp, Inc. (the Company) and its wholly owned subsidiary Ottawa Savings Bank (the Bank). All significant intercompany transactions and balances are eliminated in consolidation.

##### *Entity structure*

In 2005, the Board of Directors of the Bank unanimously adopted a plan of conversion providing for the conversion of the Bank from an Illinois chartered mutual savings bank to a federally chartered stock savings bank and the purchase of all of the common stock of the Bank by the Company. The depositors of the Bank approved the plan at a meeting held in 2005.

In adopting the plan, the Board of Directors of the Bank determined that the conversion was advisable and in the best interests of its depositors and the Bank. The conversion was completed in 2005 when the Company issued 1,223,701 shares of common stock to Ottawa Savings Bancorp MHC (a mutual holding company), and 1,001,210 shares of common stock to the public. As of December 31, 2013, Ottawa Savings Bancorp MHC holds 1,223,701 shares of common stock, representing 57.8% of the Company's common shares outstanding.

##### *Nature of business*

The primary business of the Company is the ownership of the Bank. Through the Bank, the Company is engaged in providing a variety of financial services to individual and corporate customers in the Ottawa, Illinois area, which is primarily an agricultural area consisting of several rural communities with small to medium sized businesses. The Bank's primary source of revenue is interest and fees related to single-family residential loans to middle-income individuals.

*Use of estimates*

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the fair value of securities available for sale, the determination of the allowance for loan losses, valuation of deferred income taxes, and the determination of the liability for postretirement benefits.

*Concentration of credit risk*

Most of the Bank's business activity is with customers within the local Ottawa area. The Bank does not have any significant concentrations to any one industry or customer.

*Cash and cash equivalents*

For purposes of reporting cash flows, cash and cash equivalents include cash on hand and amounts due from banks, including cash items in process of clearing. Cash flows from loans, deposits, and federal funds sold or purchased are treated as net increases or decreases in the statement of cash flows.

**Ottawa Savings Bancorp, Inc. & Subsidiary**

**Notes to Consolidated Financial Statements**

**Note 1. Summary of Significant Accounting Policies (Continued)**

The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risk on cash and cash equivalents.

*Investment securities*

Debt securities that management has the positive intent and ability to hold to maturity are classified as “held to maturity” and reported at amortized cost.

Debt securities classified as available for sale are those debt securities that the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Any decision to sell a security classified as available for sale would be based on various factors, including significant movements in interest rates, changes in maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Securities available for sale are carried at fair value. The difference between the fair value and amortized cost, adjusted for amortization of premium and accretion of discounts, computed by the interest method over their contractual maturity, results in an unrealized gain or loss. Unrealized gains or losses are reported as accumulated other comprehensive income (loss), net of the related deferred tax effect and are included as a component of stockholders' equity. Gains or losses from the sale of securities are determined using the specific identification method and are included in earnings. Declines in the fair value of available for sale securities below their amortized cost basis that are deemed to be other than temporary are reflected in earnings as realized losses. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

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

To determine if an “other-than-temporary” impairment (OTTI) exists on an investment security, the Company first determines if (a) it intends to sell the security or (b) it is more likely than not that it will be required to sell the security before its anticipated recovery. If either of the conditions is met, the Company will recognize an “other-than-temporary” impairment in earnings equal to the difference between the security’s fair value and its adjusted cost basis. If neither of the conditions is met, the Company determines (a) the amount of the impairment related to credit loss and (b) the amount of the impairment due to all other factors. The difference between the present values of the cash flows expected to be collected and the amortized cost basis is the credit loss. The credit loss is the portion of the other-than-temporary impairment that is recognized in earnings and is a reduction to the cost basis of the security. The portion of total impairment related to all other factors is included in other comprehensive income (loss).

*Non-marketable equity securities*

Investments in the Federal Home Loan Bank of Chicago, Bankers Bank of Wisconsin, and the Upper Illinois River Valley Development Corporation are carried at cost.

**Ottawa Savings Bancorp, Inc. & Subsidiary**

**Notes to Consolidated Financial Statements**

**Note 1. Summary of Significant Accounting Policies (Continued)**

*Loans*

The Bank primarily lends to small and mid-sized businesses, non-residential real estate customers and consumers providing mortgage, commercial and consumer loans. A substantial portion of the loan portfolio is represented by mortgage loans throughout Ottawa, Illinois and the surrounding area. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

It is the Bank's policy to review each prospective credit in order to determine the appropriateness and the adequacy of security or collateral prior to making a loan. In the event of borrower default, the Bank seeks recovery in compliance with state lending laws, the Bank's lending standards, and credit monitoring and remediation procedures.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are generally reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield over the contractual life of the loan using the interest method.

The following portfolio segments and classes of loan receivables have been identified by the Company:

- Commercial
- Non-residential real estate
- One-to-four family residential real estate
- Multi-family residential real estate
- Consumer direct
- Purchased auto loans

Generally, for all classes of loans receivable, loans are considered past due when contractual payments are delinquent for 31 days or greater. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful.

For all classes of loans receivable, loans will generally be placed on nonaccrual status when the loan has become over 90 days past due (unless the loan is well secured and in the process of collection).

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**Ottawa Savings Bancorp, Inc. & Subsidiary**

**Notes to Consolidated Financial Statements**

**Note 1. Summary of Significant Accounting Policies (Continued)**

When a loan is placed on nonaccrual status, income recognition is ceased. Previously recorded but uncollected amounts of interest on nonaccrual loans are reversed at the time the loan is placed on nonaccrual status. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Should full collection of principal be expected, cash collected on nonaccrual loans can be recognized as interest income.

For all classes of loans receivable, nonaccrual loans may be restored to accrual status provided the following criteria are met:

- The loan is current, and all principal and interest amounts contractually due have been made,
- All principal and interest amounts contractually due, including past due payments, are reasonably assured of repayment within a reasonable period, and
- There is a period of minimum repayment performance, as follows, by the borrower in accordance with contractual terms:
  - Six months of repayment performance for contractual monthly payments, or
  - One year of repayment performance for contractual quarterly or semi-annual payments.

Troubled debt restructuring exists when the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession (either imposed by court order, law, or agreement between the borrower and the Company) to the borrower that it would not otherwise consider. The Company is attempting to maximize its recovery of the balances of the loans through these various concessionary restructurings.

The following criteria, related to granting a concession, together or separately, create a troubled debt restructuring:

- A modification of terms of a debt such as one or a combination of:
  - The reduction of the stated interest rate to a rate lower than the current market rate for new debt with similar risk.
  - The extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk.
  - The reduction of the face amount or maturity amount of the debt as stated in the instrument or other agreement.

•The reduction of accrued interest.

- A transfer from the borrower to the Company of receivables from third parties, real estate, other assets, or an equity position in the borrower to fully or partially satisfy a loan.

*Allowance for loan losses*

For all portfolio segments, the allowance for loan losses is an amount necessary to absorb known and inherent losses that are both probable and reasonably estimable and is established through a provision for loan losses charged to earnings. Loan losses, for all portfolio segments, are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

For all portfolio segments, the allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. In addition, regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses and may require the Company to make additions to the allowance based upon their judgment about information available to them at the time of their examinations.



## Ottawa Savings Bancorp, Inc. & Subsidiary

### Notes to Consolidated Financial Statements

#### Note 1. Summary of Significant Accounting Policies (Continued)

The general component consists of quantitative and qualitative factors and covers non-impaired loans. The quantitative factors are based on historical loss experience adjusted for qualitative factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company using the most recent twelve quarters with heavier weighting given to the most recent quarters. The weighting applies 40% to each of the most recent four quarters and 30% to each of the next eight quarters.

Due to changing economic conditions which resulted in reduced charge-offs through June 30, 2013, management evaluated and changed the historical loss period used in the allowance for loan losses calculation from using the most recent eight quarters of loss history to calculate historical loss rates to the twelve quarters of loss history. The weighting applied to the quarters had been graduated, with heavier weightings applied to the most recent quarters of loss history. Going forward the weighting applied to the quarters is still graduated, with heavier weightings applied to the most recent quarters of loss history; however, the weighting applied has a lesser graduation than the previous methodology. Management evaluated the impact of the change in methodology by calculating the allowance for loan losses using both the old methodology and the new methodology at June 30, 2013, and determined that the change in methodology did not have a material impact on the allowance for loan losses as of June 30, 2013.

This actual loss experience is supplemented with other qualitative factors based on the risks present for each portfolio segment. These qualitative factors include consideration of the following:

- Levels of and trends in delinquencies and impaired loans
- Levels of and trends in charge-offs and recoveries
- Trends in volume and terms of loans
- Effects of any changes in risk selection and underwriting standards
- Other changes in lending policies, procedures and practices
- Experience, ability and depth of lending management and other relevant staff
- National and local economic trends and conditions
- Industry conditions
- Effects of changes in credit concentrations

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the

loan agreement. 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. Impairment is measured on a loan by loan basis for commercial and non-residential loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

A discussion of the risk characteristics and the allowance for estimated losses on loans, by each portfolio segment, follows:

For commercial loans, the Company focuses on small and mid-sized businesses that have annual revenues below \$5,000,000 with primary operations as wholesalers, manufacturers, building contractors, business services companies, and retailers. The Company provides a wide range of commercial loans, including lines of credit for working capital and operational purposes, and term loans for the acquisition of facilities, equipment and other purposes. The Company also originates commercial loans through Bankers Health Group (BHG). BHG specializes in loans to healthcare professionals of all specialties throughout the United States. The loans for BHG are primarily comprised of working capital and equipment loans. We underwrite these loans based on our criteria and service the loans in-house. Approval is generally based on the following factors:

## Ottawa Savings Bancorp, Inc. & Subsidiary

### Notes to Consolidated Financial Statements

#### Note 1. Summary of Significant Accounting Policies (Continued)

- Ability and stability of current management of the borrower;
- Stable earnings with positive financial trends;
- Sufficient cash flow to support debt repayment;
- Earnings projections based on reasonable assumptions;
- Financial strength of the industry and business; and
- Value and marketability of collateral.

Collateral for commercial loans generally includes accounts receivable, inventory, and equipment. The lending policy specifies approved collateral types and corresponding maximum advance percentages. The value of collateral pledged on loans must exceed the loan amount by a margin sufficient to absorb potential erosion of its value in the event of foreclosure and cover the loan amount plus costs incurred to convert it to cash. The lending policy specifies maximum term limits for commercial loans. For term loans, the maximum term is 5 years. Generally, term loans range from 3 to 5 years. For lines of credit, the maximum term is 365 days. In addition, the Company often takes personal guarantees as support for repayment. Loans may be made on an unsecured basis if warranted by the overall financial condition of the borrower.

Non-residential real estate loans are subject to underwriting standards and processes similar to commercial loans, in addition to those standards and processes specific to real estate loans. Collateral for non-residential real estate loans generally includes the underlying real estate and improvements, and may include additional assets of the borrower. The lending policy specifies maximum loan-to-value limits based on the category of non-residential real estate (non-residential real estate loans on improved property, raw land, land development, and commercial construction). These limits are the same limits established by regulatory authorities. The lending policy also includes guidelines for real estate appraisals, including minimum appraisal standards based on certain transactions. In addition, the Company often takes personal guarantees as support for repayment.

Some of the non-residential loans that the Company originates finance the construction of residential dwellings and land development. For land development, the loans generally can be made with a maximum loan to value ratio of 70% and a maximum term up to 10 years. Additionally, the Company will underwrite commercial construction loans for commercial development projects including condominiums, apartment buildings, single-family subdivisions, single-family speculation loans, as well as owner-occupied properties used for business. These loans provide for payment of interest only during the construction phase and may, in the case of an apartment or commercial building, convert to a permanent loan upon completion. In the case of a single family subdivision or construction or builder loan, as individual lots are sold, the principal balance is reduced by a minimum of 80% of the net lot sales price. In the

case of a commercial construction loan, the construction period may be from nine months to two years. Loans are generally made to a maximum of 70% of the appraised value as determined by an appraisal of the property made by an independent state certified general real estate appraiser. Periodic inspections are required of the property during the term of the construction loan for both residential and commercial construction loans.

For commercial and non-residential real estate loans, the allowance for estimated losses on loans consists of specific and general components. For loans that are considered impaired as defined above, 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.

## Ottawa Savings Bancorp, Inc. & Subsidiary

### Notes to Consolidated Financial Statements

#### Note 1. Summary of Significant Accounting Policies (Continued)

The Company hires an independent firm to perform a loan review annually to validate the risk ratings on commercial and non-residential loans. Additionally, the reviews include an analysis of debt service requirements, covenant compliance, if applicable, and collateral adequacy. They also perform a documentation review on selected loans to determine if the credit is properly documented and closed in accordance with approval authorities and conditions.

Generally, the Company's one-to-four family real estate loans conform to the underwriting standards of Freddie Mac and Fannie Mae which would allow the Company the ability to resell the loans in the secondary market. The Company structures most loans that will not conform to those underwriting requirements as adjustable rate mortgages that adjust in one, three or five year increments and retains those in its portfolio. The board approved lending policy establishes minimum appraisal and credit underwriting guidelines. The Company also participates with the USDA Rural Development Company to offer loans to qualifying borrowers. USDA guaranteed loans are granted up to 100% of the appraised value and the USDA guarantees up to 90% of the loan. These loans typically require no down payment, but are subject to maximum income limitations.

The Company also originates loans for multi-family dwellings. These loans follow board and regulatory approved underwriting guidelines similar to commercial loans, in addition to those standards and processes specific to real estate loans. Collateral for multi-family real estate loans generally includes the underlying real estate and improvements, and may include additional assets of the borrower. The board approved lending policy specifies maximum loan-to-value limits based on the type of property. The lending policy also includes guidelines for real estate appraisals, including minimum appraisal standards based on certain transactions. The policy also specifies minimum ongoing credit administration procedures including the collection of financial statements, tax returns and rent rolls when applicable. Additionally, the Company will take personal guarantees and cross collateralize other assets of the guarantors as support for repayment.

The Company provides many types of installment and other consumer loans including motor vehicle, home improvement, share loans, personal unsecured loans, home equity, and small personal credit lines. The lending policy addresses specific credit guidelines by consumer loan type. Unsecured loans generally have a maximum borrowing limit of \$25,000 and a maximum term of four years.

The procedures for underwriting consumer loans include an assessment of the applicant's payment history on other debts and ability to meet existing obligations and payments on the proposed loans. Although the applicant's credit-worthiness is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, to the proposed loan amount.

The Company purchases auto loans from regulated financial institutions. These types of loans are primarily low balance individual auto loans. The Company reviews the loans at least three days prior to the purchase. Any specific loan can be refused within thirty days of the sale of any given loan pool.

For residential real estate loans, multi-family, consumer direct loans (e.g. installment, in-house auto, other consumer loans, etc.) and purchased auto loans, the allowance for estimated losses on loans consists of a specific and general component. The specific component is evaluated for only loans that are classified as impaired, which is based on current information and events if it is probable that the company will be unable to collect the scheduled payments according to the terms of the agreement. Impairment on these is measured on a case-by-case basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent. For large groups of smaller balance homogenous loans that are under 90 days past due, they are collectively evaluated for impairment. To determine the general component, the Company applies quantitative factors based on historical charge-off experience in total for each segment. Additionally, the historical loss factors are adjusted based on qualitative factors determined by the Company which impact each segment.

## Ottawa Savings Bancorp, Inc. & Subsidiary

### Notes to Consolidated Financial Statements

#### Note 1. Summary of Significant Accounting Policies (Continued)

For residential real estate loans, multi-family real estate loans, consumer direct loans and purchased auto loans, loans are not risk ranked individually. They are only classified when the borrower is 90 days or more past due or if the borrower has another loan with the Company that is over 90 days past due and dependent upon the same collateral. Under such circumstances, all of the loans connected with the collateral are classified as substandard and these loans are evaluated for impairment.

Troubled debt restructurings are considered impaired loans and are subject to the same allowance methodology as described above for impaired loans by portfolio segment.

#### *Servicing*

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. Capitalized servicing rights are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Company later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income.

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

*Transfers of financial assets*

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

*Foreclosed real estate*

Real estate properties acquired through, or in lieu of, loan foreclosure are initially recorded at fair value less estimated costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less estimated cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other expenses.



**Ottawa Savings Bancorp, Inc. & Subsidiary**

**Notes to Consolidated Financial Statements**

**Note 1. Summary of Significant Accounting Policies (Continued)**

*Income taxes*

Deferred income tax assets and liabilities are computed quarterly for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to amounts which are more likely than not realizable. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Income tax expense is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation process, if any. A tax position that meets the more likely than not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more likely than not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized. The Company has no uncertain tax positions for which a liability has been recorded. The Company is no longer subject to examination by federal or state taxing authorities for the tax year 2009 and the years prior.

*Premises and equipment*

Land is carried at cost. Premises and equipment are carried at cost, less accumulated depreciation. Premises and equipment are depreciated using the straight-line and accelerated depreciation methods over the estimated useful lives of the assets:

	Years		
Buildings	5	-	50
Furniture and equipment	5	-	39

*Employee stock ownership plan*

The Bank has an employee stock ownership plan (ESOP) covering substantially all employees. The cost of shares issued to the ESOP but not yet allocated to participants is presented in the consolidated balance sheets as a reduction of stockholders' equity. Compensation expense is recorded based on the market price of the shares as they are committed to be released for allocation to participant accounts.

*Stock-based compensation*

The Company recognizes compensation cost for all stock-based awards based on the estimated grant date fair value. The fair value of stock options are estimated using a Black-Scholes option pricing model and amortized to expense over the option's vesting periods, as more fully disclosed in Note 11.

**Ottawa Savings Bancorp, Inc. & Subsidiary**

**Notes to Consolidated Financial Statements**

**Note 1. Summary of Significant Accounting Policies (Continued)**

*Off-balance-sheet financial instruments*

Financial instruments include off-balance-sheet credit instruments, such as commitments to originate loans, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

*Comprehensive income (loss)*

Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale net of the related tax effect.

*Loss contingencies*

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. In the normal course of business, management will reach settlements over legal issues which are recorded in the period received. Management does not believe there are any such matters that will have a material effect on the consolidated financial statements.

*Fair value measurements*

In accordance with the provisions of FASB ASC 820, *Fair Value Measurements and Disclosures*, fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly

transaction between market participants and is not adjusted for transaction costs. This guidance also establishes a framework for measuring fair value and expands disclosure of fair value measurements. See Note 15 for additional information.

*Fair value of financial instruments*

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 16. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

**Ottawa Savings Bancorp, Inc. & Subsidiary****Notes to Consolidated Financial Statements****Note 1. Summary of Significant Accounting Policies (Continued)***Earnings per share*

Basic earnings per share is based on net income divided by the weighted average number of shares outstanding during the period, including allocated and committed-to-be-released Employee Stock Ownership Plan (“ESOP”) shares and vested Management Recognition Plan (“MRP”) shares. Diluted earnings per share show the dilutive effect, if any, of additional common shares issuable under stock options and awards. See Note 11 for additional information on the MRP and RRP plans.

	<b>Years ended December</b>	
	<b>31,</b>	
	<b>2013</b>	<b>2012</b>
Net income available to common stockholders	\$929,128	\$674,190
Basic potential common shares:		
Weighted average shares outstanding	2,117,979	2,117,979
Weighted average unallocated ESOP shares	(33,256 )	(38,349 )
Weighted average unvested MRP shares	(6,488 )	(8,632 )
Basic weighted average shares outstanding	2,078,235	2,070,998
Dilutive potential common shares:		
Weighted average unrecognized compensation on MRP shares	5,093	18,445
Weighted average RRP options outstanding *	-	-
Dilutive weighted average shares outstanding	2,083,328	2,089,443
Basic earnings per share	\$0.45	\$0.33
Diluted earnings per share	\$0.45	\$0.32

\*The effect of share options for both 2013 and 2012 were not included in the calculation of diluted earnings per share because to do so would have been anti-dilutive.

*Segment reporting*

The Company views the Bank as one operating segment, therefore, separate reporting of financial segment information is not considered necessary. The Company approaches the Bank as one business enterprise which

operates in a single economic environment since the products and services, types of customers and regulatory environment all have similar characteristics.

*Recent accounting pronouncements*

In February, 2013, the FASB issued ASU No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. The Update improves the reporting of reclassifications out of accumulated other comprehensive income by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP) to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. The adoption of ASU No. 2013-02 on January 1, 2013 did not have an impact on the Company's financial position, results of operation or cash flows.

**Ottawa Savings Bancorp, Inc. & Subsidiary****Notes to Consolidated Financial Statements****Note 1. Summary of Significant Accounting Policies (Continued)**

In January 2014, the FASB issued ASU No. 2014-04, *Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. The update clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (i) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (ii) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar agreement. In addition, the update requires disclosure of both the amount of foreclosed residential real estate property held by the creditor and the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure in accordance with local requirements of the applicable jurisdiction. An entity can elect to adopt the amendments using either a modified retrospective method or a prospective transition method. The amendments are effective for annual and interim periods beginning after December 15, 2014, with early adoption permitted. The Company does not expect the adoption of this update to have a significant impact on its financial position, results of operation or cash flows.

**Note 2. Restrictions on Cash and Amounts Due from Banks**

At December 31, 2013 and 2012, the Bank was not required to maintain a minimum average balance on hand with the Federal Reserve Bank.

**Note 3. Investment Securities**

The amortized cost and fair values of investment securities, with gross unrealized gains and losses, follows:

Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
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**December 31, 2013:****Available for Sale**

State and municipal securities	\$8,676,586	\$ 80,152	\$ 312,219	\$8,444,519
Residential mortgage-backed securities	25,877,289	369,098	143,826	26,102,561
	\$34,553,875	\$ 449,250	\$ 456,045	\$34,547,080

**December 31, 2012:****Held to Maturity**

Residential mortgage-backed securities	\$12	\$ 1	\$ -	\$13
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**Available for Sale**

State and municipal securities	6,789,496	343,292	12,266	7,120,522
Residential mortgage-backed securities	21,364,176	478,917	100,012	21,743,081
	\$28,153,672	\$ 822,209	\$ 112,278	\$28,863,603

At both December 31, 2013 and 2012, securities with a carrying value of approximately \$300,000 were pledged to secure public deposits and for other purposes as required or permitted by law.



**Ottawa Savings Bancorp, Inc. & Subsidiary****Notes to Consolidated Financial Statements****Note 3. Investment Securities (Continued)**

The amortized cost and fair value at December 31, 2013, by contractual maturity, are shown below. Maturities may differ from contractual maturities in residential mortgage-backed securities because the mortgages underlying the securities may be called or repaid without any penalties. Therefore, stated maturities of residential mortgage-backed securities are not disclosed.

	Securities Available for Sale	
	Amortized Cost	Fair Value
Due after three months through one year	\$-	\$-
Due after one year through five years	-	-
Due after five years through ten years	3,338,684	3,285,583
Due after ten years	5,337,902	5,158,936
Residential mortgage-backed securities	25,877,289	26,102,561
	\$34,553,875	\$34,547,080

There were no proceeds from the sale of securities in 2013 and proceeds of \$3.0 million in 2012. There were no realized gains in 2013 and gross realized gains of \$58,614 in 2012. There were no realized losses in 2013 and gross realized losses of \$44,666 in 2012. The tax provision applicable to these net realized gains amounted to none and \$4,742 in 2013 and 2012, respectively.

Information pertaining to securities with gross unrealized losses at December 31, 2013 and 2012 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less than 12 Months Fair	12 Months or More Fair	Total Fair	Unrealized
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	Value	Losses	Value	Losses	Value	Losses
<b>December 31, 2013</b>						
<b>Securities Available for Sale</b>						
State and municipal securities	\$4,937,528	\$ 288,364	\$258,573	\$ 23,855	\$5,196,101	\$ 312,219
Residential mortgage-backed securities	9,832,934	122,774	994,240	21,052	10,827,174	143,826
	\$14,770,462	\$ 411,138	\$1,252,813	\$ 44,907	\$16,023,275	\$ 456,045
<b>December 31, 2012</b>						
<b>Securities Available for Sale</b>						
State and municipal securities	\$1,160,173	\$ 12,266	\$-	\$ -	\$1,160,173	\$ 12,266
Residential mortgage-backed securities	4,318,926	73,606	2,587,548	26,406	6,906,474	100,012
	\$5,479,099	\$ 85,872	\$2,587,548	\$ 26,406	\$8,066,647	\$ 112,278

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**Ottawa Savings Bancorp, Inc. & Subsidiary****Notes to Consolidated Financial Statements****Note 3. Investment Securities (Continued)**

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability to retain and whether it is not more likely than not the Company will be required to sell its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports.

At December 31, 2013, 27 securities had unrealized losses with aggregate depreciation of 2.77% from the Company's amortized cost basis. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell these securities and it is not more likely than not the Company will be required to sell these securities before recovery of the amortized cost basis, which may be maturity, the Company does not consider these investments to be other than temporarily impaired at December 31, 2013.

**Note 4. Loans and Allowance for Credit Losses (Continued)***Loans*

The components of loans, net of deferred loan costs (fees), are as follows:

	December 31, 2013	December 31, 2012
Residential real estate loans:		
One-to-four family residential loans	\$77,406,656	\$83,018,756
Multi-family residential loans	2,744,963	4,849,766
<b>Total residential real estate loans</b>	<b>80,151,619</b>	<b>87,868,522</b>

Other loans:

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Non-residential real estate loans	17,016,805	20,506,860
Commercial loans	7,860,312	8,648,191
Consumer direct	392,273	542,652
Purchased auto	8,162,189	7,810,067
<b>Total other loans</b>	<b>33,431,579</b>	<b>37,507,770</b>
<b>Gross loans</b>	<b>113,583,198</b>	<b>125,376,292</b>
Less: Allowance for loan losses	(2,910,580 )	(3,381,441 )
<b>Loans, net</b>	<b>\$110,672,618</b>	<b>\$121,994,851</b>

Purchases of loans receivable, segregated by class of loans, for the periods indicated were as follows:

	Years Ended December	
	31,	
	2013	2012
Purchased auto	\$4,048,406	\$5,846,908

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**Ottawa Savings Bancorp, Inc. & Subsidiary****Notes to Consolidated Financial Statements****Note 4. Loans and Allowance for Credit Losses (Continued)**

Net (charge-offs), segregated by class of loans, were as follows:

	Years Ended December	
	31, 2013	2012
One-to-four family	\$(1,121,124)	\$(2,302,726)
Multi-family	(267,628 )	(133,430 )
Non-residential	51,820	(771,745 )
Commercial	-	(52,573 )
Consumer direct	(647 )	(351 )
Purchased auto	(8,282 )	(17,146 )
Net (charge-offs)/recoveries	\$(1,345,861)	\$(3,277,971)

## Ottawa Savings Bancorp, Inc. &amp; Subsidiary

## Notes to Consolidated Financial Statements

## Note 4. Loans and Allowance for Credit Losses (Continued)

The following table presents the activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2013 and 2012:

<b>December 31, 2013</b>	One-to-Four Family	Multi-family	Non-residential	Commercial	Consumer Direct	Purchased Auto	Total
Balance at beginning of period	\$2,057,336	\$ 161,901	\$ 1,012,119	\$ 75,130	\$ 1,465	\$ 73,490	\$3,381,441
Provision charged to income	1,341,113	247,094	(675,724 )	(45,165 )	880	6,802	875,000
Loans charged off	(1,135,452)	(282,154 )	(84,364 )	-	(647 )	(16,760 )	(1,519,377)
Recoveries of loans previously charged off	14,328	14,526	136,184	-	-	8,478	173,516
Balance at end of period	\$2,277,325	\$ 141,367	\$ 388,215	\$ 29,965	\$ 1,698	\$ 72,010	\$2,910,580
Period-end amount allocated to:							
Loans individually evaluated for impairment	\$235,166	\$ -	\$ 29,977	\$ -	\$ -	\$ -	\$265,143
Loans collectively evaluated for impairment	2,042,159	141,367	358,238	29,965	1,698	72,010	2,645,437
Balance at end of period	\$2,277,325	\$ 141,367	\$ 388,215	\$ 29,965	\$ 1,698	\$ 72,010	\$2,910,580
<b>December 31, 2012</b>	One-to-Four Family	Multi-family	Non-residential	Commercial	Consumer Direct	Purchased Auto	Total
Balance at beginning of period	\$3,113,345	\$ 438,542	\$ 1,145,889	\$ 10,571	\$ 3,578	\$ 35,487	\$4,747,412
Provision charged to income	1,246,717	(143,211 )	637,975	117,132	(1,762 )	55,149	1,912,000
Loans charged off	(2,351,742)	(133,430 )	(771,745 )	(52,573 )	(531 )	(26,351 )	(3,336,372)

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Recoveries of loans previously charged off	49,016	-	-	-	180	9,205	58,401
Balance at end of period	\$2,057,336	\$ 161,901	\$ 1,012,119	\$ 75,130	\$ 1,465	\$ 73,490	\$ 3,381,441
Period-end amount allocated to:							
Loans individually evaluated for impairment	\$147,209	\$ -	\$ 31,208	\$ -	\$ -	\$ -	\$178,417
Loans collectively evaluated for impairment	1,910,127	161,901	980,911	75,130	1,465	73,490	3,203,024
Balance at end of year	\$2,057,336	\$ 161,901	\$ 1,012,119	\$ 75,130	\$ 1,465	\$ 73,490	\$ 3,381,441

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**Ottawa Savings Bancorp, Inc. & Subsidiary****Notes to Consolidated Financial Statements****Note 4. Loans and Allowance for Credit Losses (Continued)**

The following table presents the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2013 and 2012:

<b>December 31, 2013</b>	One-to-four Family	Multi-family	Non-residential	Commercial	Consumer Direct	Purchased Auto	Total
Loans individually evaluated for impairment	\$3,455,604	\$-	\$2,332,243	\$-	\$-	\$-	\$5,787,847
Loans collectively evaluated for impairment	73,951,052	2,744,963	14,684,562	7,860,312	392,273	8,162,189	107,795,351
Ending Balance	\$77,406,656	\$2,744,963	\$17,016,805	\$7,860,312	\$392,273	\$8,162,189	\$113,583,198
<b>December 31, 2012</b>	One-to-four Family	Multi-family	Non-residential	Commercial	Consumer Direct	Purchased Auto	Total
Loans individually evaluated for impairment	\$2,891,821	\$-	\$2,726,297	\$-	\$-	\$-	\$5,618,118
Loans collectively evaluated for impairment	80,126,935	4,849,766	17,780,563	8,648,191	542,652	7,810,067	119,758,174
Ending Balance	\$83,018,756	\$4,849,766	\$20,506,860	\$8,648,191	\$542,652	\$7,810,067	\$125,376,292

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions.



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## Ottawa Savings Bancorp, Inc. &amp; Subsidiary

## Notes to Consolidated Financial Statements

## Note 4. Loans and Allowance for Credit Losses (Continued)

The following table presents loans individually evaluated for impairment, by class of loans, as of December 31, 2013 and 2012:

	Unpaid	Recorded	Recorded	Total	Related	Average
	Contractual	Investment	Investment	Recorded	Allowance	Recorded
	Principal	With No	With	Investment		Investment
	Balance	Allowance	Allowance			
<b>December 31, 2013</b>						
One-to-four family	\$3,851,948	\$2,729,178	\$726,426	\$3,455,604	\$235,166	\$3,480,595
Multi-family	-	-	-	-	-	16,033
Non-residential	2,631,792	2,090,766	241,477	2,332,243	29,977	2,288,596
Commercial	-	-	-	-	-	-
Consumer direct	-	-	-	-	-	-
Purchased auto	-	-	-	-	-	-
	\$6,483,740	\$4,819,944	\$967,903	\$5,787,847	\$265,143	\$5,785,224
	Unpaid	Recorded	Recorded	Total	Related	Average
	Contractual	Investment	Investment	Recorded	Allowance	Recorded
	Principal	With No	With	Investment		Investment
	Balance	Allowance	Allowance			
<b>December 31, 2012</b>						
One-to-four family	\$3,664,253	\$820,150	\$2,071,671	\$2,891,821	\$147,209	\$6,141,106
Multi-family	-	-	-	-	-	104,209
Non-residential	6,596,593	683,589	2,042,708	2,726,297	31,208	1,814,361
Commercial	-	-	-	-	-	605
Consumer direct	-	-	-	-	-	12,057
Purchased auto	-	-	-	-	-	12,057
	\$10,260,846	\$1,503,739	\$4,114,379	\$5,618,118	\$178,417	\$8,084,395

For the years ended December 31, 2013 and 2012, the Company recognized no accrued or cash basis interest income on impaired loans.

Our loan portfolio also includes certain loans that have been modified in a troubled debt restructuring (“TDR”), where economic concessions have been granted to borrowers who have experienced financial difficulties. These concessions typically result from our loss mitigation activities and could include reductions in the interest rate, payment extensions, forbearance or other actions. Certain TDRs are classified as nonperforming at the time of restructuring and typically are returned to performing status after considering the borrower’s sustained repayment performance for a reasonable period of at least six months.

When we modify loans in a TDR, we evaluate any possible impairment similar to other impaired loans based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan agreement, or use the current fair value of the collateral, less estimated selling costs for collateral dependent loans. If we determine that the value of the modified loan is less than the recorded investment in the loan (net of previous charge-offs and deferred loan fees or costs), impairment is recognized through an allowance estimate or a charge-off to the allowance. In periods subsequent to modification, we evaluate all TDRs, including those that have payment defaults, for possible impairment and recognize impairment through the allowance.

## Ottawa Savings Bancorp, Inc. & Subsidiary

### Notes to Consolidated Financial Statements

#### Note 4. Loans and Allowance for Credit Losses (Continued)

The impaired loans at December 31, 2013 and 2012, include approximately \$3.1 million of loans whose terms have been modified in troubled debt restructurings. The restructured loans are being monitored as they have not attained per accounting guidelines the performance requirements for the set time period to achieve being returned to accrual status.

Loans classified as troubled debt restructuring during the years ended December 31, 2013 and 2012, segregated by class of loans, are shown in the table below.

	Year Ended			Year Ended		
	December 31, 2013			December 31, 2012		
	Number of Modifications (as of period end)	Recorded Amount	Increase in Allowance	Number of Modifications (as of period end)	Recorded Amount	Increase in Allowance
One-to-four family	5	\$ 662,065	\$ 2,609	6	\$ 633,198	\$ -
Multi-family	-	-	-	-	-	-
Non-residential	-	-	-	1	1,807,708	7,708
Commercial	-	-	-	-	-	-
Consumer direct	-	-	-	-	-	-
Purchased auto	-	-	-	-	-	-
	5	\$ 662,065	\$ 2,609	7	\$ 2,440,906	\$ 7,708

For the year ended December 31, 2013, all five of the one-to-four family loan modifications were classified as TDRs due to A/B note restructurings which involved principal reductions. One of the new modifications paid-off two existing TDRs, with one new performing A note at a market rate and a charge off of the associated B note. Another of the new modifications restructured 7 impaired loans into an A/B note structure with the new A note at a market rate and performing and a charge off of the associated B note. The other three of the new modifications restructured 3 impaired loans for the same borrower into three A/B note structures with three new A notes at market rates but still nonperforming and a charge off of the associated B notes. Total charge-offs were approximately \$616,000 for these TDR's.

None of the loan modifications classified as TDRs during 2013 and 2012 had payment defaults (i.e. 60 days or more past due following a modification), during 2013 and 2012, respectively. All TDRs are evaluated for possible impairment and any impairment identified is recognized through the allowance. Additionally, the qualitative factors are updated quarterly for trends in economic and nonperforming factors, including consideration of TDRs.

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**Ottawa Savings Bancorp, Inc. & Subsidiary****Notes to Consolidated Financial Statements****Note 4. Loans and Allowance for Credit Losses (Continued)**

The following table presents the recorded investment in nonaccrual loans and loans past due over 90 days still on accrual status, by class of loans, as of December 31, 2013 and 2012:

		Loans Past Due
<b>December 31, 2013</b>	Nonaccrual	Over 90 Days Still Accruing
One-to-four family	\$3,549,498	\$ -
Multi-family	-	-
Non-residential	2,332,243	-
Commercial	-	-
Consumer direct	-	-
Purchased auto	-	-
	\$5,881,741	\$ -

		Loans Past Due
<b>December 31, 2012</b>	Nonaccrual	Over 90 Days Still Accruing
One-to-four family	\$3,067,190	\$106,457
Multi-family	-	-
Non-residential	2,985,987	164,305
Commercial	-	-
Consumer direct	-	-
Purchased auto	-	-
	\$6,053,177	\$270,762

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The following table presents the aging of the recorded investment in loans, by class of loans, as of December 31, 2013 and 2012:

	Loans	Loans	Loans 90	Total Past Due Loans	Current Loans	Total Loans
	30-59	60-89	or			
	Days Past Due	Days Past Due	More Days Past Due			
<b>December 31, 2013</b>						
One-to-four family	\$2,550,329	\$492,545	\$1,613,697	\$4,656,571	\$72,750,085	\$77,406,656
Multi-family	263,313	-	-	263,313	2,481,650	2,744,963
Non-residential	289,111	428,645	318,475	1,036,231	15,980,574	17,016,805
Commercial	25,795	-	-	25,795	7,834,517	7,860,312
Consumer direct	947	-	-	947	391,326	392,273
Purchased auto	22,719	-	-	22,719	8,139,470	8,162,189
	\$3,152,214	\$921,190	\$1,932,172	\$6,005,576	\$107,577,622	\$113,583,198

	Loans	Loans	Loans 90	Total Past Due Loans	Current Loans	Total Loans
	30-59	60-89	or			
	Days Past Due	Days Past Due	More Days Past Due			
<b>December 31, 2012</b>						
One-to-four family	\$2,322,111	\$616,274	\$1,621,408	\$4,559,793	\$78,458,963	\$83,018,756
Multi-family	97,267	-	-	97,267	4,752,499	4,849,766
Non-residential	473,458	334,389	516,414	1,324,261	19,182,599	20,506,860
Commercial	23,601	-	-	23,601	8,624,590	8,648,191
Consumer direct	-	-	-	-	542,652	542,652
Purchased auto	6,422	19,257	-	25,679	7,784,388	7,810,067
	\$2,922,859	\$969,920	\$2,137,822	\$6,030,601	\$119,345,691	\$125,376,292

## Ottawa Savings Bancorp, Inc. & Subsidiary

### Notes to Consolidated Financial Statements

#### Note 4. Loans and Allowance for Credit Losses (Continued)

##### Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. For commercial and non-residential real estate loans, the Company's credit quality indicator is internally assigned risk ratings. Each commercial loan is assigned a risk rating upon origination. The risk rating is reviewed annually, at a minimum, and on an as needed basis depending on the specific circumstances of the loan.

For residential real estate, multi-family real estate, consumer direct and purchased auto loans, the Company's credit quality indicator is performance determined by delinquency status. Delinquency status is updated regularly by the Company's loan system for residential real estate, multi-family real estate and consumer direct loans. The Company receives monthly reports on the delinquency status of the purchased auto loan portfolio from the servicing company.

The Company uses the following definitions for risk ratings:

Pass – loans classified as pass are of a higher quality and do not fit any of the other “rated” categories below (e.g. special mention, substandard or doubtful). The likelihood of loss is considered remote.

Special Mention – loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard – loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful – 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.



Not Rated – loans in this bucket are not evaluated on an individual basis.

As of December 31, 2013 and 2012, the risk category of loans by class is as follows:

<b>December 31, 2013</b>	Pass	Special			Not rated
		Mention	Substandard	Doubtful	
One-to-four family	\$-	\$1,242,347	\$3,455,604	\$ -	\$72,708,705
Multi-family	-	-	-	-	2,744,963
Non-residential	12,565,850	2,118,712	2,332,243	-	-
Commercial	7,860,021	291	-	-	-
Consumer direct	-	-	-	-	392,273
Purchased auto	-	-	-	-	8,162,189
<b>Total</b>	<b>\$20,425,871</b>	<b>\$3,361,350</b>	<b>\$5,787,847</b>	<b>\$ -</b>	<b>\$84,008,130</b>

<b>December 31, 2012</b>	Pass	Special			Not rated
		Mention	Substandard	Doubtful	
One-to-four family	\$-	\$3,925,077	\$2,891,821	\$ -	\$76,201,858
Multi-family	-	3,826	-	-	4,845,940
Non-residential	17,466,220	314,343	2,726,297	-	-
Commercial	8,486,147	162,044	-	-	-
Consumer direct	-	3,766	-	-	538,886
Purchased auto	-	-	-	-	7,810,067
<b>Total</b>	<b>\$25,952,367</b>	<b>\$4,409,056</b>	<b>\$5,618,118</b>	<b>\$ -</b>	<b>\$89,396,751</b>

**Ottawa Savings Bancorp, Inc. & Subsidiary****Notes to Consolidated Financial Statements****Note 4. Loans and Allowance for Credit Losses (Continued)**

The Bank has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal officers, their immediate families and companies in which these parties have a 10% or more beneficial ownership. In the opinion of management, these loans are made with substantially the same terms, including interest rate and collateral, as those prevailing for comparable transactions with other customers and do not involve more than the normal risk of collectability.

**Note 5. Servicing**

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of mortgage and other loans serviced for others were \$23,943,969 and \$23,162,585 at December 31, 2013 and 2012, respectively.

**Note 6. Accrued Interest Receivable**

Accrued interest receivable at December 31, 2013 and 2012, are summarized as follows:

	2013	2012
State and municipal securities	\$105,886	\$90,567
Residential mortgage-backed securities	90,288	82,593
Loans	456,519	523,478
	\$652,693	\$696,638

**Note 7. Premises and Equipment**

Premises and equipment at December 31, 2013 and 2012, are summarized as follows:

	2013	2012
Cost:		
Land	\$1,966,899	\$1,966,899
Buildings	6,694,313	6,688,463
Furniture and equipment	1,537,282	1,534,560
	10,198,494	10,189,922
Less: Accumulated depreciation	3,747,085	3,560,128
	\$6,451,409	\$6,629,794

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**Ottawa Savings Bancorp, Inc. & Subsidiary****Notes to Consolidated Financial Statements****Note 8. Deposits**

Deposits at December 31, 2013 and 2012 are summarized as follows:

	2013		2012	
	Amount	Percent	Amount	Percent
Non-interest bearing checking	\$5,219,028	3.58 %	\$4,313,635	2.78 %
Interest bearing checking	14,382,388	9.87 %	12,425,307	8.01 %
Money market	21,794,546	14.95 %	20,666,315	13.33 %
Passbook savings	16,941,081	11.62 %	15,217,679	9.81 %
Certificates of deposit	87,431,608	59.98 %	102,451,709	66.07 %
Interest bearing	140,549,623	96.42 %	150,761,010	97.22 %
Total	\$145,768,651	100.00 %	\$155,074,645	100.00 %

Interest expense on deposits for the years ended December 31, 2013 and 2012, is summarized as follows:

	December 31,	
	2013	2012
Money market	\$50,793	\$85,218
Savings	13,711	19,563
Certificates of deposit	1,381,045	2,054,420
Checking	6,410	10,441
	\$1,451,959	\$2,169,642

Deposits from directors, principal officers, and their immediate families at December 31, 2013 and 2012 were \$1,824,825 and \$1,529,230, respectively.

The aggregate amount of public deposits at December 31, 2013 and 2012 were \$2,968,766 and \$2,977,627, respectively.

The aggregate amount of certificates of deposit within a minimum denomination of \$100,000 was approximately \$35,803,000 and \$41,799,000 at December 31, 2013 and 2012, respectively. Of these certificates of deposit, there was approximately \$7,606,000 and \$9,075,000 at December 31, 2013 and 2012, respectively with minimum denominations of \$250,000.

At December 31, 2013, scheduled maturities of certificates of deposit are as follows:

2014	\$38,496,666
2015	20,974,016
2016	8,346,210
2017	8,571,082
2018	11,043,634
	\$87,431,608

The Company held brokered deposits of approximately \$272,000 and \$525,000 at December 31, 2013 and 2012, respectively. The broker receives a fee from the Company for the brokered deposits. Total fee expenses of \$606 and \$588 were recognized for the years ended December 31, 2013 and 2012, respectively.

**Ottawa Savings Bancorp, Inc. & Subsidiary**

**Notes to Consolidated Financial Statements**

**Note 9. Borrowings**

Our borrowings consist of open line advances from the Federal Home Loan Bank of Chicago and Federal Funds purchased from Bankers Bank of Wisconsin. As a member, we are required to own capital stock in the Federal Home Loan Bank of Chicago and are authorized to apply for advances on the security of such stock and certain of our mortgage loans and other assets (principally securities which are obligations of, or guaranteed by, the United States), provided certain standards related to credit-worthiness have been met. At December 31, 2013, we had the ability to borrow \$50.4 million from the FHLBC. In addition, as of December 31, 2013, the Bank had \$5.0 million of available credit from Bankers Bank of Wisconsin to purchase Federal Funds. There were no Federal Home Loan Bank advances and no Federal Funds purchased outstanding at December 31, 2013 and 2012.

**Note 10. Employment Benefit and Retirement Plans**

*Employee stock ownership plan*

On May 6, 2005, the Company adopted an employee stock ownership plan (ESOP) for the benefit of substantially all employees. The ESOP borrowed \$763,140 from the Company and used those funds to acquire 76,314 shares of the Company's stock in the initial public offering at a price of \$10.00 per share.

Shares purchased by the ESOP with the loan proceeds are held in a suspense account and are allocated to ESOP participants on a pro rata basis as principal and interest payments are made by the ESOP to the Company. The loan is secured by shares purchased with the loan proceeds and will be repaid by the ESOP with funds from the Company's discretionary contributions to the ESOP and earnings on the ESOP assets. Annual principal and interest payments of approximately \$77,000 are to be made by the ESOP.

As shares are released from collateral, the Company will report compensation expense equal to the current market price of the shares, and the shares will become outstanding for earnings-per-share (EPS) computations. Dividends on allocated ESOP shares reduce retained earnings; dividends on unallocated ESOP shares reduce accrued interest. During 2013, 5,087 shares, with an average fair value of \$7.85 per share were committed to be released, resulting in ESOP compensation expense of \$37,799, as compared to 5,088 shares, with an average fair value of \$5.82

per share, resulting in ESOP compensation expense of \$29,585 for 2012.

A terminated participant or the beneficiary of a deceased participant who received a distribution of employer stock from the ESOP has the right to require the Company to purchase such shares at their fair market value any time within 60 days of the distribution date. If this right is not exercised, an additional 60 day exercise period is available in the year following the year in which the distribution is made and begins after a new valuation of the stock has been determined and communicated to the participant or beneficiary. At December 31, 2013 and 2012, respectively, 37,539 shares at a fair value of \$8.50, and 34,451 shares at a fair value of \$6.90, have been classified as mezzanine capital.

	December 31,	
	2013	2012
Shares allocated	45,788	40,701
Shares withdrawn from the plan	(8,249 )	(6,250 )
Unallocated shares	30,526	35,613
Total ESOP shares	68,065	70,064
Fair value of unallocated shares	\$259,471	\$245,730

**Ottawa Savings Bancorp, Inc. & Subsidiary**

**Notes to Consolidated Financial Statements**

**Note 10. Employment Benefit and Retirement Plans (Continued)**

*Supplemental executive retirement plan (SERP)*

On September 19, 2007, the Bank entered into salary continuation agreements with certain of its executive officers to provide additional benefits upon retirement. The present value of the estimated liability under the agreement is being accrued using a discount rate of 6 percent ratably over the remaining years to the date when the executive is first eligible for benefits. The recorded SERP liability was \$667,521 and \$576,774 for the years ended December 31, 2013 and 2012, respectively. The SERP compensation charged to expense totaled \$106,978 and \$93,972 for the years ended December 31, 2013 and 2012, respectively.

*401(k) plan*

The Bank maintains a voluntary 401(k) plan for substantially all employees. Employees may contribute a percentage of their compensation to the plan subject to certain limits based on federal tax laws. The Bank makes matching contributions to the 401(k) plan of 50 percent of the first 6 percent of an employee's compensation contributed to the plan. The Bank also makes Safe Harbor contributions, in addition to any matching contributions, equal to 3 percent of an eligible employee's compensation to the 401(k) plan each pay period. Employer contributions vest to the employee ratably over a five-year period. Employer contribution expense was \$71,154 for 2013 and \$59,771 for 2012.

*Deferred compensation*

The Bank has deferred compensation agreements with certain directors. Contributions to the plan for the years ended December 31, 2013 and 2012 were \$52,885 and \$53,864, respectively. The deferred compensation liability included on the balance sheet in other liabilities was \$1,105,696 and \$939,028 as of December 31, 2013 and 2012, respectively.

*Post-retirement health benefit plan*



The Bank has a contributory post-retirement health benefit plan for officers that meet eligibility requirements outlined in the employee handbook. The accounting for the health care plan anticipates future cost-sharing changes that are consistent with the Bank's expressed intent to increase retiree contributions.

Post-retirement health benefits valuation

	December 31,	
	2013	2012
Number of participants:		
Retirees	3	3
Active employees - fully eligible	1	1
Active employees - not yet eligible	3	3
Total	7	7

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**Ottawa Savings Bancorp, Inc. & Subsidiary****Notes to Consolidated Financial Statements****Note 10. Employment Benefit and Retirement Plans (Continued)**

Obligations and funded status:

	Year ended December 31,	
	2013	2012
<b>Change in benefit obligation</b>	(Amounts in thousands)	
Benefit obligation at beginning of year	\$241	\$184
Service cost	5	4
Interest cost	10	9
Actuarial loss	36	47
Benefits paid	(7 )	(6 )
Retiree contributions	3	3
Benefit obligation at end of year	288	241
<b>Change in plan assets</b>		
Employer contributions	3	3
Retiree contributions	4	3
Benefits paid	(7 )	(6 )
Fair value of plan assets at year end	-	-
Funded status	(288)	(241)
Actuarial loss (gain)	(116)	(171)
Net amount recognized	\$(404)	\$(412)

Amounts recognized in the statement of financial position consist of:

	December 31,	
	2013	2012
Accumulated post-retirement benefit obligation:		
Retirees	\$(64,642 )	\$(52,721 )
Active employees - fully eligible	(63,757 )	(55,724 )
Active employees - not yet eligible	(159,300)	(132,062)
Total	(287,699)	(240,507)
Plan assets at fair value	-	-
Funded status	(287,699)	(240,507)
Actuarial (gain)	(116,134)	(171,279)

(Accrued) cost included in other liabilities            \$(403,833) \$(411,786)

Components of Net Periodic Benefit Cost:

	Year ended	
	December 31,	
	2013	2012
Service cost	\$4,706	\$3,549
Interest cost	9,741	9,136
Amortization net gain	(19,789)	(18,291)
Net cost	\$(5,342 )	\$(5,606 )

**Ottawa Savings Bancorp, Inc. & Subsidiary**

**Notes to Consolidated Financial Statements**

**Note 10. Employment Benefit and Retirement Plans (Continued)**

Weighted average assumptions used to determine net periodic benefit cost:

	December 31,	
	2013	2012
Discount rate	4.92%	4.00%
Expected long-term return on plan assets	-	-
Rate of compensation increase	-	-

Assumed health care cost trend rates:

	December 31,	
	2013	2012
Health care cost trend rate assumed for next year	8.00%	8.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	6.00%	4.00%
Year that the rate reaches the ultimate trend rate	2018	2017

A one-percentage-point change in the assumed health care cost trend rate would have the following effects:

	1-Percentage-Point	
	Point Increase	Point Decrease
	(Amounts in thousands)	
Effect on total of service and interest cost components	\$ 3	\$ (2 )
Effect on post-retirement benefit obligation	\$ 55	\$ (44 )

Cash Flows:

Contributions: The Bank expects to contribute \$9,000 to its post-retirement benefit plan in 2014.

Estimated Future Benefit Payments: The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

Year	Other Benefits (Amounts in thousands)
2014	\$ 9
2015	11
2016	15
2017	21
2018	23
2019- 2023	181

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**Ottawa Savings Bancorp, Inc. & Subsidiary****Notes to Consolidated Financial Statements****Note 11. Stock Compensation***Management recognition plan*

A Management Recognition and Retention Plan (“MRP”) provides for the issuance of shares to directors and officers. Pursuant to the Ottawa Savings Bancorp, Inc. 2006 Equity Incentive Plan, 43,608 shares were purchased by the Company in November 2006, at an average cost of \$13.46 per share. Granted shares vest in equal installments over a five year period, with ownership of the shares transferring to the recipient upon vesting. The unamortized cost of shares not yet vested of \$21,024 and \$33,977 at December 31, 2013 and 2012, respectively, are reported as reductions of stockholders’ equity.

A summary of the status of the MRP stock awards is as follows:

		Weighted Average Grant Date Fair Value
Year ending December 31, 2013	Shares	
Outstanding and non-vested at beginning of year	6,719	\$ 5.16
Granted	-	-
Vested and transferred to recipients	(2,180)	) 5.94
Outstanding and non-vested at end of year	4,539	\$ 4.79
		Weighted Average Grant Date Fair Value
Year ending December 31, 2012	Shares	
Outstanding and non-vested at beginning of year	8,899	\$ 5.35

Granted	-	-
Vested and transferred to recipients	(2,180	) 5.94
Outstanding and non-vested at end of year	6,719	\$ 5.16

The total compensation cost at December 31, 2013, related to non-vested shares not yet recognized was approximately \$21,000 with an average expense recognition period of 1.8 years. The Company recognized compensation expense of approximately \$13,000 and \$7,100, for the years ended December 31, 2013 and 2012, respectively. At December 31, 2013, 4,539 shares remain non-vested and are expected to be exercisable in accordance with their original terms.

#### *Stock option plan*

A Recognition and Retention Plan (“RRP”) provides for the issuance of stock options to directors, officers and employees. Pursuant to the Ottawa Savings Bancorp, Inc. 2006 Equity Incentive Plan, on November 21, 2006, the Company granted stock options to purchase 92,666 shares of the Company’s common stock, at an exercise price of \$12.35 per share. Under the same plan, the Company granted stock options to purchase 5,451 shares of the Company’s common stock, at an exercise price of \$9.90 per share on December 21, 2008, 8,722 shares of the Company’s common stock, at an exercise price of \$6.00 per share on November 17, 2010, and 13,083 shares of the Company’s common stock, at an exercise price of \$4.25 per share on November 16, 2011. The options become exercisable in equal installments over a five year period from the grant date. The options expire ten years from the grant date.

**Ottawa Savings Bancorp, Inc. & Subsidiary****Notes to Consolidated Financial Statements****Note 11. Stock Compensation (Continued)**

The fair value of the stock options granted has been estimated using a Black-Scholes option pricing model. This option pricing model requires management to make subjective assumptions, such as expected stock price volatility, dividend rates, and expected time to exercise. There were no options granted during 2013 and 2012.

A summary of the status of the outstanding RRP stock options is as follows:

Year ended December 31, 2013	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at beginning of year	92,667	\$ 10.46	5.10	\$ -
Granted	-	-		
Exercised	-	-		
Outstanding at end of year	92,667	\$ 10.46	4.10	\$ -
Exercisable at year end	81,326	\$ 11.26	3.61	\$ -

Year ended December 31, 2012	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at beginning of year	92,667	\$ 10.46	6.10	\$ -



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Granted	-	-			
Exercised	-	-			
Outstanding at end of year	92,667	\$ 10.46	5.10	\$	-
Exercisable at year end	75,875	\$ 11.64	4.37	\$	-

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**Ottawa Savings Bancorp, Inc. & Subsidiary****Notes to Consolidated Financial Statements****Note 11. Stock Compensation (Continued)**

A summary of the vesting status of the RRP stock options at December 31, 2013 is as follows:

Stock Options	Shares	Weighted
		Average Exercise Price
Non-vested at beginning of year	16,792	\$ 5.16
Granted	-	-
Vested	(5,451 )	5.94
Non-vested at end of year	11,341	\$ 4.79

The total compensation cost at December 31, 2013, related to non-vested options not yet recognized was approximately \$25,500 with an average expense recognition period of 1.8 years. The Company recognized compensation expense of approximately \$14,000 and \$11,000 for each of the years ended December 31, 2013 and 2012, respectively.

**Note 12. Income Taxes**

The Company and Bank file a consolidated federal income tax return on a calendar year basis.

Income tax expense (benefit) is summarized as follows:

	Years Ended	
	December 31,	
	2013	2012
Federal:		
Current	\$363,770	\$(229,782)
Deferred	28,623	464,562
	392,393	234,780
State:		
Current	138,944	73,510
Deferred	8,655	(38,088 )
	147,599	35,422
	\$539,992	\$270,202

The Company's income tax differed from the maximum statutory federal rate of 35% for the years ended December 31, 2013 and 2012, as follows:

	Years Ended	
	December 31,	
	2013	2012
Expected income taxes	\$514,192	\$330,537
Income tax effect of:		
State taxes, net of federal tax benefit	95,939	23,024
Tax exempt interest	(83,386 )	(63,766 )
Income taxed at lower rates	(14,691 )	(9,444 )
Other	27,938	(10,149 )
	\$539,992	\$270,202

**Ottawa Savings Bancorp, Inc. & Subsidiary****Notes to Consolidated Financial Statements****Note 12. Income Taxes (Continued)**

The components of the net deferred tax asset are as follows:

	December 31,	
	2013	2012
Deferred tax assets		
Unrealized loss on securities available for sale	\$2,310	\$-
Employee benefit plans	857,758	759,470
Allowance for loan losses	1,146,769	1,332,288
Net operating loss carryforwards	109,708	136,242
MRP/RRP compensation	183,885	186,562
Other	149,642	70,478
	2,450,072	2,485,040
Deferred tax liabilities		
Unrealized gain on securities available for sale	-	(241,377 )
	-	(241,377 )
<b>Net deferred tax asset</b>	<b>\$2,450,072</b>	<b>\$2,243,663</b>

Retained earnings at December 31, 2013 include approximately \$1,169,000 for which no federal income tax liability has been recognized. This amount represents an allocation of income to bad debt deductions for tax purposes only. Reductions of amounts so allocated for purposes other than bad debt losses or adjustments arising from carry-back of net operating losses would create income for tax purposes only, which would be subject to the then current corporate income tax rate. The unrecorded deferred income tax liability on the above amount was approximately \$453,000 at December 31, 2013.

At December 31, 2013 the Company had Illinois net operating loss carry forwards of \$2.0 million. At December 31, 2012 the Company had federal and Illinois net operating loss carry forwards of \$2.2 million comprised of approximately \$0.1 million of federal and \$2.1 million of Illinois. The Illinois net operating loss carry forwards will begin to expire in 2023.

Management believes that it is more likely than not that the deferred tax assets included in the accompanying consolidated balance sheets will be fully utilized. We have determined that no valuation allowance is required as of December 31, 2013, although there is no guarantee that those assets will be fully recognizable in future periods.

**Note 13. Regulatory Matters**

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

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**Ottawa Savings Bancorp, Inc. & Subsidiary**

**Notes to Consolidated Financial Statements**

**Note 13. Regulatory Matters (continued)**

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total risk-based capital and Tier 1 capital to risk-weighted assets (as defined in the regulations), Tier 1 capital to adjusted total assets (as defined), and tangible capital to adjusted total assets (as defined). Management believes as of December 31, 2013 and 2012, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2013, the most recent examination conducted by the OCC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as disclosed in the following table. There are no conditions or events that management believes have occurred that would change the Bank's capitalization classification.

The Bank's actual capital amounts and ratios as of December 31, 2013 and 2012 are presented below:

Actual	For Capital Adequacy Purposes:	To Be Well
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