

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2010 or

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

For the transition period from _____ to _____

Commission File Number: 0-26003

ALASKA PACIFIC BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Alaska (State or other jurisdiction of incorporation or organization) 92-0167101 (I.R.S. Employer Identification No.)

2094 Jordan Avenue, Juneau, Alaska 99801
(Address of principal executive offices) (Zip code)

Registrant's telephone number, including area code: (907) 789-4484

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

Securities registered pursuant to Section 12(g) of the Exchange 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 15(d) of the Exchange Act. Yes No

Indicate by check mark whether the registrant (1) 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

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 (§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 (§229.405 of this chapter) 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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer 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 March 1, 2011, there were 655,415 issued and 654,486 outstanding shares of the registrant's common stock, which are traded on the over-the-counter market through the OTC "Electronic Bulletin Board" under the symbol "AKPB." Based on the closing price of the common stock on June 30, 2010, the aggregate value of the Common Stock outstanding held by nonaffiliates of the registrant was \$3.4

million (550,283 shares at \$6.15 per share). For purposes of this calculation, shares of common stock held by each executive officer and director have been excluded.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Proxy Statement for the 2010 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

**Alaska Pacific Bancshares, Inc. and Subsidiary
Juneau, Alaska**

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Forward-Looking Statements

“Safe Harbor” statement under the Private Securities Litigation Reform Act of 1995: This Form 10-K contains certain “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may be identified by the use of words such as “believe,” “expect,” “anticipate,” “should,” “planned,” “estimated,” and “potential.” These forward-looking statements relate to, among other things, expectations of the business environment in which we operate, projections of future performance, perceived opportunities in the market, potential future credit experience, and statements regarding our strategies. These forward-looking statements are based upon current management expectations and may, therefore, involve risks and uncertainties. Our actual results, performance, or achievements may differ materially from those suggested, expressed, or implied by forward-looking statements as a result of a wide variety or range of factors including, but not limited to: the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs that may be impacted by deterioration in the housing and commercial real estate markets and may lead to increased losses and non-performing assets in our loan portfolio, result in our allowance for loan losses not being adequate to cover actual losses, and require us to materially increase our reserves; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources; deposit flows; fluctuations in the demand for loans, the number of unsold homes and other properties and fluctuations in real estate values in our market areas; adverse changes in the securities markets; results of examinations of us and our bank subsidiary by the Office of Thrift Supervision and the Federal Deposit Insurance Corporation, or other regulatory authorities, including the possibility that any such

regulatory authority may, among other things, require us to increase our reserve for loan losses, write-down assets, change our regulatory capital position or affect our ability to borrow funds or maintain or increase deposits, which could adversely affect our liquidity and earnings; the possibility that we will be unable to comply with the conditions imposed upon us in the Orders to Cease and Desist entered into with the Office of Thrift Supervision, including but not limited to our ability to reduce our non-performing assets, which could result in the imposition of additional restrictions on our operations; our ability to control operating costs and expenses; the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; difficulties in reducing risk associated with the loans on our balance sheet; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our work force and potential associated charges; computer systems on which we depend could fail or experience a security breach, or the implementation of new technologies may not be successful; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; our ability to manage loan delinquency rates; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; legislative or regulatory changes that adversely affect our business including changes in regulatory polices and principles, including the interpretation of regulatory capital or other rules; the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the implementing regulations; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; the economic impact of war or any terrorist activities; other economic, competitive, governmental, regulatory, and technological factors affecting our operations; pricing, products and services; time to lease excess space in Company-owned buildings; future legislative changes in the United States Department of Treasury Troubled Asset Relief Program Capital Purchase Program; and other risks detailed in our reports filed with the Securities and Exchange Commission. Any of the forward-looking statements that we make in this Form 10-K and in the other public statements we make may turn out to be wrong because of the inaccurate assumptions we might make, because of the factors illustrated above or because of other factors that we cannot foresee. Because of these and other uncertainties, our actual future results may be materially different from those expressed in any forward- looking statements made by or on our behalf. Therefore, these factors should be considered in evaluating the forward-looking statements, and undue reliance should not be placed on such statements. We undertake no responsibility to update or revise any forward-looking statements.

As used throughout this report, the terms “we”, “our” or “us” refer to Alaska Pacific Bancshares, Inc. and our consolidated subsidiary, Alaska Pacific Bank.

Available Information

Alaska Pacific Bancshares, Inc. posts its annual report to shareholders, annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and press releases on its investor information page at www.alaskapacificbank.com. These reports are posted as soon as reasonably practicable after they are electronically filed with the Securities and Exchange Commission (“SEC”). All of Alaska Pacific Bancshares, Inc.’s SEC filings are also available free of charge at the SEC’s website at www.sec.gov or by calling the SEC at 1-800-SEC-0330.

PART I

Item 1. Business

General

Alaska Pacific Bancshares, Inc. (“Company”), an Alaska corporation, was organized on March 19, 1999 for the purpose of becoming the holding company for Alaska Pacific Bank (“Alaska Pacific” or the “Bank”) upon the Bank’s conversion from a federal mutual to a federal stock savings bank (“Conversion”). The Conversion was completed on July 1, 1999. At December 31, 2010, the Company had total assets of \$174.4 million, total deposits of \$147.5 million and stockholders’ equity of \$19.8 million. The Company has not engaged in any significant activity other than holding the stock of the Bank. Accordingly, the information set forth in this report, including financial statements and related data, relates primarily to the Bank.

Alaska Pacific was founded as “Alaska Federal Savings and Loan Association of Juneau” in 1935 and changed its name to “Alaska Federal Savings Bank” in October 1993. In connection with the Conversion, Alaska Pacific changed its name from “Alaska Federal Savings Bank” to its current title. The Bank, as a federally-chartered savings institution, is regulated by the Office of Thrift Supervision (“OTS”), its primary federal regulator, and the Federal Deposit Insurance Corporation (“FDIC”), as its deposit insurer. The Bank’s deposits are insured up to applicable limits by the Deposit Insurance Fund administered by the FDIC. The Bank has been a member of the Federal Home Loan Bank (“FHLB”) System since 1937.

Alaska Pacific operates as a community oriented financial institution and is devoted to serving the needs of its customers. The Bank’s business consists primarily of attracting retail deposits from the general public and using those funds to originate one-to-four-family mortgage loans, commercial business loans, consumer loans, construction loans and commercial real estate loans.

Participation in the U.S. Treasury’s Capital Purchase Program.

On February 9, 2009, the Company received \$4.8 million from the U.S. Treasury Department as part of the Treasury’s Capital Purchase Program. The Company issued \$4.8 million in senior preferred stock, with a related warrant to purchase up to \$717,150 in common stock, to the U.S. Treasury. The warrant provides the Treasury the option to purchase up to 175,772 shares of the Company’s common stock at a price of \$4.08 per share at any time during the next ten years. The preferred stock pays a 5% dividend for the first five years, after which the rate will increase to 9% if the preferred shares are not redeemed by the Company. The terms and conditions of the transaction and the preferred stock conform to those provided by the U.S. Treasury. A summary of the Capital Purchase Program can be found on the Treasury’s web site at www.ustreas.gov/initiatives/eesa. The additional capital enhances our capacity to support the communities we serve through expanded lending activities and economic development. This capital will also add flexibility in considering strategic opportunities that may be available to us as the financial services industry continues to consolidate.

Regulatory Matters

On September 28, 2010, the Company and the Bank each entered into a Stipulation and Consent to the Issuance of an Order to Cease and Desist with the Office of Thrift Supervision (individually an “Order” and collectively the “Orders”).

Under the terms of the OTS Orders, the Company and the Bank, without the prior written approval of the OTS, may not:

- Increase assets during any quarter;
- Pay dividends;
- Increase brokered deposits;
- Repurchase shares of the Company's outstanding common stock;
- Issue any debt securities or incur any debt (other than that incurred in the normal course of business); and
- Make payments on any existing debt.

Other material provisions of the Orders require the Bank and the Company to:

- develop a capital plan for preserving and enhancing capital levels that is acceptable to the OTS;
- develop a business plan for enhancing, measuring and maintaining profitability, increasing earnings, acceptable to the OTS;
- submit a comprehensive plan for reducing classified assets, acceptable to the OTS;
- develop and submit a policy for the management and maintenance of liquidity, which includes a contingency plan for anticipating funding needs and alternative funding sources, acceptable to the OTS;
- develop and submit a plan to internally audit the nature, scope and risk of activities and operations, acceptable to the OTS;
- revise and submit a plan to comply with applicable consumer and related compliance laws and regulations, including a risk assessment process to measure such compliance, acceptable to the OTS;
- develop and submit a plan regarding information technology ("IT") management, including a succession plan for key personnel, duties/responsibilities and training of IT personnel, acceptable to the OTS;
- develop and implement a risk based IT audit program that complies with all laws and regulations;
- develop and submit a plan for addressing contingency planning related to any back-up IT server(s);
- not appoint any new director or senior executive officer or change the responsibilities of any current senior executive officers without notifying the OTS;
- not enter into, renew, extend or revise any compensation or benefit agreements for directors or senior executive officers;
- not make any indemnification, severance or golden parachute payments;
- not enter into any arrangement or contract with a third party service provider that is significant to the overall operation or financial condition of the Bank, or that is outside the normal course of business;
- ensure the Bank's compliance with applicable laws, rules, regulations and agency guidelines, including the terms of the order; and
- prepare and submit progress reports to the OTS regarding compliance with the capital plan, business plan, and certain classified assets.

The Company and the Bank have implemented a comprehensive plan to achieve full compliance with the Orders. The Orders contain target dates to achieve the items listed above including that the Bank's Tier 1 (Core) capital ratio be equal to or greater than 8%, after the funding of an adequate allowance for loan and lease losses by September 30, 2010. At December 31, 2010, the Bank's Tier 1 (Core) capital ratio was 11.24% after the funding of an adequate allowance for loan and lease losses, which exceeded the Order requirements. Despite the Bank exceeding the capital ratio requirements of the Order, under OTS regulations an institution that enters into a written order (such as the Order) is automatically considered to be not "well capitalized" and, therefore, the Bank is deemed "adequately capitalized" for OTS purposes in connection with the Order.

In addition, both the Company and the Bank must obtain prior regulatory approval before adding any new director or senior executive officer or changing the responsibilities of any current senior executive officer or pay pursuant to or by entering into certain severance and other forms of compensation agreements.

The OTS Orders will remain in effect until modified or terminated by the OTS. A copy of the Order is attached to the Form 8-K that was filed with the Securities and Exchange Commission (“SEC”) on October 4, 2010. See also Item 1A. “Risk Factors -- We are subject to certain regulatory restrictions and lack of compliance could result in monetary penalties and/or additional regulatory actions.”

Market Area

Alaska Pacific Bank’s primary markets are in the communities of Juneau, Ketchikan and Sitka, but the Bank serves the entire region of southeast Alaska. The southeast spans nearly 500 miles from Yakutat in the north to Prince of Wales Island to the south and encompasses approximately 35,000 square miles of land distributed amongst the islands and coastline of the Alaska Panhandle. Southeast Alaska is home to approximately 69,000 residents in 14 communities, a population that, with the exception of Juneau, Ketchikan and Sitka, has shown slow but steady decline over the past nine years. The three major markets are geographically isolated with no road access, and are accessible only by ferry or airline. While the region shares similar economic characteristics there are some diverse and unique industries from community to community.

Historically, Southeast Alaska has been relatively immune from the direct impact of economic problems in the “lower 48.” The region has demonstrated its stability over time missing the “booms” and avoiding the “busts” without significant swings in either direction. While not totally immune, the region remained relatively insulated from the recent deep recession and did not experience the levels of unemployment or drop in real estate values felt in many other parts of the country. As a primary example, according to the State of Alaska Department of Labor, the December 2010 unemployment rate for Juneau, the Bank’s largest market area, was 5.8% compared to 8% statewide and 9% nationwide. Relative to housing, Juneau saw its greatest drop in values during 2008, which was 9%, but over 2009 and midway through the 2010, values had recovered by 4% for each of the periods, offsetting the 2008 decline.

Previous concerns over the tourism market, with specific attention on the cruiseship industry, has dissipated somewhat. While there were material declines in the industry over the past two seasons, current trends regarding the number of cruiseship visitors to the region indicate that 2011 will mirror 2010, with 2012 expected to return to near pre-recession levels. In Juneau, the Kensington Gold Mine finally began production after years of environmental litigation, adding a significant private sector employer to the local market. In Ketchikan, the Ketchikan Ship Yard continues with its expansion plans. These two projects alone will create more than 400 new, high paying jobs in the region, offsetting more than half of the decline experienced over the past two to three years.

Alaska Pacific’s administrative headquarters and largest banking office, one full service branch and the Bank’s mortgage operation, are located in Juneau which has a population of 30,661 as of 2009. The population showed a 1% increase between 2008 and 2009. Juneau is the capital of Alaska with its primary economic resources being state and federal government, tourism, fish processing, fishing and mining. Juneau’s historically active mining industry (primarily gold and silver), which had seen decades of decline, has gained importance in the area’s economy. According to the Alaska Department of Labor, the largest employers in Juneau are the state, local and federal agencies, followed by Bartlett Regional Hospital and the University of Alaska. In terms of employment and total payroll between private and governmental agencies in 2009, the private sector employed an annual average of 10,245 employees with annual wages of \$374 million while government employed an annual average of 7,284 with annual wages of \$380 million.

Two full service offices of Alaska Pacific are located in Ketchikan, with a population of approximately 12,994 estimated as of July 2009 by the Alaska Department of Labor. Ketchikan is an industrial center and a major port of entry into Southeast Alaska. Ketchikan’s key economic industries are a large fishing fleet, fish

processing facilities, timber and wood products manufacturing, and tourism. The largest employers in the Ketchikan Gateway Borough include the city and state government, Ketchikan General Hospital, the Ketchikan Gateway School District, the Ketchikan Ship Yard and the federal government.

One full service office of Alaska Pacific is located in Sitka, with a population of approximately 8,627 estimated as of July 2009 by the Alaska Department of Labor. Sitka is located on the west coast of Baranof Island on Sitka Sound. The primary economic sources in Sitka are fishing, fish processing, tourism, government, transportation, and retail and health care services. The largest employers in Sitka include the Southeast Alaska Regional Health Corp., the Sitka Borough School District, city, state and federal governments and the Sitka Community Hospital. Other Sitka employers include the Alaska State Trooper Training Academy and numerous businesses involved in commercial and sport fishing and tourism.

Lending Activities

General. At December 31, 2010, Alaska Pacific's loan portfolio (excluding loans held for sale) amounted to \$141.9 million, or 81% of total assets at that date. Alaska Pacific originates conventional mortgage loans, construction loans, commercial real estate loans, land loans, consumer loans and commercial business loans. Over 75% of Alaska Pacific's loan portfolio is secured by real estate, either as primary or secondary collateral, located in its primary market area.

Loan Portfolio Analysis. The following table sets forth the composition of Alaska Pacific's loan portfolio (excluding loans held for sale) as of the dates indicated.

| <i>(dollars in thousands)</i> December 31, | 2010 | | 2009 | |
|--|-----------|---------|-----------|---------|
| | Amount | Percent | Amount | Percent |
| Real estate: | | | | |
| Permanent: | | | | |
| One-to-four-family | \$25,194 | 17.75% | \$33,787 | 21.37% |
| Multifamily | 1,959 | 1.38 | 1,736 | 1.10 |
| Commercial nonresidential | 66,084 | 46.56 | 64,453 | 40.77 |
| Total permanent | 93,237 | 65.69 | 99,976 | 63.24 |
| Land | 6,463 | 4.56 | 9,697 | 6.13 |
| Construction: | | | | |
| One-to-four-family | 1,819 | 1.28 | 3,050 | 1.93 |
| Commercial nonresidential | 1,227 | 0.86 | 2,637 | 1.67 |
| Total construction | 3,046 | 2.14 | 5,687 | 3.60 |
| Commercial business | 19,365 | 13.64 | 19,856 | 12.56 |
| Consumer: | | | | |
| Home equity | 13,509 | 9.52 | 16,522 | 10.45 |
| Boat | 4,242 | 2.99 | 4,287 | 2.71 |
| Automobile | 1,167 | 0.82 | 1,269 | 0.80 |
| Other | 909 | 0.64 | 814 | 0.51 |
| Total consumer | 19,827 | 13.97 | 22,892 | 14.47 |
| Total loans | 141,938 | 100.00% | 158,108 | 100.00% |
| Less: | | | | |
| Allowance for loan losses | 1,583 | | 1,786 | |
| Loans, net | \$140,355 | | \$156,322 | |

One-to-four-family Real Estate Lending. Historically, Alaska Pacific has concentrated its lending activities on the origination of loans secured by first mortgages on existing one-to-four-family residences located in its primary market area. At December 31, 2010, \$25.2 million, or 17.8%, of Alaska Pacific's total loan portfolio consisted of these loans. Alaska Pacific originated \$30.5 million and \$47.6 million of one-to-four-family residential mortgage loans during the years ended December 31, 2010 and 2009, respectively.

Generally, Alaska Pacific's fixed-rate one-to four-family mortgage loans have maturities of 15 and 30 years and are fully amortizing with monthly payments sufficient to repay the total amount of the loan with interest by the end of the loan term. Generally, Alaska Pacific originates these loans under terms, conditions and documentation which permits them to be sold to U.S. Government sponsored agencies such as the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Alaska Housing Finance Corporation ("AHFC"), a state agency that provides affordable housing programs. Alaska Pacific's fixed-rate loans customarily include "due on sale" clauses, which gives the Bank the right to declare a loan immediately due and payable in the event the borrower sells or otherwise disposes of the real property subject to the mortgage and the loan is not paid.

Alaska Pacific offers adjustable rate mortgage loans at rates and terms competitive with market conditions. At December 31, 2010, \$4.0 million, or 15.9%, of Alaska Pacific's one-to-four-family residential loan portfolio consisted of adjustable rate mortgage loans. Demand for conventional adjustable rate mortgage loans has been very low in the Bank's market area, but have increased with the advent of "hybrid mortgages," which are adjustable rate loans with the interest rate fixed for an initial period of three to five years.

Alaska Pacific originates one-to-four-family mortgage loans under Freddie Mac, the Federal Housing Administration, the Veterans Administration, and AHFC programs. Alaska Pacific generally sells these loans in the secondary market, with servicing retained. This means that Alaska Pacific retains the right to collect principal and interest payments on the loans and forward these payments to the purchaser of the loan, maintain escrow accounts for payment of taxes and insurance and perform other loan administration functions. See "-- Loan Originations, Sales and Purchases." Alaska Pacific also uses a larger private mortgage investor as a source for funding mortgages through correspondent lending programs.

Alaska Pacific requires title insurance insuring the status of its lien on all loans where real estate is the primary source of security. Alaska Pacific also requires that fire and casualty insurance, and flood insurance where appropriate, be maintained in an amount at least equal to the outstanding loan balance.

One-to-four-family residential mortgage loans may be made up to 80% of the appraised value of the security property without private mortgage insurance. Pursuant to underwriting guidelines adopted by the Board of Directors, Alaska Pacific can lend up to 97% of the appraised value of the property securing a one-to-four-family residential loan; however, Alaska Pacific generally obtains private mortgage insurance on the portion of the principal amount that exceeds 80% of the appraised value of the security property.

Alaska Pacific also originates loans secured by non-owner occupied residential properties that are sold to Freddie Mac.

Land Lending. Alaska Pacific also originates loans secured by first mortgages on residential building lots on which the borrower proposes to construct a primary residence. These loans generally have terms of up to 12 years and can be either fixed-rate or floating rate loans. Alaska Pacific also originates commercial land loans, which have floating rates that adjust annually. At December 31, 2010 and 2009, land loans amounted to \$6.5 million and \$9.7 million, respectively. The \$3.2 million decrease in land loans during fiscal 2010 was primarily attributable to a decline in demand for land loans and a \$1.3 million foreclosed land loan during 2010.

Loans secured by undeveloped land or improved lots involve greater risks than one-to-four-family residential mortgage loans because these loans are more difficult to evaluate. If the estimate of value proves to be inaccurate, in the event of default and foreclosure, Alaska Pacific may be confronted with a property value that is insufficient to assure full repayment of the loan.

Construction Lending. At December 31, 2010, construction loans amounted to \$3.0 million, or 2.2% of total loans, most of which were secured by properties located in Alaska Pacific's primary market area. This compares with \$5.7 million, or 3.6% of the total loan portfolio at December 31, 2009. The \$2.7 million decrease is attributable to a decline in demand for construction loans, both residential and commercial.

At December 31, 2010, \$3.0 million of our construction loan portfolio consisted of loans requiring interest only payments of which \$2.1 million or 70% of the total construction loans were relying on the interest reserve to make this payment. As a result, construction lending often involves the disbursement of substantial funds with repayment dependent on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor themselves to repay principal and interest.

Construction loans are made for maximum terms of nine to 18 months and are made at fixed or adjustable rates with interest payable monthly. Alaska Pacific originates construction loans to individuals who have a contract with a builder for the construction of their residence. Alaska Pacific typically requires that permanent financing with Alaska Pacific or some other lender be in place prior to closing any construction loan to an individual. Alaska Pacific generally underwrites these loans, which typically convert to a fully amortizing adjustable- or fixed-rate loan at the end of the construction term, according to the underwriting standards for a permanent loan.

Construction loans to builders, or speculative loans, are typically made with a maximum loan-to-value ratio of the lesser of 80% of the cost of construction or 75% of the appraised value. Construction loans made to home builders are termed “speculative” because the home builder does not have, at the time of loan origination, a signed contract with a home buyer who has a commitment for permanent financing with either Alaska Pacific or another lender for the finished home. The home buyer may be identified either during or after the construction period, with the risk that the builder will have to service the debt on the speculative construction loan and finance real estate taxes and other carrying costs of the completed home for a significant time after the completion of construction until the home buyer is identified.

Prior to making a commitment to fund a construction loan, Alaska Pacific requires an appraisal of the property by an independent state-licensed and qualified appraiser approved by the Board of Directors. Alaska Pacific’s staff also reviews and inspects projects prior to any disbursement of funds during the term of the construction loan. The review consists of examining the percentage of funds expended compared to the percentage of work completed and examining interest reserves compared to work left to finish the project.

Although construction lending affords Alaska Pacific the opportunity to achieve higher interest rates and fees with shorter terms to maturity than one-to-four-family mortgage lending, construction lending is generally considered to involve a higher degree of risk than one-to-four-family mortgage lending. Generally, these loans are considered to involve more risk than one-to-four-family loans because they are more difficult to evaluate. At the time the loan is made, the value of the collateral securing the loan must be estimated based on the projected selling price at the time the residence is completed, typically six to 12 months later, and on estimated building and other costs (including interest costs). However, appraisers will use both market and income valuation approaches in addition to cost to establish value. Changes in the demand for new housing in the area and higher-than-anticipated building costs may cause actual results to vary significantly from those estimated. Accordingly, Alaska Pacific may be confronted, at the time the residence is completed, with a loan balance exceeding the value of the collateral. Because construction loans require active monitoring of the building process, including cost comparisons and on-site inspections, these loans are more difficult and costly to monitor. Increases in market rates of interest may have a more pronounced effect on construction loans by rapidly increasing the end-purchasers’ borrowing costs, thereby reducing the overall demand for new housing. The fact that in-process homes are difficult to sell and typically must be completed in order to be successfully sold also complicates the process of working out problem construction loans. This may require Alaska Pacific to advance additional funds and/or contract with another builder to complete the residence. Furthermore, in the case of speculative construction loans, there is the added risk associated with identifying an end-purchaser for the finished home.

Alaska Pacific has attempted to minimize the foregoing risks by, among other things, limiting its construction lending, and especially speculative loans, to a small number of well-known local builders. One-to-four-family construction loans generally range in size from \$100,000 to \$600,000, while commercial nonresidential and multifamily construction loans have generally ranged from \$500,000 to \$2.5 million. At December 31, 2010, the largest construction loan was approximately \$1.0 million for a land development construction project located in Alaska, which was performing in accordance with its terms.

Multifamily and Commercial Real Estate Lending. The multifamily residential loan portfolio consists primarily of loans secured by small apartment buildings and the commercial real estate loan portfolio consists primarily of loans secured by retail, office, warehouse, mini-storage facilities and other improved commercial properties. These loans generally range in size from \$100,000 to \$2.5 million and at December 31, 2010 the largest loan totaled \$2.6 million and was performing in accordance with its terms. At December 31, 2010, Alaska Pacific had \$2.0 million of multifamily residential and \$66.1 million of commercial real estate loans, or 1.4% and 46.6%, respectively, of the total loan portfolio at this date. Multifamily and commercial real estate loans are generally underwritten with loan-to-value ratios of up to 75% of the lesser of the appraised value or the purchase price of the property. These loans generally are made at interest rates based on the prime rate for 15 to 20 year terms, with adjustment periods of one, three or five years and an adjustment rate equal to the prime rate plus a negotiated margin of 1% to 3%. In addition, many of these loans have interest rate floors ranging from 5.25% to 6.00%. Alaska Pacific is increasingly using interest rate floors in the current low interest rate environment to protect or enhance yield. While a majority of Alaska Pacific's multifamily and commercial real estate loans are secured by properties located within Alaska Pacific's primary market area, others are secured by properties elsewhere in Alaska as well as Washington, Oregon, Utah, Colorado, California, and Idaho.

Alaska Pacific is also an approved lender under the AHFC Multifamily Participation Program, which was introduced in 1998. The AHFC Multifamily Participation Program provides for up to 80% of the loan amount, which allows Alaska Pacific to pursue larger lending opportunities while mitigating its risk.

From time to time, Alaska Pacific purchases participations in multifamily and commercial real estate loans from other banks in Alaska and the Pacific Northwest, generally ranging from \$500,000 to \$2.5 million. Such loans are on similar terms and are subject to the same underwriting standards as loans originated by Alaska Pacific. Alaska Pacific's lending policy limits participation loans by geographic region, loan type and lead lender concentrations. Additionally, the Board of Directors must approve all participation loans. Alaska Pacific monitors participation loans by maintaining consistent communication with lead lenders, receipt of status updates on each credit and by review of annual financial statements of the borrowers.

Multifamily residential and commercial real estate lending entails significant additional risks as compared with single-family residential property lending. Multifamily residential and commercial real estate loans typically involve large loan balances to single borrowers or groups of related borrowers. The payment experience on these loans typically is dependent on the successful operation of the real estate project. Supply and demand conditions in the market for office, retail and residential space can significantly affect these risks, and, as such, may be subject to a greater extent to adverse conditions in the economy generally. Alaska Pacific reviews all commercial real estate loans in excess of \$500,000 on an annual basis to ensure that the loan meets current underwriting standards.

Future growth of commercial real estate loans is restricted by regulation which generally limits such loans, under Alaska Pacific's federal thrift charter, to 400% of total capital for regulatory purposes, or approximately \$78.0 million at December 31, 2010.

Commercial Business Lending. At December 31, 2010, commercial business loans amounted to \$19.4 million, or 13.6% of total loans. Future growth of commercial business loans is restricted by regulation which generally limits such loans, under Alaska Pacific's federal thrift charter, to 20% of total assets, or approximately \$35.0 million at December 31, 2010.

Alaska Pacific originates commercial business loans to small sized businesses in its primary market area. Commercial business loans are generally made to finance the purchase of seasonal inventory needs, new or used equipment, and for short-term working capital. Security for these loans generally includes equipment, boats, accounts receivable and inventory, although commercial business loans are sometimes granted on an unsecured basis. Commercial business loans are made for terms of seven years or less, depending on the purpose of the loan and the collateral, with operating lines of credit made for one year or less renewed annually at an interest rate based on the prime rate, usually adding a margin of between one-half and three percentage points. Such loans generally are originated in principal amounts between \$100,000 and \$1.0 million. At December 31, 2010, the

largest commercial business loan for \$2.0 million was secured by equipment and inventory and was performing in accordance with terms.

Alaska Pacific originates guaranteed loans through the Small Business Administration, the U.S. Department of Agriculture and the Alaska Industrial Development and Export Authority. Alaska Pacific has also worked with local municipal agencies, such as the Juneau Economic Development Council and the Cities of Sitka and Ketchikan in exploring participation or guaranty programs in each of these cities. Generally in these programs, Alaska Pacific receives guarantees of between 75% and 90% of the loan amount. In addition, Alaska Pacific has retained portions of commercial business loans originated through participation programs with economic development agencies such as the Alaska Industrial Development and Export Authority, often retaining portions of as little as 10%.

Alaska Pacific also makes commercial business loans secured by commercial charter boats and commercial fishing boats. These loans have 10 to 15 year terms with an interest rate that adjusts based on the prime interest rate. In connection with the loans on these boats, Alaska Pacific receives a ship's preferred marine mortgage to protect its interest in the collateral. Alaska Pacific has also granted a flooring line to one boat dealer for the purchase of boats and other related marine equipment.

Commercial business lending generally involves greater risk than residential mortgage lending and involves risks that are different from those associated with residential, commercial and multifamily real estate lending. Real estate lending is generally considered to be collateral based lending with loan amounts based on predetermined loan-to-collateral values, and liquidation of the underlying real estate collateral is viewed as the primary source of repayment in the event of borrower default. Although commercial business loans often have equipment, inventory, accounts receivable or other business assets as collateral, the liquidation of collateral in the event of a borrower default is often not a sufficient source of repayment because accounts receivable may be uncollectible and inventories and equipment may be obsolete or of limited use, among other conditions. Accordingly, the repayment of a commercial business loan depends primarily on the creditworthiness of the borrower (and any guarantors), while liquidation of collateral is a secondary and often insufficient source of repayment.

Consumer Lending. At December 31, 2010, consumer loans totaled \$19.8 million, or 14.0% of total loans. Consumer loans generally have shorter terms to maturity or repricing and higher interest rates than long-term, fixed-rate mortgage loans. In addition to home equity, boat loans and automobile loans, Alaska Pacific's consumer loans consist of loans secured by land, airplanes, deposit accounts, and unsecured loans for personal or household purposes.

The largest category of Alaska Pacific's consumer loan portfolio is home equity loans that are made on the security of residences. At December 31, 2010, home equity loans totaled \$13.5 million, or 9.5% of the total loan portfolio, compared to \$16.5 million, or 10.5% of the total loan portfolio at December 31, 2009. Home equity loans generally do not exceed 95% of the appraised value of the residence or 100% of the tax assessment including the outstanding principal of the first mortgage. Closed-end loans are generally fixed-rate and have terms of up to 25 years requiring monthly payments of principal and interest. Home equity lines of credit generally have adjustable interest rates. These rates are graduated based on credit scores. Recently, with the slowdown in price appreciation or actual declines in values, homeowner's equity in some high loan to value (LTV) home equity loans may have declined. However, Alaska has not experienced the rapid declines in home prices experienced by many parts of the country where home prices rose much faster.

At December 31, 2010, consumer boat loans amounted to \$4.2 million, or 3.0%, of the total loan portfolio compared to \$4.3 million, or 2.7% of the total loan portfolio at December 31, 2009. Alaska Pacific offers boat loans with maturities of between five and 20 years, which generally range in principal amounts from \$15,000 to \$350,000 and are secured by new and used boats. Alaska Pacific makes boat loans of less than \$100,000 at fixed rates of interest and loans over \$100,000 are made at an interest rate that is adjustable based on the prime lending rate. Alaska Pacific generally makes boat loans on new boats of up to 90% of the value and 85% on used boats, but in certain instances it will loan up to 100% of the value depending on the borrower's credit score.

At December 31, 2010, automobile loans amounted to \$1.2 million, or 0.8%, of the total loan portfolio, relatively unchanged from \$1.3 million or 0.8% of the total loan portfolio at December 31, 2009. Alaska Pacific offers automobile loans with maturities of up to seven years with fixed rates of interest.

Other consumer loans include loans collateralized by deposit accounts and other types of collateral, and by unsecured loans to qualified individuals. These loans amounted to \$909,000, or 0.6%, of total loans at December 31, 2010, compared to \$814,000, or 0.5%, of total loans at December 31, 2009.

Alaska Pacific also requires title, fire and casualty insurance on secured consumer loans. The only title exception is for home equity loans under \$50,000 where a property profile, obtained from a title company, indicates there are no liens or encumbrances not previously disclosed.

Consumer loans entail greater risk than do residential mortgage loans, particularly in the case of consumer loans which are unsecured or secured by rapidly depreciating assets such as automobiles or boats and particularly used automobiles. In these cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus 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 these loans. These loans may also give rise to claims and defenses by a consumer loan borrower against an assignee of these loans such as Alaska Pacific, and a borrower may be able to assert against this assignee claims and defenses that it has against the seller of the underlying collateral.

Loan Maturity and Repricing. The following table sets forth certain information at December 31, 2010 regarding the dollar amount of loans maturing in Alaska Pacific's portfolio based on their contractual terms to final maturity, but does not include scheduled payments or potential prepayments. Demand loans, loans having no stated schedule of repayments and no stated maturity, and overdrafts are reported as due in one year or less. Loan balances are net of undisbursed loan proceeds and unearned discounts, and do not include loans held for sale.

| <i>(in thousands)</i> December 31, 2010 | Within 1 Year | After 1 Year | After 3 Years | After 5 Years | Beyond 10 Years | Total | After 1 Year | |
|--|------------------|--------------------|--------------------|---------------------|--------------------|------------------|-----------------|--------------------------|
| | | Through 3 Years | Through 5 Years | Through 10 Years | | | Fixed Rates | Adjust- able Rates |
| Real estate: | | | | | | | | |
| Permanent: | | | | | | | | |
| One-to-four- family | \$ 1,383 | \$ 2,776 | 2,776 | \$ 6,939 | \$11,320 | \$25,194 | \$23,130 | \$ 681 |
| Multifamily | 207 | 456 | 648 | 648 | - | 1,959 | - | 1,752 |
| Commercial | | | | | | | | |
| nonresidential | 7,091 | 13,336 | 12,503 | 26,845 | 6,309 | 66,084 | 7,512 | 51,481 |
| Land | 2,253 | 1,595 | 1,182 | 1,382 | 51 | 6,463 | 1,262 | 2,948 |
| Construction: | | | | | | | | |
| One-to-four- family | 1,819 | - | - | - | - | 1,819 | - | - |
| Commercial nonresidential | 1,227 | - | - | - | - | 1,227 | - | - |
| Commercial business | 2,769 | 5,539 | 5,539 | 5,518 | - | 19,365 | 4,968 | 11,628 |
| Consumer: | | | | | | | | |
| Home equity | 1,071 | 2,221 | 2,325 | 4,381 | 3,511 | 13,509 | 11,736 | 702 |
| Boat | 347 | 685 | 678 | 1,487 | 1,045 | 4,242 | 3,707 | 188 |
| Automobile | 328 | 502 | 237 | 92 | 8 | 1,167 | 839 | - |
| Other | 145 | 168 | 158 | 266 | 172 | 909 | 727 | 37 |
| Total Loans | \$18,640 | \$27,278 | \$26,046 | \$47,558 | \$22,416 | \$141,938 | \$53,881 | \$69,417 |

Loan Solicitation and Processing. Alaska Pacific obtains its loan applicants from walk-in traffic, which is generated through media advertising and referrals from existing customers, from on-line loan applications through its web site, and through officer business development calls and activities. Local real estate agents refer a portion of Alaska Pacific's mortgage loan applicants, and dealers refer some consumer loans, such as boat loans. Alaska Pacific requires title insurance on all of its mortgage loans. All mortgage loans require fire and extended coverage on appurtenant structures and flood insurance, if applicable.

Loan approval authority varies based on loan type. The Chief Executive Officer, the Chief Credit Officer, and the Chief Lending Officer each has authority to approve all residential mortgage loans up to and including \$300,000 that are originated for Alaska Pacific's portfolio, and up to the agency limit if the loan is to be sold in the secondary market; multifamily and commercial real estate loans up to and including \$300,000; commercial business loans up to and including \$300,000 (\$100,000 if unsecured); and consumer loans up to and including \$300,000 (\$100,000 if unsecured). Alaska Pacific's Senior Loan Committee, consisting of the Chief Executive Officer, Chief Credit Officer, Chief Lending Officer and two senior lending officers, must approve loans in excess of these amounts up to and including \$750,000. The Directors' Loan Committee must approve all loans in excess of the Senior Loan Committee's approval authority up to 75% of Alaska Pacific's legal lending limit. The Board of Directors must approve all loans in excess of the Directors' Loan Committee's approval authority.

Upon receipt of a loan application from a prospective borrower, a credit report and other data are obtained to verify specific information relating to the loan applicant's employment, income and credit standing. An independent appraiser approved by Alaska Pacific and licensed or certified by the State of Alaska undertakes an appraisal of any real estate offered as collateral. Alaska Pacific promptly notifies applicants of the decision. Interest rates are subject to change if the approved loan is not closed within the time of the commitment.

Alaska Pacific has an automated underwriting system for consumer loans, enabling expedited approval of consumer loans at any branch location. This system also enables processing of online loan applications from customers. In addition, Alaska Pacific has a system for online loan applications for mortgage loans.

Pursuant to OTS regulations, loans to one borrower cannot exceed 15% of Alaska Pacific's unimpaired capital and surplus. At December 31, 2010, the loans-to-one-borrower limitation for Alaska Pacific was \$3.0 million, and Alaska Pacific had no loans in excess of this limitation except where guaranteed by a government agency or approved prior to December 31, 2010, at a time when the Bank's legal lending limit was higher.

Loan Originations, Sales and Purchases. Alaska Pacific's lending activities include the origination of one-to-four-family residential mortgage loans, construction and land loans, loans to businesses, commercial real estate, multifamily and consumer loans.

Alaska Pacific generally sells loans without recourse and with servicing retained except in its correspondent lending programs. Correspondent lending involves the sale of one-to-four-family mortgages to private (non-government sponsored enterprises or GSE) institutional investors, usually with servicing rights released. By retaining the servicing, Alaska Pacific receives fees for performing the traditional services of processing payments, accounting for loan funds, and collecting and paying real estate taxes, hazard insurance and other loan-related items, such as private mortgage insurance. At December 31, 2010, Alaska Pacific's servicing portfolio was \$129.1 million. For the year ended December 31, 2010, loan servicing fees totaled \$287,000.

The value of the loans that are serviced for others is significantly affected by interest rates. In general, during periods of falling interest rates, mortgage loans prepay at faster rates and the value of the mortgage servicing declines. Conversely, during periods of rising interest rates, the value of the servicing rights generally increases as a result of slower rates of prepayment. Alaska Pacific may be required to recognize a decrease in value by taking a charge against earnings, which would cause its profits to decrease.

In addition, Alaska Pacific retains certain amounts in escrow for the benefit of investors. Alaska Pacific is able to invest these funds but is not required to pay interest on them. At December 31, 2010, these escrow balances totaled \$533,000.

The following table shows total loans originated, purchased, sold and repaid during the periods indicated.

| <i>(in thousands)</i> Year ended December 31, | 2010 | 2009 |
|---|-------------|-------------|
| Loans originated: | | |
| Real estate: | | |
| Permanent: | | |
| One-to-four-family | \$30,538 | \$47,598 |
| Multifamily | 270 | - |
| Commercial nonresidential | 9,677 | 10,551 |
| Land | 462 | 874 |
| Construction: | | |
| One-to-four-family | 1,709 | 4,203 |
| Multifamily | 140 | 1,505 |
| Commercial nonresidential | 531 | 851 |
| Commercial business | 12,439 | 11,439 |
| Consumer: | | |
| Home equity | 622 | 2,430 |
| Boat | 1,068 | 1,238 |
| Automobile | 416 | 719 |
| Other | 2,655 | 2,697 |
| Total loans originated | 60,527 | 84,105 |
| Loans purchased | - | 647 |
| Loans sold | (31,245) | (39,309) |
| Foreclosed loans | (1,885) | (3,508) |
| Principal repayments and other changes | (43,172) | (55,340) |
| Net decrease in loans and loans held for sale | \$ (15,775) | \$ (13,405) |

One-to-four-family loans sold relate to loans sold primarily to Freddie Mac without recourse. One-to-four-family mortgage loan originations declined in 2010 to \$30.5 million, a 35.9% decrease over the \$47.6 million of such loans originated in 2009.

A portion of Alaska Pacific's originations in 2010 and 2009 represent refinancing of loans originally made by Alaska Pacific and other lenders.

Loan Commitments. Occasionally, Alaska Pacific issues, without charge, commitments for fixed- and adjustable-rate single-family residential mortgage loans conditioned upon the occurrence of certain events. These commitments are made in writing on specified terms and conditions and are honored for up to 60 days. Commercial commitments issued by Alaska Pacific include commitments for fixed-term loans as well as business lines of credit; letters of credit are not offered. At December 31, 2010, Alaska Pacific had \$10.9 million of outstanding net loan commitments, including unused portions on commercial business lines of credit and undisbursed funds on construction loans. For additional information on loan commitments, see Note 14 of the Notes to Consolidated Financial Statements included in Item 8 of this Form 10-K.

Loan Origination and Other Fees. Alaska Pacific often receives loan origination fees and discount "points." Loan fees and points are a percentage of the principal amount of the loan that are charged to the borrower for funding the loan. The amount of fees and points charged by Alaska Pacific varies, though the range generally is between one half and two points. Accounting standards require fees received (net of certain loan origination costs) for originating loans to be deferred and amortized into interest income over the contractual life of the loan. Net deferred fees associated with loans that are prepaid are recognized as income at the time of prepayment. Alaska Pacific had \$495,000 of net deferred loan fees at December 31, 2010.

Nonperforming Assets and Delinquencies. Alaska Pacific utilizes one loan collector that is a Bank employee to monitor the loan portfolio and communicate with customers concerning past due payments. The size of the portfolio and historically low delinquency rates allow one individual to manage consumer, commercial and residential loans, including those loans serviced for other investors. When a borrower fails to make a required payment, Alaska Pacific institutes collection procedures. The process for monitoring consumer, commercial and residential loans is the same for each type of loan until foreclosure or repossession of the collateral. Depending on the value or nature of the collateral, the loan servicing manager, senior lender or senior management directs any further action in consultation with the Bank's legal counsel.

Customers who miss a payment are mailed a computer-generated notice 15 days after the payment due date. If the customer does not pay promptly, the collector telephones the customer 20 days after the payment due date. After 30 days, the collector sends a letter, which begins the demand process. Follow-up contacts are made between the 30th and 60th day, after which the collector sends a demand letter that specifies the action Alaska Pacific will take and the deadline for resolving the delinquency. While most delinquencies are cured promptly, the collector initiates foreclosure or repossession, according to the terms of the security instrument and applicable law, if the deadline in the 60-day letter is not met.

Residential loans have a highly structured process for foreclosure. In addition to Alaska Pacific's residential loan portfolio, Alaska Pacific services real estate loans for other investors who in turn have their own requirements that must be followed. Alaska Pacific evaluates consumer and commercial business loans individually depending on the nature and value of the collateral.

Alaska Pacific places all loans that are past due 90 days or more on nonaccrual status and all previously accrued interest income is reversed. Alaska Pacific charges off consumer loans when it is determined they are no longer collectible.

Alaska Pacific's Board of Directors is informed monthly as to the status of all mortgage, commercial and consumer loans that are delinquent 30 days or more, the status on all loans currently in foreclosure, and the status of all foreclosed and reposessed property owned by Alaska Pacific.

The following table sets forth information with respect to Alaska Pacific's nonperforming assets at the dates indicated.

| <i>(dollars in thousands)</i> December 31, | 2010 | 2009 |
|---|----------|----------|
| Loans accounted for on a nonaccrual basis: | | |
| Consumer | \$ - | \$ 78 |
| Commercial business | 448 | 236 |
| Real estate | - | 2,541 |
| Total | 448 | 2,855 |
| Accruing loans which are contractually past due 90 days or more | - | - |
| Total of nonaccrual and 90 days past due loans | 448 | 2,855 |
| Real estate owned and repossessed assets | 1,791 | 2,598 |
| Total nonperforming assets | \$ 2,239 | \$ 5,453 |
| Nonaccrual and 90 days or more past due loans as a percentage of loans | 0.32% | 1.81% |
| Nonaccrual and 90 days or more past due loans as a percentage of total assets | 0.26% | 1.60% |
| Nonperforming assets as a percentage of total assets | 1.28% | 3.06% |

During the years ended December 31, 2010 and 2009, approximately \$13,000 and \$789,000, respectively, of interest would have been recorded if these loans had been current according to their original terms and had been outstanding throughout the year.

We have made significant progress in reducing our nonperforming assets by \$3.2 million, or 58.9% at December 31, 2010 as compared to December 31, 2009. This was accomplished by transferring nonperforming loans to real estate owned through the foreclosure process, taking deeds in lieu of foreclosure, accepting short sales and charge-offs.

Real Estate Owned and Repossessed Assets. Alaska Pacific classifies real estate acquired as a result of foreclosure and other repossessed collateral as repossessed assets until sold. When Alaska Pacific acquires collateral, it is recorded at the lower of its cost, which is the unpaid principal balance of the related loan plus acquisition costs, or fair value less cost to sell. Subsequent to acquisition, the property is carried at the lower of the acquisition amount or fair value. At December 31, 2010, Alaska Pacific held real estate owned and repossessed assets of \$1.8 million, which consisted of other real estate owned and repossessed consumer assets.

Asset Classification. The OTS has adopted various regulations regarding problem assets of savings institutions. The regulations require that each insured institution review and classify its assets on a regular basis. In addition, in connection with examinations of insured institutions, OTS examiners have authority to identify problem assets and, if appropriate, require them to be classified. There are three classifications for problem assets: substandard, doubtful and loss. Substandard assets must have one or more defined weaknesses and are characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. Doubtful assets have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. An asset classified loss is considered uncollectible and of such little value that continuance as an asset of the institution is not warranted. The regulations have also created a special mention category, described as assets which do not currently expose an insured institution to a sufficient degree of risk to warrant classification but do possess credit deficiencies or potential weaknesses deserving management's close attention. If an asset or portion thereof is classified loss, the loss amount is charged off.

Alaska Pacific monitors its asset quality through the use of an Asset Classification Committee, which is comprised of senior lenders and executive officers. The Committee meets monthly to review the loan portfolio, with specific attention given to assets with an identified weakness, as well as reviewing the local, state and national economic trends and the adequacy of the allowance for loan losses.

When the Committee classifies problem assets as either substandard or doubtful, a specific allowance in an amount deemed prudent may be established. General allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been specifically allocated to particular problem assets. When an insured institution classifies problem assets as a loss, it is required to recognize the loss in the period in which they are deemed uncollectible. Our determination as to the classification of our assets and the amount of our valuation allowances is subject to review by the OTS and FDIC, which can order the establishment of additional loss allowances or the charge-off of specific loans against established loss reserves. Assets which do not currently expose us to sufficient risk to warrant classification as substandard, doubtful and loss but possess weaknesses are designated by us as special mention.

At December 31, 2010 and 2009, the aggregate amounts of Alaska Pacific's classified, special mention and repossessed assets, net of loan balances guaranteed, (as determined by Alaska Pacific), were as follows:

| <i>(in thousands)</i> December 31, | 2010 | 2009 |
|--|---------|----------|
| Doubtful | \$200 | \$450 |
| Substandard assets | 6,865 | 4,892 |
| Special mention | 436 | 3,623 |
| Other real estate owned and repossessed assets | 1,791 | 2,598 |
| Total classified loans, special mention loans and repossessed assets | \$9,292 | \$11,563 |

At December 31, 2010 classified loans totaled \$7.1 million compared to \$5.3 million at December 31, 2009. Loans classified as substandard increased \$2.0 million to \$6.9 million at December 31, 2010 from \$4.9 million at December 31, 2009 due to an increase in loans to borrowers where the primary source of repayment is lacking and the Bank is relying on a secondary source for repayment. Measures taken to reduce classified assets since the Orders were issued include transferring nonperforming loans to real estate owned through the foreclosure process, accepting short sales and charge-offs.

Impaired Loans. Loans are deemed to be impaired when management determines that it is probable that all amounts due under the contractual terms of the loan agreements will not be collectible in accordance with the original loan agreement. All loans considered to be impaired are evaluated for impairment. Impairment is measured by comparing the fair value of the collateral or present value of future cash flows to the recorded investment in the loan. Loans with balances totaling \$9.6 million at December 31, 2010 and \$5.3 million at December 31, 2009 were considered to be impaired. The \$4.3 million increase in impaired loans consisted of loans no longer classified as impaired or charged off offset with additional loans. The total number of impaired loans was 16 and 15 as of December 31, 2010 and 2009, respectively. Total estimated impairments of \$310,000 and \$514,000, respectively, were recognized on impaired loans in evaluating the adequacy of the allowance for loan losses at December 31, 2010 and 2009.

The following table reflects loan balances considered to be impaired by asset type at December 31, 2010 and 2009.

| <i>(in thousands)</i> December 31, | 2010 | 2009 |
|------------------------------------|----------------|----------------|
| Residential real estate | \$ - | \$ 541 |
| Commercial real estate | 6,855 | 909 |
| Land | 2,021 | 3,263 |
| Construction – residential | - | 180 |
| Construction – commercial | - | 209 |
| Consumer | 42 | 212 |
| Commercial business | 683 | 28 |
| Total impaired loans | <u>\$9,601</u> | <u>\$5,342</u> |

At December 31, 2010, 91% of impaired loans totaling \$8.7 million included loans to six borrowers. Additional information regarding these six borrowers, by market area as of December 31, 2010 is provided in the following table:

| <i>Loan Type</i> | <i>Description</i> | <i>Market Area</i> | <i>Loan Balance December 31, 2010 (in thousands)</i> |
|--|------------------------|--------------------|--|
| Land | Land | Alaska | \$ 2,021 |
| Commercial Real Estate | Commercial Real Estate | Alaska | 839 |
| Commercial Real Estate | Commercial Real Estate | Idaho | 2,053 |
| Commercial Real Estate | Commercial Real Estate | Alaska | 2,429 |
| Commercial Real Estate | Commercial Real Estate | Alaska | 830 |
| Commercial Real Estate | Commercial Real Estate | Idaho | 537 |
| Total – Impaired loans of six largest credit relationships | | | <u>\$ 8,709</u> |

Potential Problem Loans. Potential problem loans are loans that do not yet meet the criteria for placement on non-accrual status, but where known information about the possible credit problems of the borrowers causes management to have serious concerns as to the ability of the borrower to comply with present loan repayment terms, and may result in the future inclusion of such loans in the non-accrual loan category. At December 31, 2010, Alaska Pacific had \$436,000 of loans that were identified as potential problems consisting primarily of permanent one-to-four family loans secured by residential real estate located in Alaska.

Allowance for Loan Losses. Alaska Pacific maintains an allowance for loan losses sufficient to absorb losses inherent in the loan portfolio. The allowance for loan losses decreased \$200,000, or 11.4%, to \$1.6 million at December 31, 2010 from \$1.8 million at December 31, 2009. Alaska Pacific has established a systematic methodology to ensure that the allowance is adequate. The *Asset Classification Policy* requires an ongoing quarterly assessment of the probable estimated losses in the portfolios. The Asset Classification Committee reviews the following information:

- All loans classified during the previous analysis.
- Growth and composition of the portfolio.
- Historical loan losses.
- Past due loans.
- Reports from Alaska Pacific’s managers and analysis of potential problem loans.
- Current economic conditions.
- Trends in Alaska Pacific’s delinquencies.

For additional information regarding the information reviewed by the Asset Classification Committee to determine the allowance for loan losses, see Note 5 of the Notes to Consolidated Financial Statements.

Alaska Pacific's loan categories that it considers in evaluating risk may be broadly described as residential, commercial and consumer. The following comments represent management's view of the risks inherent in several component portfolio categories.

- *One-to-four-family Residential* - Alaska Pacific's market area is comprised primarily of a population with above-average incomes and market conditions that have, over the long term, supported a stable or increasing market value of real estate. Absent an overall economic downturn in the economy, experience in this portfolio indicates that losses are minimal provided the property is reasonably maintained, and marketing time to resell the property is relatively short.
- *Multifamily Residential* - There have been minimal losses taken in this segment of the portfolio, however, the rental market is very susceptible to the effects of an economic downturn. While Alaska Pacific monitors loan-to-value ratios, the conditions that would create a default and foreclosure would carry through to a new owner, which may require that Alaska Pacific discount the property or hold it until conditions improve.
- *Commercial Real Estate* - As with multifamily loans, the classification of commercial real estate loans closely corresponds to economic conditions which will limit the income potential and marketability of the property, resulting in higher risk than a loan secured by a single-family residence.
- *Construction Loans (Residential and Commercial)* - There are a variety of risks in construction lending, increased in Alaska by a short building season, difficult building sites and construction delays attributable to delivery of materials. While Alaska Pacific has established construction loan policies and underwriting guidelines designed to mitigate the risk, there is still a higher risk of loss with these loans.
- *Commercial Business Loans* - These types of loans carry the highest degree of risk, relying on the ongoing success of the business to repay the loan. Collateral for commercial credits is often difficult to secure, and even more difficult to liquidate in the event of a default.
- *Consumer Loans* - The consumer loan portfolio has a wide range of factors, determined primarily by the nature of the collateral and the credit history and capacity of the borrower. These loans tend to be smaller in principal amount and secured by second deeds of trust on homes, automobiles, and pleasure boats. Loans for automobiles and pleasure boats generally experience higher than average wear in the Alaskan environment and hold a higher degree of risk of loss in the event of repossession.

The allowance for loan losses represents management's best estimate of incurred credit losses inherent in the Company's loan portfolio as of December 31, 2010. Although management believes that it uses the best information available to make these determinations, future adjustments to the allowance for loan losses may be necessary and results of operations could be significantly and adversely affected if circumstances differ substantially from the assumptions used in making the determinations. For additional information, see the discussion included in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Provision and Allowance for Loan Losses."

While Alaska Pacific believes it has established its existing allowance for loan losses in accordance with generally accepted accounting principles, there can be no assurance that regulators, in reviewing Alaska Pacific's loan portfolio, will not request Alaska Pacific to increase significantly its allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses will be adequate or that substantial increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses may adversely affect Alaska Pacific's financial condition and results of

operations. In addition, the determination of the amount of the Company's allowance for loan losses is subject to review by bank regulators, as part of the routine examination process, which may result in the establishment of additional reserves based upon their judgment of information available to them at the time of their examination.

The following table sets forth an analysis of the changes in the allowance for loan losses for the periods indicated.

| <i>(dollars in thousands)</i> Year ended December 31, | 2010 | 2009 |
|---|---------|---------|
| Allowance at beginning of period | \$1,786 | \$2,688 |
| Provision for loan losses | 899 | 2,947 |
| Charge-offs: | | |
| Permanent: | | |
| One-to-four-family | (211) | - |
| Commercial nonresidential | - | (125) |
| Land | (664) | (2,965) |
| Construction: | | |
| One-to-four-family | (180) | - |
| Commercial nonresidential | (209) | - |
| Commercial business | (30) | (760) |
| Consumer: | | |
| Boat | (58) | (25) |
| Auto | (14) | - |
| Total charge-offs | (1,366) | (3,875) |
| Recoveries: | | |
| Commercial business | 264 | 26 |
| Consumer: | | |
| Home equity | - | - |
| Automobile | - | - |
| Total recoveries | 264 | 26 |
| Net charge-offs | (1,102) | (3,849) |
| Balance at end of period | \$1,583 | \$1,786 |
| Allowance for loan losses as a percentage of loans outstanding at the end of the period | 1.12% | 1.13% |
| Net charge-offs as a percentage of average loans outstanding during the period | 0.75% | 2.32% |
| Allowance for loan losses as a percentage of nonperforming loans at end of period | 355.55% | 62.56% |

The following table sets forth the breakdown of the allowance for loan losses by loan category for the dates indicated.

| December 31, | 2010 | | | 2009 | | |
|---------------------------------|----------------|---|---------------------------------------|----------------|---|---------------------------------------|
| | Amount | As a % of Outstanding Loans in Category | % of Loans in Category to Total Loans | Amount | As a % of Outstanding Loans in Category | % of Loans in Category to Total Loans |
| <i>(dollars in thousands)</i> | | | | | | |
| Real estate: | | | | | | |
| Permanent: | | | | | | |
| One-to-four-family | \$ 73 | 0.29% | 17.75% | \$ 56 | 0.16% | 21.40% |
| Multifamily | 14 | 0.71 | 1.38 | 13 | 0.75 | 1.10 |
| Commercial non-residential | 858 | 1.30 | 46.56 | 444 | 0.69 | 40.78 |
| Land | 11 | 0.17 | 4.56 | 56 | 0.57 | 6.14 |
| Construction: | | | | | | |
| One-to-four-family | 4 | 0.22 | 1.28 | 144 | 4.66 | 1.95 |
| Multifamily | - | - | - | - | - | - |
| Commercial nonresidential | 3 | 0.24 | 0.86 | 236 | 8.82 | 1.69 |
| Commercial | 537 | 2.77 | 13.64 | 615 | 3.09 | 12.53 |
| Consumer: | | | | | | |
| Home equity | 23 | 0.17 | 9.52 | 114 | 0.69 | 10.40 |
| Boat | 29 | 0.68 | 2.99 | 87 | 2.03 | 2.70 |
| Automobile | 4 | 0.34 | 0.82 | 2 | 0.16 | 0.80 |
| Other | 3 | 0.33 | 0.64 | 19 | 2.34 | 0.51 |
| Unallocated | 24 | - | - | - | - | - |
| Total allowance for loan losses | <u>\$1,583</u> | 1.12% | <u>100.00%</u> | <u>\$1,786</u> | 1.13% | <u>100.00%</u> |

Investment Activities

Federal law permits Alaska Pacific to invest in various types of liquid assets, including U.S. Treasury obligations, securities of various federal agencies and of state and municipal governments, deposits at the FHLB of Seattle, certificates of deposit of federally insured institutions, certain bankers' acceptances and federal funds. Subject to various restrictions, Alaska Pacific may also invest a portion of its assets in commercial paper and corporate debt securities. Alaska Pacific must also maintain an investment in FHLB stock as a condition of membership in the FHLB of Seattle.

Investment securities provide liquidity for funding loan originations and deposit withdrawals and enable Alaska Pacific to improve the match between the maturities and repricing of its interest-rate sensitive assets and liabilities. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources."

Alaska Pacific's Asset Liability Management Committee determines appropriate investments in accordance with the Board of Directors' approved investment policies and procedures. Alaska Pacific's policies generally limit investments to U.S. Government and agency securities and mortgage-backed securities issued and guaranteed by Freddie Mac, the Federal National Mortgage Association ("Fannie Mae") and the Government National Mortgage Association ("Ginnie Mae"). Alaska Pacific's policies provide that investment purchases be ratified at monthly Board of Directors' meetings. Certain considerations, which include the interest rate, yield, settlement date and maturity of the investment, Alaska Pacific's liquidity position, and anticipated cash needs and sources (which in turn include outstanding commitments, upcoming maturities, estimated deposits and anticipated loan amortization and repayments) affect the making of investments. The effect that the proposed investment would have on Alaska Pacific's credit and interest rate risk, and risk-based capital is also considered. From time to time, investment levels may be increased or decreased depending upon the yields on investment alternatives and

upon management's judgment as to the attractiveness of the yields then available in relation to other opportunities and its expectation of the level of yield that will be available in the future, as well as management's projections as to the short-term demand for funds to be used in Alaska Pacific's loan origination and other activities.

The following table sets forth the composition of Alaska Pacific's investment portfolios at the dates indicated.

| December 31, <i>(dollars in thousands)</i> | 2010 | | | 2009 | | |
|--|------------|----------------|----------------------|------------|----------------|----------------------|
| | Fair Value | Amortized Cost | Percent of Portfolio | Fair Value | Amortized Cost | Percent of Portfolio |
| Mortgage-backed securities: | | | | | | |
| Fannie Mae | \$1,567 | \$1,516 | 73.42% | \$1,930 | \$1,890 | 74.5% |
| Freddie Mac | 220 | 220 | 10.65% | 254 | 263 | 10.4% |
| Ginnie Mae | 283 | 246 | 11.91% | 330 | 292 | 11.5% |
| U.S. agencies and corporations: | | | | | | |
| Small Business Administration pools | 85 | 83 | 4.02% | 92 | 91 | 3.6% |
| Total investment securities available for sale | \$2,155 | \$2,065 | 100.0% | \$2,606 | \$2,536 | 100.0% |

While management has no specific plans to sell any security, the entire portfolio has been designated as "available-for-sale" at December 31, 2010 and 2009, to allow flexibility in managing the portfolio.

At December 31, 2010, the portfolio of U.S. Government and agency securities had an aggregate estimated fair value of \$85,000 and the portfolio of mortgage-backed securities had an estimated fair value of \$2.1 million.

At December 31, 2010, mortgage-backed securities consisted of Freddie Mac, Fannie Mae and Ginnie Mae issues with an amortized cost of \$2.0 million. The mortgage-backed securities portfolio had coupon rates ranging from 2.5% to 9.0% and had a weighted average yield of 4.3% at December 31, 2010.

Mortgage-backed securities, which also are known as mortgage participation certificates or pass-through certificates, typically represent interests in pools of single-family or multifamily mortgages in which payments of both principal and interest on the securities are generally made monthly. The principal and interest payments on these mortgages are passed from the mortgage originators, through intermediaries, generally U.S. Government agencies and government sponsored enterprises, that pool and resell the participation interests in the form of securities, to investors such as Alaska Pacific. These U.S. Government agencies and government-sponsored enterprises, which guarantee the payment of principal and interest to investors, primarily include the Freddie Mac, Fannie Mae and the Ginnie Mae. Mortgage-backed securities typically are issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans with interest rates that fall within a specific range and have varying maturities. Mortgage-backed securities generally yield less than the loans that underlie these securities because of the cost of payment guarantees and credit enhancements. In addition, mortgage-backed securities are usually more liquid than individual mortgage loans and may be used to collateralize certain liabilities and obligations of Alaska Pacific. These types of securities also permit Alaska Pacific to optimize its regulatory capital because they have low risk weighting.

The actual maturity of a mortgage-backed security may be less than its stated maturity due to prepayments of the underlying mortgages. Prepayments that are faster than anticipated may shorten the life of the security and may result in a loss of any premiums paid and thereby reduce the net yield on these securities. Although prepayments of underlying mortgages depend on many factors, including the type of mortgages, the coupon rate, the age of mortgages, the geographical location of the underlying real estate collateralizing the mortgages and general levels of market interest rates, the difference between the interest rates on the underlying mortgages and the prevailing mortgage interest rates generally is the most significant determinant of the rate of prepayments. During periods of declining mortgage interest rates, if the coupon rate of the underlying mortgages exceeds the

prevailing market interest rates offered for mortgage loans, refinancing generally increases and accelerates the prepayment of the underlying mortgages and the related security. Under these circumstances, Alaska Pacific may be subject to reinvestment risk because, to the extent that Alaska Pacific's mortgage-backed securities amortize or prepay faster than anticipated, Alaska Pacific may not be able to reinvest the proceeds of these repayments and prepayments at a comparable rate.

The table below sets forth certain information regarding the carrying value, weighted average yields and maturities or periods to repricing of Alaska Pacific's investment portfolios at December 31, 2010.

| <i>(dollars in thousands)</i> as of December 31, 2010 | Amortized Cost | Weighted Average Yield | Weighted Average Maturity (Yrs) |
|--|-------------------|------------------------------|---------------------------------------|
| Mortgage backed securities | \$2,070 | 4.26% | 8.00 |
| US government agencies | 85 | 3.98% | 8.42 |

Alaska Pacific's investment policy permits investment in "off balance sheet" derivative instruments such as "forwards," "futures," "options" and "swaps" used as hedges; however, Alaska Pacific has not utilized such instruments.

As a member of the FHLB of Seattle, the Bank is required to own capital stock in the FHLB of Seattle. The minimum amount of stock held is based on percentages specified by the FHLB of Seattle outstanding advances. The carrying value of FHLB of Seattle stock totaled \$1.8 million at December 31, 2010. The redemption of any excess stock held by the Bank is at the discretion of the FHLB of Seattle, and under present policies may take up to five years. Alaska Pacific did not receive a dividend during the years ended December 31, 2010 and 2009.

Management evaluates the FHLB of Seattle stock for impairment. The determination of whether this investment is impaired is based on Alaska Pacific's assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as: (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB and (4) the liquidity position of the FHLB.

On October 25, 2010, the FHLB of Seattle agreed to the stipulation and issuance of a Consent Order by its primary regulator the Federal Housing Finance Agency ("FHFA"). The Consent Order sets forth requirements for capital management, asset composition and other operational and risk management improvements. Additionally, the FHFA and the FHLB of Seattle have agreed to a Stabilization Period that ends upon the filing of the FHLB of Seattle's June 30, 2011 financial statements. During this period, the FHLB of Seattle's classification as undercapitalized will remain in place. Subsequently, the FHLB of Seattle may begin repurchasing member stock at par and paying dividends, upon achieving and maintaining financial thresholds established by the FHFA as part of the agency's supervisory process, subject to FHFA's approval.

Under FHFA regulations, a Federal Home Loan Bank that fails to meet any regulatory capital requirement may not declare a dividend or redeem or repurchase capital stock in excess of what is required for members' current loans. Based upon an analysis by Standard and Poor's regarding the Federal Home Loan Banks, they stated that the FHLB System has a special public status (organized under the Federal Home Loan Bank Act of 1932) and because of the extraordinary support offered to it by the U.S. Treasury in a crisis, (though not used), it can be considered an extension of the government. Management believes the U.S. government would almost certainly support the credit obligations of the FHLB System. Alaska Pacific has determined there is not an other-than-temporary impairment on its FHLB of Seattle stock investment as of December 31, 2010. For additional information, see Item 1.A. "Risk Factors -- Further deterioration in the financial position of the Federal Home

Loan Bank of Seattle may result in future impairment losses on our investment in Federal Home Loan Bank stock.”

Alaska Pacific had no securities (other than U.S. Government and agency securities and mutual funds which invest exclusively in such securities), which had an aggregate book value in excess of 10% of shareholders' equity at December 31, 2010.

Deposit Activities and Other Sources of Funds

General. Deposits and loan repayments are the major sources of Alaska Pacific's funds for lending and other investment purposes. Scheduled loan repayments are a relatively stable source of funds, while general interest rates and money market conditions significantly influence deposit inflows and outflows and loan prepayments. Alaska Pacific may use borrowings on a short-term basis to compensate for reductions in the availability of funds from other sources. Alaska Pacific may also use borrowings on a longer-term basis for general business purposes.

Deposit Accounts. Alaska Pacific attracts deposits from within its primary market area through the offering of a broad selection of deposits as set forth in the following table. In determining the terms of its deposit accounts, Alaska Pacific considers current market interest rates, profitability to Alaska Pacific, matching deposit and loan products and its customer preferences and concerns. Alaska Pacific's deposit mix and pricing is generally reviewed weekly by Chief Financial and Chief Operating Officer. Deposits from municipalities and other public entities were \$5.4 million at December 31, 2010.

Pursuant to the Order, Alaska Pacific may not increase its brokered deposits without regulatory approval. At December 31, 2010, Alaska Pacific had \$1.9 million of brokered deposits issued through the Certificate of Deposit Account Registry Service (“CDARS”). CDARS deposits range in maturities from one month to three years, and carry interest rates that are generally higher than locally obtained time deposits. As a result, Alaska Pacific utilizes these deposits as an alternative supplemental funding source in addition to advances from the FHLB of Seattle.

In the unlikely event Alaska Pacific is liquidated, depositors will be entitled to full payment of their deposit accounts prior to any payment being made to the Company, as the sole stockholder of the Bank. Substantially all of the Bank's depositors are residents of the State of Alaska.

The following table sets forth information concerning Alaska Pacific's time deposits and other interest-bearing deposits at December 31, 2010.

| Weighted Average Interest Rate | Original Term | Category | Amount (in thou- sands) | Minimum Balance | Percentage of Total Deposits |
|---|---------------------------|-------------------------|-------------------------------|--------------------|------------------------------------|
| 0.00% | N/A | Noninterest-bearing | \$29,046 | \$ 100 | 19.69% |
| 0.04 | N/A | Interest-bearing demand | 34,103 | 100 | 23.11 |
| 0.26 | N/A | Money market | 26,949 | 100 | 18.26 |
| 0.06 | N/A | Savings | 19,824 | 100 | 13.44 |
| <u>Certificates of Deposit</u> | | | | | |
| 0.10 | Seven days | Fixed-rate | 296 | 2,000 | 0.20 |
| 0.15 | One month | Fixed-rate | - | 2,000 | 0.00 |
| 0.20 | Two months | Fixed-rate | 123 | 2,000 | 0.08 |
| 0.35 | Three months | Fixed-rate | 2,302 | 2,000 | 1.56 |
| 0.65 | Six months | Fixed-rate | 4,773 | 2,000 | 3.24 |
| 0.67 | Nine months | Fixed-rate | 805 | 2,000 | 0.55 |
| 0.91 | One year | Fixed-rate | 7,969 | 2,000 | 5.40 |
| 2.00 | 15 months | Fixed-rate | 2,916 | 2,000 | 1.98 |
| 1.37 | 18 months | Fixed-rate | 3,987 | 2,000 | 2.70 |
| 1.93 | Two years | Fixed-rate | 2,540 | 2,000 | 1.72 |
| 2.38 | Three years | Fixed-rate | 862 | 2,000 | 0.59 |
| 3.35 | Four years | Fixed-rate | 272 | 2,000 | 0.18 |
| 3.40 | Five years | Fixed-rate | 2,541 | 2,000 | 1.72 |
| 0.35 | Various specials | Fixed-rate | 200 | 5,000 | 0.14 |
| 1.18 | Gold minor one year | Fixed-rate | 1,770 | 500 | 1.20 |
| 8.00 | Deferred Comp one year | Fixed-rate | 1,289 | 2,000 | 0.87 |
| 0.50 | CDARS - various | Fixed-rate | 1,879 | 2,000 | 1.27 |
| 0.75 | 1 - 2-1/2 years | Variable-rate | 3,102 | 2,000 | 2.10 |
| 0.57% | | TOTAL | \$147,548 | | 100.00% |

The following table sets forth the balances and changes in dollar amounts of deposits in the various types of accounts offered by Alaska Pacific at the dates indicated.

| <i>(dollars in thousands)</i> December 31, | 2010 | | | 2009 | |
|--|------------------|------------------|---------------------|------------------|------------------|
| | Amount | Percent of Total | Increase (Decrease) | Amount | Percent of Total |
| Noninterest-bearing demand accounts | \$29,046 | 19.69% | \$1,630 | \$27,416 | 18.50% |
| Interest-bearing demand accounts | 34,103 | 23.11 | 1,629 | 32,474 | 21.91 |
| Money market deposit accounts | 26,949 | 18.26 | (2,033) | 28,982 | 19.55 |
| Savings accounts | 19,824 | 13.44 | 654 | 19,170 | 12.93 |
| Fixed-rate certificates which mature: | | | | | |
| Within 1 year | 27,784 | 18.83 | 7,194 | 20,590 | 13.90 |
| After 1 year, but within 2 years | 4,294 | 2.91 | (7,077) | 11,371 | 7.67 |
| After 2 years, but within 5 years | 2,446 | 1.66 | (962) | 3,408 | 2.30 |
| Variable-rate certificates which mature: | | | | | |
| Within 1 year | 1,814 | 1.23 | 1,048 | 2,862 | 1.93 |
| After 1 year, but within 2 years | 921 | 0.62 | 921 | - | - |
| After 2 years, but within 5 years | 367 | 0.25 | (1,577) | 1,944 | 1.31 |
| Total | \$147,548 | 100.00% | \$(669) | \$148,217 | 100.00% |

Time Deposits Maturities and Weighted Average Rates

The following table sets forth the amount, maturities and weighted average rates of time deposits at December 31, 2010.

| <i>(in thousands)</i> Year ending December 31, | Weighted Average Interest Rate |
|--|--------------------------------|
| 2011 | \$29,598 1.45% |
| 2012 | 5,215 1.42% |
| 2013 | 1,227 1.81% |
| 2014 | 426 2.64% |
| 2015 and thereafter | 1,160 2.69% |
| | \$37,626 |

Deposit Activities and Other Sources of Funds

The following table sets forth the deposit activities of Alaska Pacific for the periods indicated.

| <i>(in thousands)</i> Year ended December 31, | 2010 | 2009 |
|---|-----------|-----------|
| Beginning balance | \$148,217 | \$162,175 |
| Net deposits before interest credited | (1,516) | (15,327) |
| Interest credited | 847 | 1,369 |
| Net increase (decrease) in deposits | (669) | (13,958) |
| Ending balance | \$147,548 | \$148,217 |

Borrowings. Deposits and loan repayments are the primary source of funds for Alaska Pacific's lending and investment activities. However, Alaska Pacific may rely upon advances from the FHLB of Seattle to supplement its supply of lendable funds and to meet deposit withdrawal requirements. The FHLB of Seattle functions as a central reserve bank providing credit for thrift institutions and many other member financial

institutions. The FHLB of Seattle requires Alaska Pacific, as a member, to own capital stock in the FHLB of Seattle and authorizes it to apply for advances on the security of this stock and certain of its mortgage loans and other assets (principally securities which are obligations of, or guaranteed by, the U.S. Government) provided certain creditworthiness standards have been met. Advances are made pursuant to several different credit programs. Each credit program has its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based on the financial condition of the member institution and the adequacy of collateral pledged to secure the credit. At December 31, 2010, Alaska Pacific had a borrowing capacity of approximately \$43.6 million with the FHLB of Seattle, of which \$37.6 million was unused compared with \$44.8 million and \$35.0 million, respectively, at December 31, 2009. At December 31, 2010, there was \$5.0 million outstanding on the line and an additional \$1.0 million of the borrowing line was committed to secure public deposits.

The following table sets forth certain information regarding Alaska Pacific's advances from the FHLB of Seattle at the end of and during the periods indicated:

| <i>(dollars in thousands)</i> Year ended December 31, | 2010 | 2009 |
|---|----------|----------|
| Advances: | | |
| Maximum amount of borrowings outstanding during the year at any month end | \$13,200 | \$23,624 |
| Average outstanding during the year | 9,021 | 12,156 |
| Balance outstanding at end of year | 5,000 | 9,834 |
| Approximate weighted average rate paid: | | |
| Average during the year | 2.88% | 4.06% |
| At end of year | 4.40 | 3.05 |

REGULATION

General

The Bank, as a federally chartered savings bank, is subject to extensive regulation, examination and supervision by the OTS, as its primary federal regulator, and the FDIC as its deposit insurer. Alaska Pacific is a member of the FHLB System, and its deposit accounts are insured up to applicable limits by the Deposit Insurance Fund ("DIF") administered by the FDIC. Alaska Pacific must file reports with the OTS and the FDIC 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 OTS and, under certain circumstances, the FDIC to evaluate the Bank's safety and soundness and compliance with various regulatory requirements. This regulatory structure establishes a comprehensive framework of activities in which a thrift can engage and 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 OTS, the FDIC or Congress, could have a material adverse impact on the Company and the Bank and their operations.

On July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd Frank Act"). The financial reform and consumer protection act imposes new restrictions and an expanded framework of regulatory oversight for financial institutions, including depository institutions. In addition, the new law changes the jurisdictions of existing bank regulatory agencies and in particular transfers the regulation of savings and loan holding companies from the OTS to the Board of Governors of the Federal Reserve System ("Federal Reserve"), effective one year from the effective date of the legislation.

The following discussion summarizes significant aspects of the new law that may affect the Company and the Bank. Regulations implementing these changes have not been promulgated, so we cannot determine the full impact on our business and operations at this time.

The following aspects of the financial reform and consumer protection act are related to the operations of Alaska Pacific:

- A new independent consumer financial protection bureau will be established within the Federal Reserve, empowered to exercise broad regulatory, supervisory and enforcement authority with respect to both new and existing consumer financial protection laws. Smaller financial institutions, like the Bank, will be subject to supervision and enforcement by their primary federal banking regulator with respect to federal consumer financial protection laws.
- The amendment of the Federal Deposit Insurance Act to direct federal regulators to require depository institution holding companies to serve as a source of strength for their depository institution subsidiaries.
- Tier 1 capital treatment for "hybrid" capital items like trust preferred securities is eliminated subject to various grandfathering and transition rules.
- The current prohibition on payment of interest on demand deposits will be repealed, effective July 21, 2011.
- Deposit insurance is permanently increased to \$250,000 and unlimited deposit insurance for noninterest-bearing transaction accounts and IOLTA accounts is extended through December 31, 2012.
- Deposit insurance assessment base will be the depository institution's total average assets minus the sum of its average tangible equity during the assessment period.
- The minimum reserve ratio of the Deposit Insurance Fund increased to 1.35% of estimated annual insured deposits or assessment base; however, the FDIC is directed to "offset the effect" of the increased reserve ratio for insured depository institutions with total consolidated assets of less than \$10 billion.
- Eliminate the OTS one year from the date of the new law's enactment and the Office of the Comptroller of the Currency, which is currently the primary federal regulator for national banks, will become the primary federal regulator for federal thrifts, including Alaska Pacific.

The following aspects of the financial reform and consumer protection act are related to the operations of the Company:

- The Federal Reserve will have authority over savings and loan holding companies. The regulations of the OTS will remain in effect until modified by the Federal Reserve as applicable.
- Thrift holding companies will be subject to the same capital requirements as bank holding companies in five years.
- The SEC is authorized to adopt rules requiring public companies to make their proxy materials available to shareholders for nomination of their own candidates for election to the board of directors.
- Public companies will be required to provide their shareholders with a non-binding vote: (i) at least once every three years on the compensation paid to executive officers and (ii) at least once every six years on whether they should have a "say on pay" vote every one, two or three years.

- A separate, non-binding shareholder vote will be required regarding golden parachutes for named executive officers when a shareholder vote takes place on mergers, acquisitions, dispositions or other transactions that would trigger the parachute payments.
- Securities exchanges will be required to prohibit brokers from using their own discretion to vote shares not beneficially owned by them for certain "significant" matters, which include votes on the election of directors, executive compensation matters and any other matter determined to be significant.
- Disclosure in annual proxy materials will be required concerning the relationship between the executive compensation paid and the financial performance of the issuer.
- Item 402 of Regulation S-K will be amended to require companies to disclose the ratio of the Chief Executive Officer's annual total compensation to the median annual total compensation of all other employees.

Smaller reporting companies are exempt from complying with the internal control auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act. It is difficult to predict at this time what specific impact the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on community banks. However, it is expected that at a minimum they will increase our operating and compliance costs and could increase our interest expense.

Regulation and Supervision of Savings Institutions

Office of Thrift Supervision. The OTS has extensive authority over the operations of savings institutions. The OTS also has extensive enforcement authority over all savings institutions and their holding companies, including the Bank and the Company. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with the OTS. Except under certain circumstances, public disclosure of final enforcement actions by the OTS is required.

In addition, the investment, lending and branching authority of the Bank is prescribed by federal laws and it is prohibited from engaging in any activities not permitted by these laws. For example, no savings institution may invest in non-investment grade corporate debt securities. In addition, the permissible level of investment by federal institutions in loans secured by non-residential real property may not exceed 400% of total capital, except with approval of the OTS. Federal savings institutions are also generally authorized to branch nationwide. The Bank is in compliance with the noted restrictions.

The Bank's general permissible lending limit for loans-to-one-borrower is equal to the greater of \$500,000 or 15% of unimpaired capital and surplus (except for loans fully secured by certain readily marketable collateral, in which case this limit is increased to 25% of unimpaired capital and surplus). At December 31, 2010, the Bank's lending limit under this restriction was \$3.0 million and, at that date, the Bank had no loans to one borrower exceeding this amount except where guaranteed by a government agency or approved prior to December 31, 2010 at a time when the Bank's legal lending limit was higher.

The OTS, as well as the other federal banking agencies, has adopted guidelines establishing safety and soundness standards on such matters as loan underwriting and documentation, asset quality, earnings standards, internal controls and audit systems, interest rate risk exposure and compensation and other employee benefits. Any institution that fails to comply with these standards must submit a compliance plan.

All savings institutions are required to pay assessments to the OTS to fund the agency's operations. The general assessments, paid on a semi-annual basis, are determined based on the institution's total assets, including consolidated subsidiaries. The Bank's OTS assessment for the year ended December 31, 2010 was \$133,000.

FHLB System. The Bank is a member of the FHLB of Seattle, which is one of 12 regional FHLBs that administer the home financing credit function of savings institutions. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB System. It makes loans or advances to members in accordance with policies and procedures, established by the Board of Directors of the FHLB, which are subject to the oversight of the Federal Housing Finance Board. All advances from the FHLB are required to be fully secured by sufficient collateral as determined by the FHLB. In addition, all long-term advances are required to provide funds for residential home financing.

As a member, the Bank is required to purchase and maintain stock in the FHLB of Seattle. At December 31, 2010, the Bank had \$1.8 million in FHLB stock, which was in compliance with this requirement. The Bank did not receive any dividends from the FHLB of Seattle for the year ended December 31, 2010. Subsequent to December 31, 2008, the FHLB of Seattle announced that it was below its regulatory risk-based capital requirement and it is now precluded from paying dividends or repurchasing capital stock. The FHLB is not anticipated to resume dividend payments until its financial results improve. The FHLB has not indicated when dividend payments may resume.

The Federal Home Loan Banks continue to contribute to low- and moderately-priced housing programs through direct loans or interest subsidies on advances targeted for community investment and low- and moderate-income housing projects. These contributions have affected adversely the level of Federal Home Loan Bank dividends paid and could continue to do so in the future. These contributions could also have an adverse effect on the value of Federal Home Loan Bank stock in the future. A reduction in value of the Bank's FHLB stock may result in a corresponding reduction in its capital.

Federal Deposit Insurance Corporation. The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC. The Dodd-Frank Act permanently increases the maximum amount of deposit insurance for banks, savings institutions and credit unions to \$250,000 per depositor and non-interest-bearing transaction accounts and IOLTA accounts have unlimited deposit insurance through December 31, 2012. As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of and to require reporting by FDIC-insured institutions. It also may prohibit any FDIC-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious risk to the insurance fund. The FDIC also has the authority to initiate enforcement actions against savings institutions, after giving the OTS opportunity to take such action, and may terminate the deposit insurance if it determines that the institution has engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

Alaska Pacific entered into a Stipulation to the Issuance of a Consent Order ("Order") with the OTS, which became effective September 28, 2010. The OTS has also notified the Bank that it may not appoint any new director or senior executive officer or change the responsibilities of any current senior executive officers without prior notification. In addition, the Bank may not make indemnification and severance payments without complying with certain statutory restrictions, including prior written approval of the OTS. For additional information, see "—Regulatory Matters" and Item 1.A. "Risk Factors -- We are subject to certain regulatory restrictions and lack of compliance could result in monetary penalties and/or additional regulatory actions."

The FDIC assesses deposit insurance premiums on all FDIC-insured institutions quarterly based on annualized rates for one of four risk categories applied to its deposit subject to certain adjustments. Each institution is assigned to one of four risk categories based on its capital, supervisory ratings and other factors. Well capitalized institutions that are financially sound with only a few minor weaknesses are assigned to Risk Category I. Risk Categories II, III and IV present progressively greater risks to the DIF. Under the FDIC's risk-based assessment rules, effective April 1, 2009, the initial base assessment rates prior to adjustments range from 12 to 16 basis points for Risk Category I, and are 22 basis points for Risk Category II, 32 basis points for Risk Category III, and 45 basis points for Risk Category IV. Initial base assessment rates are subject to adjustments based on an institution's unsecured debt, secured liabilities and brokered deposits, such that the total base assessment rates after adjustments range from 7 to 24 basis points for Risk Category I, 17 to 43 basis points for Risk Category II, 27 to 58 basis points for Risk Category III, and 40 to 77.5 basis points for Risk Category IV.

In addition to the regular quarterly assessments, due to losses and projected losses attributed to failed institutions, the FDIC imposed a special assessment of five basis points on the amount of each depository institution's assets reduced by the amount of its Tier 1 capital (not to exceed 10 basis points of its assessment base for regularly quarterly premiums) as of June 30, 2009, which was collected on September 30, 2009.

As a result of a decline in the reserve ratio (the ratio of the DIF to estimated insured deposits) and concerns about expected failure costs and available liquid assets in the DIF, the FDIC adopted a rule requiring each insured institution to prepay on December 30, 2009 the estimated amount of its quarterly assessments for the fourth quarter of 2009 and all quarters through the end of 2012 (in addition to the regular quarterly assessment for the third quarter which was due on December 30, 2009). The prepaid amount is recorded as an asset with a zero risk weight and the institution will continue to record quarterly expenses for deposit insurance. For purposes of calculating the prepaid amount, assessments were measured at the institution's assessment rate as of September 30, 2009, with a uniform increase of 3 basis points effective January 1, 2011 and were based on the institution's assessment base for the third quarter of 2009, with deposit growth assumed quarterly at an annual rate of 5%. If events cause actual assessments during the prepayment period to vary from the prepaid amount, institutions will pay excess assessments in cash or receive a rebate of prepaid amounts not exhausted after collection of assessments due on June 13, 2013, as applicable. Collection of the prepayment does not preclude the FDIC from changing assessment rates or revising the risk-based assessment system in the future. The rule includes a process for exemption from the prepayment for institutions whose safety and soundness would be affected adversely.

As required by the Dodd-Frank Act, the FDIC has adopted rules effective April 1, 2011, under which insurance premium assessments are based on an institution's total assets minus its tangible equity (defined as Tier 1 capital) instead of its deposits. Under these rules, an institution with total assets of less than \$10 billion will be assigned to a Risk Category as described above and a range of initial base assessment rates will apply to each category, subject to adjustment downward based on unsecured debt issued by the institution and, except for an institution in Risk Category I, adjustment upward if the institution's brokered deposits exceed 10% of its domestic deposits, to produce total base assessment rates. Total base assessment rates range from 2.5 to 9 basis points for Risk Category I, 9 to 24 basis points for Risk Category II, 18 to 33 basis points for Risk Category III and 30 to 45 basis points for Risk Category IV, all subject to further adjustment upward if the institution holds more than a de minimis amount of unsecured debt issued by another FDIC-insured institution. The FDIC may increase or decrease its rates by 2.0 basis points without further rulemaking. In an emergency, the FDIC may also impose a special assessment.

The Dodd-Frank Act establishes 1.35% as the minimum reserve ratio. The FDIC has adopted a plan under which it will meet this ratio by September 30, 2020, the deadline imposed by the Dodd-Frank Act. The Dodd-Frank requires the FDIC to offset the effect on institutions with assets less than \$10 billion of the increase in the statutory minimum reserve ratio to 1.35% from the former statutory minimum of 1.15%. The FDIC has not yet announced how it will implement this offset. In addition to the statutory minimum ratio the FDIC must designate a reserve ratio, known as the designated reserve ratio ("DRR"), which may exceed the statutory minimum. The FDIC has established 2.0% as the DRR.

Federally insured institutions are required to pay a Financing Corporation assessment in order to fund the interest on bonds issued to resolve thrift failures in the 1980s. For the quarterly period ended December 31, 2010, the Financing Corporation assessment equaled 1.02 basis points for each \$100 in domestic deposits. These assessments, which may be revised based upon the level of DIF deposits, will continue until the bonds mature in the years 2017 through 2019. For 2010, Alaska Pacific incurred \$15,000 in FICO assessments.

The FDIC may terminate the deposit insurance of any insured depository institution if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall

continue to be insured for a period of six months to two years, as determined by the FDIC. Management is aware of no existing circumstances which would result in termination of the deposit insurance of Alaska Pacific.

Capital Requirements. Federally insured savings institutions, such as Alaska Pacific Bank, are required to maintain a minimum level of regulatory capital. The OTS has established capital standards, including a tangible capital requirement, a leverage ratio (or core capital) requirement and risk-based capital requirements applicable to such savings institutions. These capital requirements must be generally as stringent as the comparable capital requirements for national banks. The OTS is also authorized to impose capital requirements in excess of these standards on individual institutions on a case-by-case basis.

The capital regulations require tangible capital of at least 1.5% of adjusted total assets as defined by regulation ("Tangible Capital Ratio"). Tangible capital generally includes common stockholders' equity and retained income, and certain noncumulative perpetual preferred stock and related income. In addition, all intangible assets must be deducted from tangible capital for calculating compliance with the requirement. At December 31, 2010, the Bank had tangible capital of \$19.5 million, or 11.24% of adjusted total assets, which is \$16.9 million above the minimum requirement of 1.5% of adjusted total assets in effect on that date.

The capital standards also require core capital equal to at least 4% of adjusted total assets unless an institution's supervisory condition is such to allow it to maintain a 3.0% ratio ("Tier 1 Core Capital Ratio"). Core capital generally consists of tangible capital plus certain intangible assets, including a limited amount of purchased credit card relationships. At December 31, 2010, the Bank had core capital equal to \$19.5 million, or 11.24% of adjusted total assets, which is \$12.6 million above the minimum requirement of 4% in effect on that date.

The OTS also requires savings institutions to have core capital equal to 4% of risk-weighted assets ("Tier 1 Risk-Based Capital Ratio"). At December 31, 2010, the Bank had Tier 1 risk-based capital of \$19.5 million, or 15.29% of risk-weighted assets, which is \$14.4 million above the minimum on that date.

The OTS risk-based requirement requires savings institutions to have total risk based capital of at least 8% of risk-weighted assets ("Total risk-based capital ratio"). Total capital consists of core capital, as defined above and supplementary capital. Supplementary capital consists of certain permanent and maturing capital instruments that do not qualify as core capital and general valuation loan and lease loss allowances up to a maximum of 1.25% of risk-weighted assets. Supplementary capital may be used to satisfy the risk-based requirement only to the extent of core capital. The OTS is also authorized to require a savings institution to maintain an additional amount of total capital to account for concentration of credit risk and the risk of non-traditional activities. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet items, are multiplied by a risk weight, ranging from 0% to 100%, based on the risk inherent in the type of asset. For example, the OTS has assigned a risk weight of 50% for prudently underwritten permanent one- to-four family first lien mortgage loans not more than 90 days delinquent and having a loan-to-value ratio of not more than 80% at origination unless insured to such ratio by an insurer approved by Fannie Mae or Freddie Mac. On December 31, 2010, the Bank had total risk-based capital of \$20.8 million and risk-weighted assets of \$127.8 million, or total capital of 16.29% of risk-weighted assets. This amount was \$10.6 million above the 8% requirement in effect on that date.

The Bank is currently operating under restrictions imposed by the Order effective September 30, 2010. Pursuant to the Order the Bank is required to maintain its Tier 1 Core Capital Ratio equal to or greater than 8% after providing for an adequate allowance for loan and lease losses and Total Risk-Based Capital Ratio equal to or greater than 12%.

At December 31, 2010, the Bank exceeded each of the Capital Ratio requirements of the Order, however, under the OTS regulations an institution that enters into a written order (such as the Order) is automatically considered to be not "well capitalized" and therefore the Bank is deemed "adequately capitalized" for OTS purposes.

The OTS and the FDIC are authorized and, under certain circumstances, required to take certain actions against savings institutions that fail to meet their capital requirements. The OTS is generally required to take

action to restrict the activities of an “undercapitalized institution,” which is an institution with less than either a 4.0% core capital ratio, a 4.0% Tier 1 risk-based capital ratio, or an 8.0% risk-based capital ratio. Any such institution must submit a capital restoration plan and until the plan is approved by the OTS, may not increase its assets, acquire another institution, establish a branch or engage in any new activities, and generally may not make capital distributions. The OTS is authorized to impose the additional restrictions that are applicable to significantly undercapitalized institutions. As a condition to the approval of the capital restoration plan, any company controlling an undercapitalized institution must agree that it will enter into a limited capital maintenance guarantee with respect to the institution’s achievement of its capital requirements.

Any savings institution that fails to comply with its capital plan or has Tier 1 risk-based or core capital ratios of less than 3.0% or a risk-based capital ratio of less than 6.0% and is considered “significantly undercapitalized” will be made subject to one or more additional specified actions and operating restrictions which may cover all aspects of its operations and may include a forced merger or acquisition of the institution. An institution that becomes “critically undercapitalized” because it has a tangible capital ratio of 2.0% or less is subject to further mandatory restrictions on its activities in addition to those applicable to significantly undercapitalized institutions. In addition, the OTS must appoint a receiver, or conservator with the concurrence of the FDIC, for a savings institution, with certain limited exceptions, within 90 days after it becomes critically undercapitalized. Any undercapitalized institution is also subject to the general enforcement authority of the OTS and the FDIC, including the appointment of a conservator or a receiver.

The OTS is also generally authorized to reclassify an institution into a lower capital category and impose the restrictions applicable to such category if the institution is engaged in unsafe or unsound practices or is in an unsafe or unsound condition. The imposition by the OTS or the FDIC of any of these measures on the Bank may have a substantial adverse effect on its operations and profitability.

Emergency Economic Stabilization Act of 2008. In October 2008, the EESA was enacted. The EESA authorizes the U.S. Treasury Department to purchase from financial institutions and their holding companies up to \$700 billion in mortgage loans, mortgage-related securities and certain other financial instruments, including debt and equity securities issued by financial institutions and their holding companies in a troubled asset relief program (“TARP”). The purpose of TARP is to restore confidence and stability to the U.S. banking system and to encourage financial institutions to increase their lending to customers and to each other. Under the TARP Capital Purchase Program (“CPP”), the Treasury may purchase debt or equity securities from participating institutions. The TARP also allows direct purchases or guarantees of troubled assets of financial institutions. Participants in the CPP are subject to executive compensation limits and are encouraged to expand their lending and mortgage loan modifications. The Company completed its TARP CPP transaction in the first quarter of fiscal 2009, receiving \$4.8 million in funding on February 6, 2009. For additional information regarding the TARP CPP transaction, see “Participation in the U.S. Treasury Capital Purchase Program.”

EESA also included additional provisions directed at bolstering the economy, which we were able to participate in, such as the temporary increase in FDIC insurance coverage of deposit accounts, which increased from \$100,000 to \$250,000 through December 31, 2013.

Standards for Safety and Soundness. The federal banking regulatory agencies have prescribed, by regulation, guidelines for all insured depository institutions relating to: internal controls, information systems and internal audit systems,) loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, 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. Each insured depository institution must implement a comprehensive written information security program that includes administrative, technical and physical safeguards appropriate to the institution’s size and complexity and the nature and scope of its activities. The information security program also must be designed to ensure the security and confidentiality of customer information, protect against any unanticipated threats or hazards to the security or integrity of such information, protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer and ensure the proper disposal of customer and consumer information. Each insured depository institution must also develop and implement a risk-based response program to address incidents of unauthorized access to customer

information in customer information systems. If the OTS determines that the Bank fails to meet any standard prescribed by the Guidelines, the OTS may require the Bank to submit an acceptable plan to achieve compliance with the standard. OTS regulations establish deadlines for the submission and review of such safety and soundness compliance plans. Management of the Bank is not aware of any conditions relating to these safety and soundness standards which would require submission of a plan of compliance.

Temporary Liquidity Guaranty Program. In October 2008, the FDIC introduced the Temporary Liquidity Guarantee Program (the "TLGP"), a program designed to improve the functioning of the credit markets and to strengthen capital in the financial system during this period of economic distress. The TLGP has two components: 1) a Debt Guarantee Program ("DGP"), guaranteeing newly issued senior unsecured debt and 2) a Transaction Account Guarantee Program ("TAGP"), providing a full guarantee of noninterest bearing deposit transaction accounts, Negotiable Order of Withdrawal ("NOW") accounts paying less than 0.5% annual interest and interest on lawyers trust accounts ("IOLTA"), regardless of the amount. The Bank does not participate in the DGP but did participate in the TAGP. Under the Dodd-Frank Act and the FDIC rules, separate temporary coverage for noninterest bearing transaction accounts and IOLTA accounts became effective on December 31, 2010, terminating on December 31, 2012, so that all funds held in such accounts are fully insured, without limit. Further, unlike the TAGP, all U.S. depository institutions insured by the FDIC must participate; there is no opt out provision. The FDIC does charge a separate assessment for the temporary coverage provided under the Dodd-Frank Act.

The American Recovery and Reinvestment Act of 2009. On February 17, 2009, President Obama signed The American Recovery and Reinvestment Act of 2009 ("ARRA") into law. The ARRA is intended to revive the U.S. economy by creating millions of new jobs and stemming home foreclosures. For financial institutions that have received or will receive financial assistance under TARP or related programs, the ARRA significantly rewrites the original executive compensation and corporate governance provisions of Section 111 of the EESA. Among the most important changes instituted by the ARRA are new limits on the ability of TARP recipients to pay incentive compensation to up to 20 of the next most highly-compensated employees in addition to the "senior executive officers," a restriction on termination of employment payments to senior executive officers and the five next most highly-compensated employees and a requirement that TARP recipients implement "say on pay" shareholder votes. For additional information regarding the effects of the ARRA on the Company's senior executive officers as a result of the Company's participation in TARP, see "Risk Factors –Risks specific to our participation in TARP."

Qualified Thrift Lender Test. All savings institutions, including Alaska Pacific, are required to meet a qualified thrift lender ("QTL") test to avoid certain restrictions on their operations. This test requires a savings institution to have at least 65% of its portfolio assets, as defined by regulation, in qualified thrift investments on a monthly average for nine out of every 12 month period on a rolling basis. As an alternative, the savings institution may maintain 60% of its assets in those assets specified in Section 7701(a)(19) of the Internal Revenue Code ("Code"). Under either test, such assets primarily consist of residential housing related loans and investments. At December 31, 2010, the Bank met the test, with a ratio of 71.38%.

Any savings institution that fails to meet the QTL test must convert to a national bank charter, unless it requalifies as a QTL within one year of failure and thereafter remains a QTL. If such an association has not yet requalified or converted to a national bank, its new investments and activities are limited to those permissible for both a savings institution and a national bank, and it is limited to national bank branching rights in its home state. In addition, the association is immediately ineligible to receive any new FHLB borrowings and is subject to national bank limits for payment of dividends. If such an institution has not requalified or converted to a national bank within three years after the failure, it must divest of all investments and cease all activities not permissible for a national bank. If any association that fails the QTL test is controlled by a holding company, then within one year after the failure, the holding company must register as a bank holding company and become subject to all restrictions on bank holding companies. See "- Savings and Loan Holding Company Regulations."

Limitations on Capital Distributions. OTS regulations impose various restrictions on savings institutions with respect to their ability to make distributions of capital, which include dividends, stock redemptions or repurchases, cash-out mergers and other transactions charged to the capital account. Generally,

savings institutions, such as Alaska Pacific, that before and after the proposed distribution are well-capitalized, may make capital distributions during any calendar year equal to up to 100% of net income for the year-to-date plus retained net income for the two preceding years. However, an institution deemed to be in need of more than normal supervision by the OTS may have its dividend authority restricted by the OTS. The Bank may pay dividends to the Company in accordance with this general authority; however, it must also comply with the MOU and provide notice to, and obtain a non-objection from, the OTS prior to declaring a dividend.

Savings institutions proposing to make any capital distribution need not submit written notice to the OTS prior to such distribution unless they are a subsidiary of a holding company or would not remain well-capitalized following the distribution. Savings institutions that do not, or would not meet their current minimum capital requirements following a proposed capital distribution or propose to exceed these net income limitations, must obtain OTS approval prior to making such distribution. The OTS may object to the distribution during that 30-day period based on safety and soundness concerns. See “- Capital Requirements.”

Under the Order, the Bank is not able to pay dividends to the Company without the prior approval of the OTS. For additional information, see “—Regulatory Matters” and Item 1.A. “Risk Factors -- We are subject to certain regulatory restrictions and lack of compliance could result in monetary penalties and/or additional regulatory actions.”

Liquidity. All savings institutions, including the Bank, are required to maintain sufficient liquidity to ensure a safe and sound operation. The Bank’s primary sources of funds are deposits, proceeds from principal and interest payments on loans and mortgage-backed securities, and FHLB advances. The Bank must maintain an adequate level of liquidity to ensure the availability of sufficient funds to support loan growth and deposit withdrawals, to satisfy financial commitments and to take advantage of investment opportunities. Under the Order, the Bank is required to develop a policy for the management and maintenance of liquidity, which includes a contingency plan for anticipating funding needs and alternative funds sources, acceptable to the OTS. See “Business – “Regulatory Matters.”

Activities of Associations and Their Subsidiaries. When a savings institution establishes or acquires a subsidiary or elects to conduct any new activity through a subsidiary that the association controls, the savings institution must notify the FDIC and the OTS 30 days in advance and provide the information each agency may, by regulation, require. Savings institutions also must conduct the activities of subsidiaries in accordance with existing regulations and orders.

The OTS may determine that the continuation by a savings institution of its ownership control of, or its relationship to, the subsidiary constitutes a serious risk to the safety, soundness or stability of the association or is inconsistent with sound banking practices or with the purposes of the FDIA. Based upon that determination, the FDIC or the OTS has the authority to order the savings institution to divest itself of control of the subsidiary. The FDIC also may determine by regulation or order that any specific activity poses a serious threat to the SAIF. If so, it may require that no SAIF member engage in that activity directly.

Transactions with Affiliates. The Bank's authority to engage in transactions with "affiliates" is limited by OTS regulations and by Sections 23A and 23B of the Federal Reserve Act as implemented by the Federal Reserve Board's Regulation W. The term "affiliates" for these purposes generally means any company that controls or is under common control with an institution. The Corporation and its non-savings institution subsidiaries are affiliates of the Bank. In general, transactions with affiliates must be on terms that are as favorable to the institution as comparable transactions with non-affiliates. In addition, certain types of transactions are restricted to an aggregate percentage of the institution's capital. Collateral in specified amounts must usually be provided by affiliates in order to receive loans from an institution. In addition, savings institutions are prohibited from lending to any affiliate that is engaged in activities that are not permissible for bank holding companies and no savings institution may purchase the securities of any affiliate other than a subsidiary.

The Sarbanes-Oxley Act of 2002 generally prohibits a company from making loans to its executive officers and directors. However, there is a specific exception for loans by a depository institution to its executive officers and directors in compliance with federal banking laws. Under such laws, the Bank's authority to extend

credit to executive officers, directors and 10% stockholders ("insiders"), as well as entities that such person's control is limited. The law restricts both the individual and aggregate amount of loans the Bank may make to insiders based, in part, on the Bank's capital position and requires certain Board approval procedures to be followed. Such loans must be made on terms substantially the same as those offered to unaffiliated individuals and not involve more than the normal risk of repayment. 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. There are additional restrictions applicable to loans to executive officers.

Under the Order, the Bank cannot engage in any new transaction with an affiliate unless, with respect to each transaction, the Bank has provided 30 days advance notice to the OTS and the OTS does not object to the transaction within that 30 day period. For additional information, see "—Regulatory Matters" and Item I.A. "Risk Factors -- We are subject to certain regulatory restrictions and lack of compliance could result in monetary penalties and/or additional regulatory actions."

Federal Reserve System. The Federal Reserve Board requires that all depository institutions maintain reserves on transaction accounts or non-personal time deposits. These reserves may be in the form of cash or non-interest-bearing deposits with the regional Federal Reserve Bank. Negotiable order of withdrawal (NOW) accounts and other types of accounts that permit payments or transfers to third parties fall within the definition of transaction accounts and are subject to the reserve requirements, as are any non-personal time deposits at a savings bank. As of December 31, 2010, the Bank's deposit with the Federal Reserve Bank and vault cash exceeded its reserve requirements.

Community Reinvestment Act. Under the Community Reinvestment Act, every FDIC-insured institution has a continuing and affirmative obligation consistent with safe and sound banking practices 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 OTS, in connection with the examination of the Bank, to assess the institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications, such as a merger or the establishment of a branch, by the Bank. An unsatisfactory rating may be used as the basis for the denial of an application by the OTS. Due to the heightened attention being given to the Community Reinvestment Act in the past few years, the Bank may be required to devote additional funds for investment and lending in its local community. The Bank was examined in 2007 for Community Reinvestment Act compliance and received a rating of satisfactory in its latest examination.

Environmental Issues Associated With Real Estate Lending. The Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), a federal statute, generally imposes strict liability on all prior and present "owners and operators" of sites containing hazardous waste. However, Congress asked to protect secured creditors by providing that the term "owner and operator" excludes a person whose ownership is limited to protecting its security interest in the site. Since the enactment of the CERCLA, this "secured creditor exemption" has been the subject of judicial interpretations which have left open the possibility that lenders could be liable for cleanup costs on contaminated property that they hold as collateral for a loan.

To the extent that legal uncertainty exists in this area, all creditors, including the Bank, that have made loans secured by properties with potential hazardous waste contamination (such as petroleum contamination) could be subject to liability for cleanup costs, which costs often substantially exceed the value of the collateral property.

Privacy Standards. The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 ("GLBA"), which was enacted in 1999, modernized the financial services industry by establishing a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms and other financial service providers. The Bank is subject to OTS regulations implementing the privacy protection provisions of the GLBA.

These regulations require the Bank to disclose its privacy policy, including identifying with whom it shares "non-public personal information," to customers at the time of establishing the customer relationship and annually thereafter.

Regulation and Supervision of the Company

General. The Company is a unitary savings and loan holding company subject to regulatory oversight of the OTS. Accordingly, the Company is required to register and file reports with the OTS and is subject to regulation and examination by the OTS. In addition, the OTS has enforcement authority over the Company and its non-savings institution subsidiaries which also permit the OTS to restrict or prohibit activities that are determined to present a serious risk to the subsidiary savings institution.

Pursuant to the Order, the Company is required to ensure the Bank's compliance with applicable laws, rules and regulations and all terms and conditions of the Order issued by the OTS to the Bank. See "—Regulatory Matters" and Item 1A, "Risk Factors -- We are subject to certain regulatory restrictions and lack of compliance could result in monetary penalties and/or additional regulatory actions."

Activities Restrictions. The Company and its non-savings institution subsidiaries are subject to statutory and regulatory restrictions on their business activities specified by federal regulations, which include performing services and holding properties used by a savings institution subsidiary, activities authorized for savings and loan holding companies as of March 5, 1987, and non-banking activities permissible for bank holding companies pursuant to the Bank Holding Company Act of 1956 or authorized for financial holding companies pursuant to the GLBA.

If the Bank fails the qualified thrift lender test, the Company must, within one year of that failure, register as, and will become subject to, the restrictions applicable to bank holding companies. See "- Regulation and Supervision of Savings Institutions - Qualified Thrift Lender Test."

Dividend Payments and Common Stock Repurchases. As an Alaska corporation, the Company is subject to restrictions on the payment of dividends under Alaska law. In addition, as a savings and loan holding company, the Company's ability to declare and pay dividends is dependent on certain federal regulatory considerations. The Company is an entity separate and distinct from its principal subsidiary, Alaska Pacific Bank, and derives substantially all of its revenue in the form of dividends from this subsidiary. Accordingly, the Company is, and will be, dependent upon dividends from the Bank to pay the principal of and interest on its indebtedness, to satisfy its other cash needs and to pay dividends on its common stock. The Bank's ability to pay dividends is subject to its ability to earn net income and to meet certain regulatory requirements. See "—Regulation and Supervision of Savings Institutions - Limitations on Capital Distributions" and Item 1A, "Risk Factors -- There are regulatory and contractual limitations that may limit or prevent us from paying dividends on the common stock and we may limit or eliminate our dividends to shareholders."

As a result of our participation in the TARP CPP, we are subject to certain limitations regarding the payment of dividends on and the repurchase of our common stock. Without the consent of the U.S. Treasury, we may not increase the cash dividend on our common stock or, pay any dividends on our common stock unless we are current in our dividend payments to the U.S. Treasury on the Series A Preferred Stock. In addition and subject to limited exceptions, with the consent of the U.S. Treasury, we also may not redeem, repurchase or otherwise acquire shares of our common stock or preferred stock other than the Series A Preferred Stock or trust preferred securities. For additional information, see "Risk Factors -- Risks specific to our participation in TARP."

Mergers and Acquisitions. The Company must obtain approval from the OTS before acquiring more than 5% of the voting stock of another savings institution or savings and loan holding company or acquiring such an institution or holding company by merger, consolidation or purchase of its assets. In evaluating an application for the Company to acquire control of a savings institution, the OTS would consider the financial and managerial resources and future prospects of the Company and the target institution, the effect of the acquisition on the risk to the insurance funds, the convenience and the needs of the community and competitive factors.

Capital Requirements. Under the Dodd-Frank Act, savings and loan holding companies will not be subject to any capital requirements for five years. The OTS, however, expects the Company to support the Bank, including providing additional capital to the Bank when it does not meet its capital requirements. Under the Dodd-Frank Act, the federal banking regulators must require any company that controls an FDIC-insured depository institution to serve as a source of strength for the institution, with the ability to provide financial assistance if the institution suffers financial distress, effective when the responsibilities of the OTS are transferred to the Federal Reserve.

TAXATION

Federal Taxation

General. The Company and the Bank report their income on a fiscal year basis using the accrual method of accounting and are subject to federal income taxation in the same manner as other companies with some exceptions, including particularly the Bank's 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 the Bank or the Company.

Bad Debt Reserve. Historically, savings institutions such as the Bank which met certain definitional tests primarily related to their assets and the nature of their business ("qualifying thrift") were permitted to establish a reserve for bad debts and to make annual additions thereto, which may have been deducted in arriving at their taxable income. The Bank's deductions with respect to "qualifying real property loans," which are generally loans secured by certain interest in real property, were computed using an amount based on the Bank's actual loss experience, or a percentage equal to 8% of the Bank's taxable income, computed with certain modifications and reduced by the amount of any permitted additions to the non-qualifying reserve. Due to the Bank's loss experience, the Bank generally recognized a bad debt deduction equal to 8% of taxable income.

The thrift bad debt rules were revised by Congress in 1996. The new rules eliminated the 8% of taxable income method for deducting additions to the tax bad debt reserves for all thrifts for tax years beginning after December 31, 1995. These rules also required that all institutions recapture all or a portion of their bad debt reserves added since the base year (last taxable year beginning before January 1, 1988). The Bank has no post-1987 reserves subject to recapture. For taxable years beginning after December 31, 1995, the Bank's bad debt deduction will be determined under the experience method using a formula based on actual bad debt experience over a period of years. The unrecaptured base year reserves will not be subject to recapture as long as the institution continues to carry on the business of banking. In addition, the balance of the pre-1988 bad debt reserves continue to be subject to provisions of present law referred to below that require recapture in the case of certain excess distributions to shareholders.

Distributions. To the extent that the Bank makes "nondividend distributions" to the Company, such distributions will be considered to result in distributions from the balance of its bad debt reserve as of December 31, 1987 (or a lesser amount if the Bank's loan portfolio decreased since December 31, 1987) and then from the supplemental reserve for losses on loans ("Excess Distributions"), and an amount based on the Excess Distributions will be included in the Bank's taxable income. Nondividend distributions include distributions in excess of the Bank's current and accumulated earnings and profits, distributions in redemption of stock and distributions in partial or complete liquidation. However, dividends paid out of the Bank's current or accumulated earnings and profits, as calculated for federal income tax purposes, will not be considered to result in a distribution from the Bank's bad debt reserve. The amount of additional taxable income created from an Excess Distribution is an amount that, when reduced by the tax attributable to the income, is equal to the amount of the distribution. Thus, if the Bank makes a "nondividend distribution," then approximately one and one-half times the Excess Distribution would be includable in gross income for federal income tax purposes, assuming a 34% corporate income tax rate (exclusive of state and local taxes). See "Regulation – Regulation and Supervision of Savings Institutions -- Limitations on Capital Distributions" for limits on the payment of dividends by the Bank.

The Bank does not intend to pay dividends that would result in a recapture of any portion of its tax bad debt reserve. In addition, under the Order, the Bank is restricted from paying dividends to the Company without the prior approval of the OTS.

Corporate Alternative Minimum Tax. The Code imposes a tax on alternative minimum taxable income (“AMTI”) at a rate of 20%. The excess of the tax bad debt reserve deduction using the percentage of taxable income method over the deduction that would have been allowable under the experience method is treated as a preference item for purposes of computing the AMTI. In addition, only 90% of AMTI can be offset by net operating loss carryovers. AMTI is increased by an amount equal to 75% of the amount by which the Bank’s adjusted current earnings exceeds its AMTI (determined without regard to this preference and prior to reduction for net operating losses). For taxable years beginning after December 31, 1986, and before January 1, 1996, an environmental tax of 0.12% of the excess of AMTI (with certain modification) over \$2.0 million is imposed on companies, including the Bank, whether or not an Alternative Minimum Tax is paid.

Dividends-Received Deduction. The Company may exclude from its income 100% of dividends received from the Bank as a member of the same affiliated group of companies. The corporate dividends-received deduction is generally 70% in the case of dividends received from unaffiliated companies with which the Company and the Bank will not file a consolidated tax return, except that if the Company or the Bank owns more than 20% of the stock of a company distributing a dividend, then 80% of any dividends received may be deducted.

State Taxation

The Alaska state income tax rate applicable to the Bank is based on a graduated tax rate schedule, with a maximum rate of 9.4% on income over \$90,000. There have not been any audits of the Bank’s state tax returns during the past five years.

Audits

The Company’s income tax returns have not been audited by federal or state authorities within the last five years. For additional information regarding income taxes, see Note 13 of the Notes to Consolidated Financial Statements contained in Item 8 of this Form 10-K.

Subsidiary Activities

As of December 31, 2010, Alaska Pacific did not own any active subsidiaries.

Executive Officers

The following table sets forth certain information with respect to the executive officers of the Company and the Bank are as follows:

| Name | Age at December 31, 2010 | Position | |
|------------------------|--------------------------------|---|--|
| | | Company | Bank |
| Craig E. Dahl | 61 | Director, President and Chief Executive Officer | Director, President and Chief Executive Officer |
| Julie M. Pierce | 39 | Senior Vice President, Chief Financial Officer and Secretary | Senior Vice President and Chief Financial Officer |
| John E. Robertson | 63 | -- | Senior Vice President and Chief Credit Officer |
| Christopher P. Bourque | 59 | -- | Senior Vice President and Chief Operating Officer |
| Leslie Dahl | 51 | -- | Senior Vice President and Chief Lending Officer |

The following is a description of the principal occupation and employment of the executive officers of the Company and the Bank during at least the past five years:

Craig E. Dahl joined the Bank in 1992 and has served as President and Chief Executive Officer of the Bank since 1996 and as President and Chief Executive Officer of the Company since its formation in 1999. Prior to joining the Bank, he was President of the B.M. Behrends Bank in Juneau, Alaska. Mr. Dahl and Leslie Dahl, the Bank's Senior Vice President and Chief Lending Officer, are married to each other.

Julie M. Pierce joined the Bank in September 2007. Ms. Pierce previously held the positions of Assistant State and State Comptroller for the State of Alaska from 2005 until 2007, Director of Finance for Sealaska Heritage Institute from 2004 until 2005, and Chief Financial Officer for True North Federal Credit Union from 1999 until 2004.

John E. Robertson joined the Bank in December 2002. Mr. Robertson previously held the position of Group Vice President/Senior Relationship Banker at ABN Amro Bank from 1995 until 2002.

Christopher P. Bourque joined the Bank in June 2003 and has served as Senior Vice President and Chief Operating Officer since April 2006. Mr. Bourque previously held the position of Senior Vice President of Operations at Mount McKinley Bank in Fairbanks, Alaska from 1992 until 2000.

Leslie Dahl joined the Bank in February 2000 and has served as Senior Vice President and Chief Lending Officer since April 2006. Ms. Dahl has over 30 years of commercial lending experience. Ms. Dahl and Craig E. Dahl, the Company's and the Bank's President and Chief Executive Officer, are married to each other.

Personnel

As of December 31, 2010, the Bank had 60 full-time and four part-time employees, none of whom are represented by a collective bargaining unit. The Bank believes its relationship with its employees is good.

Competition

Alaska Pacific faces strong competition in its primary market area for the attraction of deposits (its primary source of lendable funds) and in the origination of loans. Its most direct competition for deposits has historically come from commercial banks and credit unions operating in its primary market area. The Bank competes with four commercial banks (including one Southeast Alaska based community bank, two large national banks and one statewide regional bank) and six credit unions in its primary market area. Particularly in times of high interest rates, Alaska Pacific has faced additional significant competition for investors' funds from short-term money market securities, other corporate and government securities and credit unions. The Bank's competition for loans also comes from mortgage bankers and Internet-based marketers. This competition for deposits and the origination of loans may limit Alaska Pacific's future growth.

Alaska Pacific's market share is approximately 10.7% of deposits in Southeast Alaska, according to the FDIC Deposit Market Share Report; however, this calculation does not include deposits held by credit unions. If state-wide credit unions were included in this calculation as well as "non-bank" competitors such as brokerage firms and money market mutual funds, Alaska Pacific's share would be somewhat less. Alaska Pacific's largest competitor is Wells Fargo, with a market share of approximately 49.8%. Wells Fargo acquired the former National Bank of Alaska in 2000, and Alaska Pacific has achieved some success in drawing customers away from Wells Fargo, especially small businesses, through a targeted calling effort and a marketing emphasis on the advantages of banking locally.

Item 1A – Risk Factors

An investment in our common stock is subject to risks inherent in our business. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included in this report. In addition to the risks and uncertainties described below, other risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition and results of operations. The value or market price of our common stock could decline due to any of these identified or other risks, and you could lose all or part of your investment. The risks discussed below also include forward-looking statements, and our actual results may differ substantially from those discussed in these forward-looking statements. This report is qualified in its entirety by these risk factors.

We are subject to certain regulatory restrictions and lack of compliance could result in monetary penalties and/or additional regulatory actions.

On September 28, 2010, Alaska Pacific Bancshares, Inc. and Alaska Pacific Bank each entered into a Stipulation and Consent to the Issuance of an Order to Cease and Desist with the OTS (individually an "Order" and collectively the "Orders"). Under the terms of the Orders, the Company and the Bank are required, among other things, to take certain measures in the areas of capital, classified assets, loan loss allowance determination, lending, liquidity management, and board oversight. Specifically, the Order for the Bank requires that the Bank maintain a Tier 1 capital ratio equal of at least 8% after the funding of the allowance for loan and lease losses and a total risk-based capital ratio of at least 12% and 12% by September 30, 2010. The Bank must also submit an updated strategic business plan, revise its classified asset reduction plan, internal audit program, consumer compliance plan, including developing a written liquidity and funds management policy and a written plan for information technology management, and submit such revised plans and policies to regulators. The Bank must also obtain prior regulatory approval before paying a dividend to the Company and prior to engaging in any new transactions with affiliates.

The Order for the Company requires that the Company ensure the Bank's compliance with applicable laws, rules and regulations and the terms and conditions of the Bank's Order. In addition to providing a written capital plan, as discussed below, the Company also must submit an operations plan that addresses how the

Company will meet its financial obligations. The Order also restricts the Company from paying dividends and repurchasing shares of its common stock and also may not incur any new debt, increase any current lines of credit, or guarantee the debt of any entity without prior regulatory approval.

Under the Orders, the Bank and Company must submit a written plan to maintain the Bank's capital at the levels set forth in the Order. The Orders also provide that the Bank and the Company must obtain prior regulatory approval before adding any new director or senior executive officer or changing the responsibilities of any current senior executive officer or pay pursuant to or by entering into certain severance and other forms of compensation agreements. The Orders specify certain timeframes for meeting these requirements, and the Company and the Bank must furnish periodic progress reports to the FDIC and DFI regarding its compliance with the Orders.

At December 31, 2010, the Bank exceeded all current regulatory capital requirements, including the requirements specified in the Order. The Bank has implemented a comprehensive plan to achieve compliance with all conditions in the Order. For information regarding the Bank's compliance with its capital requirements at December 31, 2010, see Item 1, "Business – Regulation – Regulation and Supervision of Savings Institutions – Capital Requirements," and Note 3 of the Notes to the Consolidated Financial Statements for additional information regarding regulatory capital requirements for the Bank for the year ended December 31, 2010.

The Orders will remain in effect until stayed, modified, terminated or suspended by the OTS. If either the Company or the Bank failed to comply with the respective Orders, they could be subject to various remedies, including among others, the regulator's exercise of powers to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation or practice, to direct an increase in capital, to restrict growth, to remove officers and/or directors and to assess civil monetary penalties. Management of the Bank and the Company have been taking action and implementing programs to comply with the requirements of the Order. Although compliance will be determined by the OTS, management believes that the Bank and the Company will comply in all material respects with the Orders. The OTS may determine at their sole discretion that the matters covered in the Orders have not been addressed satisfactorily, or that any current or past actions, violations, or deficiencies could be the subject of further regulatory enforcement actions. Such enforcement actions could involve penalties or limitations on our business and negatively affect our ability to implement our business plan, pay dividends on our common stock, or the value of our common stock as well as our financial condition and results of operations.

Our business may continue to be adversely affected by downturns in the national economy and the states where our out of market area loans are located.

Since the latter half of 2007, depressed economic conditions have prevailed in portions of the United States outside of our primary area of Southeast Alaska, including areas where the Bank has participation loans, specifically in the States of Washington, Oregon, Idaho, California and Colorado. We provide banking and financial services to customers located in our primary market of Southeast Alaska, which to date, up to this point in time and based upon its geographic location and diverse resource-based economy has not experienced the serious problems as those of markets in the lower-48 states. If there were to be a further decline of the economic conditions in our primary market, this could have an adverse effect on our business, financial condition, results of operations and prospects.

A further deterioration in economic conditions in the market areas we serve could result in the following consequences, any of which could have a materially adverse impact on our business, financial condition and results of operations:

- an increase in loan delinquencies, problem assets and foreclosures;
- the slowing of sales of foreclosed assets;

- a decline in demand for our products and services;
- a continuing decline in the value of collateral for loans may in turn reduce customers' borrowing power, reducing the value of assets and collateral associated with existing loans; and
- a decrease in the amount of our low cost or non-interest bearing deposits.

Our emphasis on commercial real estate lending may expose us to increased lending risks.

Our current business strategy is focused on the expansion of small business lending in the region, with a focus on owner-occupied commercial real estate lending. This type of lending activity, while potentially more profitable than single-family residential lending, is generally more sensitive to regional and local economic conditions, making loss levels more difficult to predict. Collateral evaluation and financial statement analysis in these types of loans requires a more detailed analysis at the time of loan underwriting and on an ongoing basis. A downturn in housing, or the real estate market, could increase loan delinquencies, defaults and foreclosures, and significantly impair the value of our collateral and our ability to sell the collateral upon foreclosure.

At December 31, 2010, we had \$2.0 million of multifamily residential and \$66.1 million of commercial real estate loans, representing 1.4% and 46.6%, respectively, of our total loan portfolio. These loans typically involve higher principal amounts than other types of loans, and repayment is dependent upon income generated, or expected to be generated, by the property securing the loan in amounts sufficient to cover operating expenses and debt service, which may be adversely affected by changes in the economy or local market conditions. For example, if the cash flow from the borrower's project is reduced as a result of leases not being obtained or renewed, the borrower's ability to repay the loan may be impaired. Commercial and multifamily mortgage loans also expose a lender to greater credit risk than loans secured by residential real estate because the collateral securing these loans typically cannot be sold as easily as residential real estate.

A secondary market for most types of commercial real estate loans is not readily liquid, so we have less opportunity to mitigate credit risk by selling part or all of our interest in these loans. As a result of these characteristics, if we foreclose on a commercial or multifamily real estate loan, our holding period for the collateral typically is longer than for one-to-four family residential mortgage loans because there are fewer potential purchasers of the collateral. Accordingly, charge-offs on commercial and multifamily real estate loans may be larger on a per loan basis than those incurred with our residential or consumer loan portfolios.

The level of our commercial real estate loan portfolio may subject us to additional regulatory scrutiny.

The FDIC, the Federal Reserve and the Office of Thrift Supervision have promulgated joint guidance on sound risk management practices for financial institutions with concentrations in commercial real estate lending. Under this guidance, a financial institution that, like us, is actively involved in commercial real estate lending should perform a risk assessment to identify concentrations. A financial institution may have a concentration in commercial real estate lending if, among other factors (i) total reported loans for construction, land development, and other land represent 100% or more of total capital, or (ii) total reported loans secured by multifamily and non-farm residential properties, loans for construction, land development and other land, and loans otherwise sensitive to the general commercial real estate market, including loans to commercial real estate related entities, represent 300% or more of total capital. The particular focus of the guidance is on exposure to commercial real estate loans that are dependent on the cash flow from the real estate held as collateral and that are likely to be at greater risk to conditions in the commercial real estate market (as opposed to real estate collateral held as a secondary source of repayment or as an abundance of caution). The purpose of the guidance is to guide banks in developing risk management practices and capital levels commensurate with the level and nature of real estate concentrations. The guidance states that management should employ heightened risk management practices including board and management oversight and strategic planning, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing. We have concluded that we have a concentration in commercial real estate lending under the foregoing standards because our \$66.1 million balance in commercial real estate loans at December 31, 2010 represented 300% or more of total capital. While we believe we have implemented policies and procedures with respect to our commercial real estate loan portfolio consistent with this guidance, bank regulators could require us to implement additional policies and procedures consistent with their interpretation of the guidance that may result in additional costs to us.

Repayment of our commercial business loans is often dependent on the cash flows of the borrower, which may be unpredictable, and the collateral securing these loans may fluctuate in value.

At December 31, 2010, we had \$19.4 million or 13.6% of total loans in commercial business loans. Commercial lending involves risks that are different from those associated with residential and commercial real estate lending. Real estate lending is generally considered to be collateral based lending with loan amounts based on predetermined loan to collateral values and liquidation of the underlying real estate collateral being viewed as the primary source of repayment in the event of borrower default. Our commercial loans are primarily made based on the cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The borrowers' cash flow may be unpredictable, and collateral securing these loans may fluctuate in value. Although commercial loans are often collateralized by equipment, inventory, accounts receivable, or other business assets, the liquidation of collateral in the event of default is often an insufficient source of repayment because accounts receivable may be uncollectible and inventories may be obsolete or of limited use, among other things. Accordingly, the repayment of commercial business loans depends primarily on the cash flow and credit worthiness of the borrower and secondarily on the underlying collateral provided by the borrower.

Our business may be adversely affected by credit risk associated with residential property.

At December 31, 2010, \$25.2 million, or 17.8% of our total loan portfolio, was secured by one-to-four single-family mortgage loans and home equity lines of credit. This type of lending is generally sensitive to regional and local economic conditions that significantly impact the ability of borrowers to meet their loan payment obligations, making loss levels difficult to predict. The decline in residential real estate values as a result of the downturn in the housing markets has reduced the value of the real estate collateral securing these types of loans and increased the risk that we would incur losses if borrowers default on their loans. Continued declines in the housing market and the economy and the associated increases in unemployment may result in higher than expected loan delinquencies or problem assets, a decline in demand for our products and services, or lack of growth or a decrease in deposits. These potential negative events may cause us to incur losses, adversely affect our capital and liquidity, and damage our financial condition and business operations.

High loan-to-value ratios on a portion of our residential mortgage loan portfolio exposes us to greater risk of loss.

Many of our residential mortgage loans are secured by liens on mortgage properties in which the borrowers have little or no equity because either we originated upon purchase a first mortgage with an 80% loan-to-value ratio, have originated a home equity loan with a combined loan-to-value ratio of up to 90% or because of the decline in home values in our market areas. Residential loans with high loan-to-value ratios will be more sensitive to declining property values than those with lower combined loan-to-value ratios and, therefore, may experience a higher incidence of default and severity of losses. In addition, if the borrowers sell their homes, such borrowers may be unable to repay their loans in full from the sale. As a result, these loans may experience higher rates of delinquencies, defaults and losses.

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

Lending money is a substantial part of our business, and each loan carries a certain risk that it will not be repaid in accordance with its terms or that any underlying collateral will not be sufficient to assure repayment. This risk is affected by, among other things:

- the cash flow of the borrower and/or the project being financed;
- changes and uncertainties as to the future value of the collateral, in the case of a collateralized loan;
- the duration of the loan;
- the credit history of a particular borrower; and
- changes in economic and industry conditions.

We maintain an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense, which we believe is appropriate to provide for probable losses in our loan portfolio. The amount of this allowance is determined by our management through periodic reviews and consideration of several factors, including, but not limited to:

- our general reserve, based on our historical default and loss experience and certain macroeconomic factors based on management's expectations of future events; and
- our specific reserve, based on our evaluation of nonperforming loans and their underlying collateral.

The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we review our loans and the loss and delinquency experience, and evaluate economic conditions and make significant estimates of current credit risks and future trends, all of which may undergo material changes. If our estimates are incorrect, the allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, resulting in the need for additions to our allowance through an increase in the provision for loan losses. Continuing deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance for loan losses. Our allowance for loan losses was 1.12% of total loans held for investment and 353% of nonperforming loans at December 31, 2010. In addition, bank regulatory agencies periodically review our allowance for loan losses and may require an increase in the provision for possible loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. If charge-offs in future periods exceed the allowance for loan losses, we will need additional provisions to increase the allowance for loan losses. Any increases in the provision for loan losses will result in a decrease in net income and may have a material adverse effect on our financial condition, results of operations and our capital.

If our investments in real estate are not properly valued or sufficiently reserved to cover actual losses, or if we are required to increase our valuation reserves, our earnings could be reduced.

We obtain updated valuations in the form of appraisals and broker price opinions when a loan has been foreclosed and the property taken in as real estate owned ("REO"), and at certain other times during the assets holding period. Our net book value in the loan at the time of foreclosure and thereafter is compared to the updated market value of the foreclosed property less estimated selling costs (fair value). A charge-off is recorded for any excess in the asset's net book value over its fair value less cost to sell. If our valuation process is incorrect, the fair value of our investments in real estate may not be sufficient to recover our net book value in such assets, resulting in the need for additional charge-offs. Additional material charge-offs to our investments in real estate could have a material adverse effect on our financial condition and results of operations.

In addition, bank regulators periodically review our REO and may require us to recognize further charge-offs. Any increase in our charge-offs, as required by such regulators, may have a material adverse effect on our financial condition and results of operations.

We may suffer losses in our loan portfolio despite our underwriting practices.

We seek to mitigate the risks inherent in our loan portfolio by adhering to specific underwriting practices. Although we believe that our underwriting criteria are appropriate for the various kinds of loans we make, we may incur losses on loans that meet our underwriting criteria, and these losses may exceed the amounts set aside as reserves in our allowance for loan losses.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition, growth and prospects.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a substantial negative effect on our liquidity. We rely on customer deposits and advances from the FHLB of Seattle ("FHLB"), the Federal Reserve Bank of San Francisco ("FRB") and other borrowings to fund our operations. Although we have historically been able to replace maturing deposits and advances if desired, we may not be able to replace such funds in the future if, among other things, our financial condition, the financial condition of the FHLB or FRB, or market conditions change. Our access to funding sources in amounts adequate to finance our activities or the terms of which are acceptable could be impaired by factors that affect us specifically or the financial services industry or economy in general - such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry in light of the recent turmoil faced by banking organizations and the continued deterioration in credit markets. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity as a result of a downturn in our primary market area of Southeast Alaska where our loans are concentrated or adverse regulatory action against us. In connection with Alaska Pacific Bank's Order, we are required to submit a policy for the management and maintenance of liquidity. For additional information, see "Item 1, Business — Regulatory Matters."

Our financial flexibility will be severely constrained if we are unable to maintain our access to funding or if adequate financing is not available to accommodate future growth at acceptable interest rates. Although we consider our sources of funds adequate for our liquidity needs, we may seek additional debt in the future to achieve our long-term business objectives. Additional borrowings, if sought, may not be available to us or, if available, may not be available on reasonable terms. If additional financing sources are unavailable, or are not available on reasonable terms, our financial condition, results of operations, growth and future prospects could be materially adversely affected. In addition, the Bank may not incur additional debt without the prior written non-objection of the OTS. Finally, if we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs.

Our growth or future losses may require us to raise additional capital in the future, but that capital may not be available when it is needed or the cost of that capital may be very high.

We are required by federal regulatory authorities to maintain adequate levels of capital to support our operations. We anticipate that our capital resources will satisfy our capital requirements for the foreseeable future. Nonetheless, we may at some point need to raise additional capital to support continued growth.

Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial condition and performance. Accordingly, we cannot make assurances that we will be able to raise additional capital if needed on terms that are acceptable to us, or at all. If we cannot raise additional capital when needed, it may have a material adverse effect on our financial condition and liquidity, results of operations and prospects.

There are regulatory and contractual limitations that may limit or prevent us from paying dividends on the common stock and we may limit or eliminate our dividends to shareholders.

As an Alaska corporation, under Alaska law we are subject to restrictions on the payment of dividends. In addition, as a savings and loan holding company, the Company's ability to declare and pay dividends is dependent on certain federal regulatory considerations. Alaska Pacific Bancshares is an entity separate and distinct from its principal subsidiary, Alaska Pacific Bank, and derives substantially all of its revenue in the form of dividends from this subsidiary. Accordingly, the Company is and will be dependent upon dividends from Alaska Pacific Bank to pay the principal of and interest on its indebtedness, to satisfy its other cash needs and to pay dividends on its common stock. Alaska Pacific Bank's ability to pay dividends is subject to their ability to earn net income and to meet certain regulatory requirements. In the event the Bank is unable to pay dividends to Alaska Pacific Bancshares, the Company may not be able to pay its obligations or pay dividends on its common

stock. Under the Orders, the Company and the Bank may not pay dividends without the prior written approval of the OTS. See "Regulation - Regulation and Supervision of Savings Institutions - Limitations on Capital Distributions" and Note 3 of the Notes to Consolidated Financial Statements. Also, Alaska Pacific Bancshares's right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors.

Alaska Pacific Bancshares is also subject to certain regulatory restrictions that could prohibit it from declaring or paying dividends or making liquidation payments on its common stock. See "Regulation - Regulation and Supervision of the Company - Dividend Payments and Common Stock Repurchases" above. In addition, the securities purchase agreement between us and Treasury limits our ability to pay dividends on and repurchase our common stock. The securities purchase agreement between us and Treasury provides that prior to the earlier of (i) November 21, 2011 and (ii) the date on which all of the shares of the Series A Preferred Stock have been redeemed by us or transferred by Treasury to third parties, we may not, without the consent of Treasury, (a) increase the cash dividend on our common stock or (b) subject to limited exceptions, redeem, repurchase or otherwise acquire shares of our common stock or preferred stock other than the Series A Preferred Stock or trust preferred securities. In addition, we are unable to pay any dividends on our common stock unless we are current in our dividend payments on the Series A Preferred Stock.

Our board of directors regularly reviews our dividend policy in light of current economic conditions for financial institutions as well as our capital needs and any applicable contractual restrictions. On a quarterly basis, the board of directors determines whether a dividend will be paid and in what amount, if any.

New or changing tax, accounting, and regulatory rules and interpretations could significantly impact strategic initiatives, results of operations, cash flows, and financial condition.

The financial services industry is extensively regulated. Federal and state banking regulations are designed primarily to protect the deposit insurance funds and consumers, not to benefit a company's stockholders. These regulations may sometimes impose significant limitations on operations. The significant federal and state banking regulations that affect us are described in this report under the heading "Item 1. Business -- Regulation." These regulations, along with the currently existing tax, accounting, securities, insurance, and monetary laws, regulations, rules, standards, policies, and interpretations control the methods by which financial institutions conduct business, implement strategic initiatives and tax compliance, and govern financial reporting and disclosures. These laws, regulations, rules, standards, policies, and interpretations are constantly evolving and may change significantly over time.

Such changes could subject us to additional costs, limit the types of financial services and products we may offer, restrict mergers and acquisitions, investments, access to capital, the location of banking offices, and/or increase the ability of non-banks to offer competing financial services and products, among other things. Further, recent regulatory changes to the rules for overdraft fees for debit transactions and interchange fees could reduce our fee income which would result in a reduction of our noninterest income. Our failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputational damage, which could have a material adverse effect on our business, financial condition and results of operations. While we have policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur.

Further deterioration in the financial position of the Federal Home Loan Bank of Seattle may result in future impairment losses on our investment in Federal Home Loan Bank stock.

At December 31, 2010, we owned \$1.8 million of stock of the Federal Home Loan Bank of Seattle, or FHLB. As a condition of membership at the FHLB, we are required to purchase and hold a certain amount of FHLB stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB and is calculated in accordance with the Capital Plan of the FHLB. Our FHLB stock has a par value of \$100, is carried at cost, and is subject to recoverability testing. The FHLB announced that it had a risk-based capital deficiency under the regulations of the Federal Housing Finance Agency (the "FHFA"), its primary regulator, as of December 31, 2008, and that it would suspend future dividends and the repurchase and

redemption of outstanding common stock. As a result, the FHLB has not paid a dividend since the fourth quarter of 2008. The FHLB has communicated that it believes the calculation of risk-based capital under the current rules of the FHFA significantly overstates the market risk of the FHLB's private-label mortgage-backed securities in the current market environment and that it has enough capital to cover the risks reflected in its balance sheet. As a result, we have not recorded an impairment on our investment in FHLB stock. However, further deterioration in the FHLB's financial position may result in impairment in the value of those securities. In addition, on October 25, 2010, the FHLB received a consent order from the FHFA. The potential impact of the consent order is unknown at this time. We will continue to monitor the financial condition of the FHLB as it relates to, among other things, the recoverability of our investment.

Continued weak or worsening credit availability could limit our ability to replace deposits and fund loan demand, which could adversely affect our earnings and capital levels.

Continued weak or worsening credit availability and the inability to obtain adequate funding to replace deposits and fund continued loan growth may negatively affect asset growth and, consequently, our earnings capability and capital levels. In addition to any deposit growth, maturity of investment securities and loan payments, we rely from time to time on advances from the FHLB to fund loans and replace deposits. If the economy does not improve or continues to deteriorate, this additional funding source could be negatively affected, which could limit the funds available to us. Our liquidity position could be significantly constrained if we are unable to access funds from the FHLB.

The maturity and repricing characteristics of our assets and liabilities are mismatched and subject us to interest rate risk which could adversely affect our net earnings and economic value.

Our financial condition and operations are influenced significantly by general economic conditions, including the absolute level of interest rates as well as changes in interest rates and the slope of the yield curve. Our profitability is dependent to a large extent on our net interest income, which is the difference between the interest received from our interest-earning assets and the interest expense incurred on our interest-bearing liabilities. Significant changes in market interest rates or errors or misjudgments in our interest rate risk management procedures could have a material adverse effect on our net earnings and economic value. We currently believe that rising interest rates will adversely affect our near-term net earnings.

Our activities, like all financial institutions, inherently involve the assumption of interest rate risk. Interest rate risk is the risk that changes in market interest rates will have an adverse impact on our earnings and underlying economic value. Interest rate risk is determined by the maturity and repricing characteristics of our assets, liabilities and off-balance-sheet contracts. Interest rate risk is measured by the variability of financial performance and economic value resulting from changes in interest rates. Interest rate risk is the primary market risk affecting our financial performance.

We believe that the greatest source of interest rate risk to us results from the mismatch of maturities or repricing intervals for our rate sensitive assets, liabilities and off-balance-sheet contracts. This mismatch or gap is generally characterized by a substantially shorter maturity structure for interest-bearing liabilities than interest-earning assets. Additional interest rate risk results from mismatched repricing indices and formulae (basis risk and yield curve risk), and product caps and floors and early repayment or withdrawal provisions (option risk), which may be contractual or market driven, that are generally more favorable to customers than to us.

Our primary monitoring tool for assessing interest rate risk is asset/liability simulation modeling, which is designed to capture the dynamics of balance sheet, interest rate and spread movements and to quantify variations in net interest income and net market value of equity resulting from those movements under different rate environments. We update and prepare our simulation modeling at least quarterly for review by senior management and our directors. We believe the data and assumptions are realistic representations of our portfolio and possible outcomes under the various interest rate scenarios. Nonetheless, the interest rate sensitivity of our net interest income and net market value of our equity could vary substantially if different assumptions were used or if actual experience differs from the assumptions used and, as a result, our interest rate risk management strategies may prove to be inadequate.

See Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Market Risk and Asset/Liability Management” for additional information concerning interest rate risk.

If external funds were not available, this could adversely impact our growth and prospects.

We rely on deposits and advances from the FHLB of Seattle and other borrowings to fund our operations. Although we have historically been able to replace maturing deposits and advances if desired, we might not be able to replace such funds in the future if our financial condition or the financial condition of the FHLB of Seattle or market conditions were to change. While we consider such sources of funds adequate for our liquidity needs, we may be compelled or elect to seek additional sources of financing in the future. Likewise, we may seek additional debt in the future to achieve our long-term business objectives, in connection with future acquisitions or for other reasons. Additional borrowings, if sought, may not be available to us or, if available, may not be on reasonable terms. If additional financing sources are unavailable or not available on reasonable terms, our financial condition, results of operations and future prospects could be materially adversely affected.

Financial reform legislation recently enacted by Congress will, among other things, tighten capital standards, create a new Consumer Financial Protection Bureau and result in new laws and regulations that are expected to increase our costs of operations.

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). This new law will significantly change the current bank regulatory structure and affect the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting the implementing rules and regulations, and consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for many months or years.

Among the many requirements in the Dodd-Frank Act for new banking regulations is a requirement for new capital regulations to be adopted within 18 months. These regulations must be at least as stringent as, and may call for higher levels of capital than, current regulations. Generally, trust preferred securities will no longer be eligible as Tier 1 capital, but the Company’s currently outstanding TARP preferred securities will continue to qualify as Tier 1 capital.

Certain provisions of the Dodd-Frank Act are expected to have a near term impact on the Company and the Bank. For example, effective one year after the date of enactment, the Dodd-Frank Act eliminates the federal prohibitions on paying interest on demand deposits, thus allowing businesses to have interest-bearing checking accounts. Depending on competitive responses, this significant change to existing law could have an adverse impact on the Company’s interest expense.

The Dodd-Frank Act also broadens the base for Federal Deposit Insurance Corporation insurance assessments. Assessments will now be based on the average consolidated total assets less tangible equity capital of a financial institution. The Dodd-Frank Act also permanently increases the maximum amount of deposit insurance for banks, savings institutions and credit unions to \$250,000 per depositor and non-interest-bearing transaction accounts and IOLTA accounts have unlimited deposit insurance through December 31, 2012.

The Dodd-Frank Act will require publicly traded companies to give stockholders a non-binding vote on executive compensation and so-called “golden parachute” payments and authorizes the Securities and Exchange Commission to promulgate rules that would allow stockholders to nominate their own candidates using a company’s proxy materials. The legislation also directs the federal banking regulators to issue rules prohibiting incentive compensation that encourages inappropriate risks. The legislation also directs the Federal Reserve Board to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded or not.

The Dodd-Frank Act creates a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets.

Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on the Company. However, compliance with this new law and its implementing regulations will result in additional operating costs that could have a material adverse effect on our financial condition and results of operations.

Increases in deposit insurance premiums and special FDIC assessments will negatively impact our earnings.

FDIC insurance premiums increased significantly in 2009 and we may pay higher FDIC premiums in the future.

The Dodd-Frank Act established 1.35% as the minimum reserve ratio. The FDIC has adopted a plan under which it will meet this ratio by the statutory deadline of September 30, 2020. The Dodd-Frank Act requires the FDIC to offset the effect on institutions with assets less than \$10 billion of the increase in the minimum reserve ratio to 1.35% from the former minimum of 1.15%. The FDIC has not announced how it will implement this offset. In addition to the statutory minimum ratio, the FDIC must set a designated reserve ratio or DRR, which may exceed the statutory minimum. The FDIC has set 2.0 as the DRR.

As required by the Dodd-Frank Act, the FDIC has adopted final regulations under which insurance premiums are based on an institution's total assets minus its tangible equity instead of its deposits. While our FDIC insurance premiums initially will be reduced by these regulations, it is possible that our future insurance premiums will increase under the final regulations.

Because of our participation in the TARP Capital Purchase Program, we are subject to several restrictions including restrictions on compensation paid to our executives.

Our ability to attract and retain key officers and employees may be impacted by legislation and regulation affecting the financial services industry. In 2009, the American Recovery and Reinvestment Act (ARRA) became law. The ARRA, through the implementing regulations of the U.S. Treasury, significantly expanded the executive compensation restrictions originally imposed on TARP participants, including us. Among other things, these restrictions limit our ability to pay bonuses and other incentive compensation and make severance payments. These restrictions will continue to apply to us for as long as the preferred stock we issued pursuant to the TARP Capital Purchase Program remains outstanding. These restrictions may negatively affect our ability to compete with financial institutions that are not subject to the same limitations.

The loss of key members of our senior management team could adversely affect our business.

We believe that our success depends largely on the efforts and abilities of our senior management. Their experience and industry contacts significantly benefit us. The competition for qualified personnel in the financial services industry is intense, and the loss of any of our key personnel or an inability to continue to attract, retain and motivate key personnel could adversely affect our business. In addition, the American Recovery and Reinvestment Act has imposed significant limitations on executive compensation for recipients, such as us, of funds under the TARP Capital Purchase Program, which may make it more difficult for us to retain and recruit key personnel.

Our real estate lending also exposes us to the risk of environmental liabilities.

In the course of our business, we may foreclose and take title to real estate, and we could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third persons for property damage, personal injury, investigation, and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, as the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we ever become subject to significant environmental liabilities, our business, financial condition and results of operations could be materially and adversely affected.

Our information systems may experience an interruption or breach in security.

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

We rely on dividends from Alaska Pacific Bank for most of our revenue.

Alaska Pacific Bancshares is a separate and distinct legal entity from Alaska Pacific Bank. We receive substantially all of our revenue from dividends from Alaska Pacific Bank. These dividends are the principal source of funds to pay dividends on our common stock. Various federal laws and regulations limit the amount of dividends that Alaska Pacific Bank may pay to Alaska Pacific Bancshares. Also, our right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. In the event the Bank is unable to pay dividends to the Company, we may not be able to pay obligations or pay dividends on Alaska Pacific's common stock. The inability to receive dividends from the Bank could have a material adverse effect on our business, financial condition and results of operations. See Item 1, "Business - Regulation – Limitations on Capital Distributions."

Our concentration of operations in Alaska and specifically the Southeast areas of Alaska make us more exposed to downturns in the State of Alaska and those areas.

Substantially all of our business is derived from operations in Alaska and specifically the Southeast areas of Alaska. The majority of our lending has been with Alaska businesses and individuals. Substantially all of these loans are collateralized and repayment is expected from the borrowers' cash flow or, secondarily, the collateral. Our exposure to credit loss, if any, is the outstanding amount of the loan if the collateral is proved to be of no value. The State of Alaska and Southeast areas rely primarily upon the natural resources industries, particularly mining and oil production, as well as tourism, government and U.S. military spending for their economic success. Our business is and will remain sensitive to economic factors that relate to these industries and local and regional business conditions. As a result, local or regional economic downturns, or downturns that disproportionately affect one or more of the key industries in regions served by the Company, may have a more pronounced effect upon its business than they might on an institution that is less geographically concentrated. The extent of the future impact of these events on economic and business conditions cannot be predicted; however, prolonged or acute fluctuations could have a material and adverse impact upon our results of operation and financial condition.

Our assets as of December 31, 2010, include a deferred tax asset, the full value of which we may not be able to realize.

We recognize deferred tax assets and liabilities based on differences between the financial statement carrying amounts and the tax bases of assets and liabilities. The net deferred tax asset results primarily from our provisions for loan losses recorded for financial reporting purposes, which has been significantly larger than net loan charge-offs deducted for tax reporting purposes. We regularly review our deferred tax assets for recoverability based on our history of earnings, expectations for future earnings, expected timing of reversals of temporary differences, and tax planning strategies. As a result of that review, management determined that a valuation allowance of \$471,000 was required at December 31, 2010. We believe the remaining net deferred tax asset at December 31, 2010 of \$544,000, is more than likely to be realized based on our expected future earnings; however, it is possible that an additional valuation allowance may be required, which could have a further adverse effect on our future results of operations and financial condition.

Our estimated allowance for off-balance sheet liabilities may be inadequate.

In the normal course of business, the Bank incurs various off-balance sheet liabilities and contingent liabilities that are not presented in its financial statements. These off-balance sheet commitments and contingent liabilities include various guarantees and commitments to extend credit. In addition, the Bank originates, and subsequently sells, nearly all residential real estate loans into the secondary market. The Bank may be required to repurchase sold loans under certain circumstances. A separate reserve for probable off-balance sheet liabilities has not been established for potential losses and there can be no assurance that a reserve to cover off-balance sheet liability losses would be sufficient.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties

The following table sets forth certain information regarding Alaska Pacific's offices at December 31, 2010.

| <u>Location</u> | <u>Year Opened</u> | <u>Square Footage</u> | <u>Deposits (in thousands)</u> |
|--|------------------------|---------------------------|------------------------------------|
| <i>Main Office:</i> | | | |
| Nugget Mall Office (1) 2094 Jordan Avenue Juneau, Alaska 99801 | 1984 | 16,000 | \$73,762 |
| <i>Branch Offices:</i> | | | |
| 301 N. Franklin Street Juneau, Alaska 99801 | 1960 | 6,268 | 29,898 |
| 410 Mission Street (2) Ketchikan, Alaska 99901 | 1974 | 2,300 | 14,209 |
| 2442 Tongass Avenue (3) Ketchikan, Alaska 99901 | 1997 | 1,550 | 7,287 |
| 315 Lincoln Street (4) Sitka, Alaska 99835 | 1978 | 2,032 | 22,392 |
| <i>Alaska Pacific Mortgage (5)</i> | | | |
| 2092 Jordan Avenue, Suite 595 Juneau, Alaska 99801 | 2003 | 2,500 | Non-depository |

- (1) Lease expires in January 2019, with one 10-year option to renew.
- (2) Lease expires in February 2013, with option to renew for five-year term.
- (3) Lease expires in May 2011, with two 6-month options to renew.
- (4) Lease expires in December 2013, with option to renew for five-year term.
- (5) Lease expires in October 2013

Alaska Pacific maintains 11 automated teller machines including six in the Juneau area, two in the Sitka area, two in the Ketchikan area, and one in Hoonah. At December 31, 2010, the net book value of Alaska Pacific's properties and its fixtures, furniture and equipment was \$2.6 million.

Item 3. Legal Proceedings

Periodically, there have been various claims and lawsuits involving the Bank, mainly as a defendant, such as claims to enforce liens, condemnation proceedings on properties in which the Bank holds security interests, claims involving the making and servicing of real property loans and other issues incident to the Bank's business. The Bank is not a party to any pending legal proceedings that it believes would have a material adverse effect on the financial condition or operations of the Bank.

Item 4. [Reserved]

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's common stock is traded on the over-the-counter market through the OTC "Electronic Bulletin Board" under the symbol "AKPB." As of December 31, 2010, there were approximately 363 stockholders of record and 654,486 shares outstanding. Generally, if the Bank satisfies its regulatory capital requirements, it may make dividend payments up to the limits prescribed in the OTS regulations. However, an institution that has converted to the stock form of ownership may not declare or pay a dividend on, or repurchase any of, its common stock if the effect thereof would cause the regulatory capital of the institution to be reduced below the amount required for the liquidation account which was established in connection with the institution's mutual-to-stock conversion.

The Bank is restricted by the amount of dividends it may pay to the Company. It is generally limited to the net income of the current fiscal year and that of the two previous fiscal years, less dividends already paid during those periods. Based on this calculation, at December 31, 2010, none of the Bank's retained earnings were available for dividends to the Company. However, payment of dividends may be further restricted by the OTS if such payment would reduce the Bank's capital ratios below required minimums or would otherwise be considered to adversely affect the safety and soundness of the institution.

The Bank currently is operating under the restrictions imposed by an Order issued by the OTS on September 28, 2010. Among other restrictions, the Order requires the Bank to: (a) submit a business plan that sets forth a plan for maintaining Tier 1 (Core) Leverage Ratio of 8% and a minimum Total Risk-Based Capital Ratio of 12% and provides a detailed financial forecast including capital ratios, earnings and liquidity and containing comprehensive business line goals and objectives; and (b) remain in compliance with the minimum capital ratios contained in the business plan. As of December 31, 2010, the Bank's Tier-1 (Core) Leverage Ratio was 11.24% (3.24% over the new required minimum) and Risk-Based Capital Ratio was 16.29%, (4.29% more than the new required minimum). Management believes that the Bank is currently in compliance with the terms of the Order. For further information regarding the Order, see Item 1, "Business – Regulatory Matters" and Item 1A, "Risk Factors -- We are subject to certain regulatory restrictions and lack of compliance could result in monetary penalties and/or additional regulatory actions."

The Company received \$4.8 million from the U.S. Treasury Department on February 9, 2009 as part of the Treasury's Capital Purchase program. The securities purchase agreement between us and Treasury limits our ability to pay dividends on and repurchase our common stock. The securities purchase agreement between us and Treasury provides that prior to the earlier of (i) November 21, 2011 and (ii) the date on which all of the shares of the Series A Preferred Stock have been redeemed by us or transferred by Treasury to third parties, we may not, without the consent of Treasury, (a) increase the cash dividend on our common stock or (b) subject to limited exceptions, redeem, repurchase or otherwise acquire shares of our common stock or preferred stock other than the Series A Preferred Stock or trust preferred securities. In addition, we are unable to pay any dividends on our common stock unless we are current in our dividend payments on the Series A Preferred Stock. These restrictions, together with the potentially dilutive impact of the warrant described in the next risk factor, could have a negative effect on the value of our common stock. Moreover, holders of our common stock are entitled to receive dividends only when, as and if declared by our Board of Directors. In 2008 the Board of Directors determined to suspend the payment of dividends until the Company's earnings improved.

The following table sets forth market price information of the Company's stock for 2010 and 2009. In 2008 the Board of Directors determined to suspend the payment of dividends until the Company's earnings improved. As a result, no dividend payments have been made during the years ended December 31, 2010 and 2009.

| Years Ended December 31, | Market Price | |
|--------------------------|--------------|--------|
| | High | Low |
| 2010: | | |
| First Quarter | \$6.50 | \$4.41 |
| Second Quarter | 6.60 | 5.90 |
| Third Quarter | 6.99 | 5.75 |
| Fourth Quarter | 6.15 | 4.00 |
| 2009: | | |
| First Quarter | \$5.00 | \$3.60 |
| Second Quarter | 4.50 | 3.55 |
| Third Quarter | 5.90 | 4.01 |
| Fourth Quarter | 5.80 | 4.25 |

Equity Compensation Plan Information

The equity compensation plan information presented under subparagraph (d) in Part III, Item 11 of this Form 10-K is incorporated herein by reference.

Issuer Purchases of Equity Securities

During the year ended December 31, 2010, the Company had no purchases of its Common Stock.

Item 6. Selected Financial Data

Not Applicable

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

General

The following discussion is intended to assist in understanding the consolidated financial condition and results of operations of the Company. The Company is not engaged in any significant business activity other than holding the stock of the Bank. Accordingly, the information in this discussion applies primarily to the Bank. The information contained in this section should be read in conjunction with the consolidated financial statements and the accompanying notes included in Item 8 of this annual report. In the following discussion, except as otherwise noted, references to "2010" or "2009" indicate the year ended December 31, 2010 or 2009, respectively.

The Bank's results of operations depend primarily on its net interest income, which is the difference between the income earned on its interest-earning assets, consisting of loans and investments, and the cost of its interest-bearing liabilities, consisting of deposits and FHLB borrowings. Among other things, fee income, provisions for loan losses, operating expenses and income tax provisions also affect the Bank's net income. General economic and competitive conditions, particularly changes in market interest rates, government legislation and policies concerning monetary and fiscal affairs, housing and financial institutions and the attendant actions of the regulatory authorities also significantly affect the Bank's results of operations.

Operating Strategy

The Company's strategy is to operate a community-oriented financial institution devoted to serving the needs of its customers. The Company's business consists primarily of attracting retail deposits from the general public and using those funds to originate residential real estate loans, land, construction, commercial real estate loans, commercial business loans, and a variety of consumer loans.

Financial Condition

Total assets were \$174.4 million at December 31, 2010, compared with \$178.3 million at December 31, 2009. The \$3.9 million decrease was primarily the result of a decline in loans.

Loans decreased \$16.2 million, or 10.2%, to \$141.9 million at December 31, 2010 from \$158.1 million at December 31, 2009. The decrease is largely attributable to a decrease in one-to-four family mortgage loans and land loans offset by an increase in commercial real estate loans.

Total commercial real estate loans increased 2.5% to \$66.1 million, or 46.6% of the portfolio at December 31, 2010, from \$64.5 million, or 40.8% of the portfolio at December 31, 2009. Land loans decreased 33.4% to \$6.5 million, or 4.6% of the portfolio at December 31, 2010, from \$9.7 million, or 6.1% of the portfolio at December 31, 2009. Total commercial business loans decreased 2.5% to \$19.4 million, or 13.6% of the portfolio at December 31, 2010, from \$19.9 million, or 12.6% of the portfolio at December 31, 2009.

Production of one-to-four-family mortgage loans declined in 2010. Originations totaled \$30.5 million in 2010, a 35.9% decrease over the \$47.6 million originated in 2009. Most of these loans were sold in the secondary market and, as a result, total one-to-four-family mortgages declined to 17.8% of the loan portfolio at December 31, 2010, compared with 21.4% of the loan portfolio at December 31, 2009.

Cash and cash equivalents increased \$14.1 million to \$21.0 million at December 31, 2010, compared to \$6.9 million at December 31, 2009.

Available-for-sale securities decreased \$451,000 to \$2.2 million at December 31, 2010, compared to \$2.6 million at December 31, 2009. The decrease was the result of normal principal reductions on mortgage-backed securities.

Premises and equipment was \$2.6 million at December 31, 2010, a \$231,000 decrease from \$2.8 million at the end of 2009.

Total deposits decreased 0.5% to \$147.5 million at December 31, 2010 from \$148.2 million at December 31, 2009. Money market accounts decreased a total of \$2.0 million to \$27.0 million at December 31, 2010 compared to \$29.0 million a year ago. During the same period, however, interest bearing demand deposits increased \$1.6 million to \$34.1 million and non-interest bearing demand deposits increased \$1.6 million to \$29.0 million. Certificates of deposit decreased \$2.5 million to \$37.6 million at December 31, 2010.

At December 31, 2010 and 2009, \$1.9 million and \$1.7 million, respectively, of the certificates of deposit were brokered CDs obtained through the Certificate of Deposit Account Registry Service ("CDARS"). These deposits carry interest rates that are generally higher than locally obtained CDs, but which are generally lower than FHLB advances.

FHLB advances decreased \$4.8 million to \$5.0 million at December 31, 2010 from \$9.8 million at December 31, 2009.

Results of Operations

Net Income (Loss). For the year ended December 31, 2010, the Company reported net income available to common shareholders of \$539,000, or \$0.76 per diluted share, after recording \$899,000 provision for loan

losses and \$255,000 benefit for income tax. This compares to a net loss available to common shareholders for the year ended December 31, 2009 of \$2.5 million, or \$(3.76) per diluted share, after recording a \$2.9 million provision for loan losses and \$18,000 income tax expense. The net income in 2010 is primarily attributable to a decrease in provision for loan loss, an increase in net interest income and decrease in other non-interest expense. For purposes of comparison, net income (loss) available to common shareholders may be separated into major components as follows:

| <i>(in thousands)</i> Year ended December 31, | 2010 | 2009 | Income Increase (Decrease) |
|--|---------|-----------|----------------------------------|
| Net interest income | \$8,482 | \$8,322 | \$160 |
| Gain on sale of loans | 524 | 712 | (188) |
| Other noninterest income | 1,262 | 1,172 | 90 |
| Net revenues | 10,268 | 10,206 | 62 |
| Noninterest expense | (8,781) | (9,432) | 651 |
| Subtotal | 1,487 | 774 | 713 |
| Provision for loan losses | (899) | (2,947) | 2,048 |
| Income (loss) before income tax | 588 | (2,173) | 2,761 |
| Income tax benefit (expense) | 255 | (18) | 273 |
| Net Income (loss) | 843 | (2,191) | 3,034 |
| Preferred stock dividend and discount accretion | (304) | (271) | (33) |
| Net income (loss) available to common shareholders | \$539 | \$(2,462) | \$3,001 |

Net Interest Income. Net interest income increased \$160,000, or 1.9%, to \$8.5 million in 2010 from \$8.3 million in 2009. The increase is due to a combination of factors, including a decrease in interest expense. See the tables in "--Average Balances, Interest and Average Yields/Cost" and in "--Rate/Volume Analysis" elsewhere in this discussion. The net interest margin on average earning assets was 5.34% for 2010 compared with 4.86% in 2009 reflecting an increase in yield on interest earning assets in addition to a decline in cost of funds. Nonaccrual loans were \$448,000 and \$2.9 million at December 31, 2010 and 2009, respectively. As of December 31, 2010 and 2009, \$13,000 and \$789,000, respectively, of interest would have been recorded if these loans had been current according to their original terms and had been outstanding throughout the year.

Average loans (including nonperforming loans and loans held for sale) decreased \$12.1 million, or 7.3%, to \$153.7 million in 2010 from \$165.8 million in 2009. The net interest margin on average interest-earning assets increased 48 basis points to 5.34% in 2010 from 4.86% in 2009.

Noninterest Income. The gain on sale of loans decreased \$188,000 to \$524,000 in 2010 from \$712,000 in 2009 as a result of a decline in gain on sale of loans and origination fees/costs associated with the decline in the production of one-to-four family mortgage loans.

Excluding mortgage banking income, noninterest income increased \$90,000, or 7.1%, to \$1.3 million in 2010 compared with \$1.2 million in 2009. The increase is primarily in mortgage servicing income. Additionally, other income of \$46,000 was recognized in 2010 from the gain on sale of commercial loans.

Noninterest Expense. Noninterest expense decreased \$651,000, or 6.9%, to \$8.8 million in 2010 from \$9.4 million in 2009. The net decrease in expense is attributable to lower real estate owned and repossessed asset expense and a decrease in compensation and benefits expense due in part to the suspension of the Bank's incentive compensation plan for 2010.

Income Tax. During the fourth quarter of 2010, the Company reduced a valuation allowance in the amount of \$434,000 against its net deferred tax asset of \$1.0 million due. The reduction in the valuation allowance had the effect of recognizing a benefit for income taxes for 2010. The remaining balance of the valuation allowance at December 31, 2010 of \$471,000 is due to uncertainty about the Company's ability to generate sufficient taxable income in the near term. The Company will not be able to recognize the tax benefits on

future losses until it can show that it is more likely than not that it will generate enough taxable income in future periods to realize the benefits of its deferred tax asset and loss carryforwards. Management believes it is more likely than not that these tax benefits will be realized which would result in a reversal of the deferred tax valuation allowance.

Provision and Allowance for Loan Losses

Provisions for loan losses are charges to earnings to bring the total allowance for loan losses to a level considered by management to be adequate to provide for known and inherent risks in the loan portfolio, including management's continuing analysis of factors underlying the quality of the loan portfolio.

The provision for loan losses decreased \$2.0 million to \$899,000 for 2010 from \$2.9 million for 2009. The provision for both years was considered appropriate in order for the allowance for loan losses to reflect management's best estimate of losses inherent in the loan portfolio. The allowance for loan losses decreased \$200,000, or 11.4%, to \$1.6 million at December 31, 2010 from \$1.8 million at December 31, 2009. The provision and the resulting allowance are reflective of numerous factors, including the following:

- Loan losses. Net loan charge offs were \$1.1 million (0.8% of total loans) in 2010 compared with \$3.8 million (2.4% of total loans) in 2009.
- Growth and composition of the portfolio. Total loans decreased \$16.2 million to \$141.9 million at December 31, 2010 compared with \$158.1 million at December 31, 2009. The decline reflects gradual changes in the loan portfolio composition away from single-family mortgages, moving to a greater proportion of commercial real estate. Management considered the higher relative risk of these loans in assessing the adequacy of the allowance.
- Management analysis of loans. As part of an assessment of the adequacy of the allowance, management performed a detailed review of individual loans for which full collectability may not be assured. Loans judged to be impaired amounted to \$9.6 million (6.8% of total loans) at December 31, 2010, compared with \$5.3 million (3.4% of total loans) at December 31, 2009. A specific allowance at December 31, 2010 and 2009 for estimated impairments of \$310,000 and \$514,000, respectively, was established for these loans.
- Past-due Loans. At December 31, 2010, \$623,000, or 0.4% of all loan balances were past due 30 days or more, compared with \$3.5 million, or 2.2% at December 31, 2009.
- Nonperforming and classified loans. Nonaccrual loans were \$448,000 (0.3% of total loans) at December 31, 2010, compared with \$2.9 million (1.8% of total loans) at December 31, 2009. Loans classified as "substandard" or "doubtful" were \$7.1 million (5.0% of total loans) at December 31, 2010 compared with \$5.3 million (3.4% of total loans) at December 31, 2009.
- Economic conditions. Management considered known economic conditions in each of the geographic areas in which the Bank makes loans. For the last several years, Southeast Alaska's economy has been relatively "flat" but stable, and management knows of no current economic conditions that warrant expectations of significant decline in the Bank's markets. However, uncertainties in both the national and local economies have been considered in assessing the allowance.

The Company's evaluation of the adequacy of the allowance for loan losses is one of its most critical management processes and is also the most subjective. While management believes that it uses the best information available to determine the allowance for loan losses, unforeseen market conditions and other events might result in adjustment to the allowance if circumstances differ substantially from the assumptions used in making the final determination. One or more of these events could have a significant effect on net income, and the effect could be both material and adverse.

For further information on the Bank's accounting for the allowance for loan losses as well as how loan impairment is determined, see Note 1 of the Notes to Consolidated Financial Statements included in Item 8 of this Form 10-K.

Average Balances, Interest and Average Yields/Cost

The earnings of the Company depend largely on the spread between the yield on interest-earning assets, which consist primarily of loans and investments, and the cost of interest-bearing liabilities, which consist primarily of deposit accounts and borrowings, as well as the relative size of the Company's interest-earning assets and interest-bearing liabilities.

The following table sets forth, for the periods indicated, information regarding average balances of assets and liabilities as well as the total dollar amounts of interest income from average interest-earning assets and interest expense on average interest-bearing liabilities, resultant yields, interest rate spread, net interest margin, and ratio of average interest-earning assets to average interest-bearing liabilities. Average balances are generally daily averages for the period.

(dollars in thousands)

| Year ended December 31, | 2010 | | | 2009 | | |
|---|-----------------|----------|------------------------|-----------------|----------|------------------------|
| | Average Balance | Interest | Average Yield/ Cost | Average Balance | Interest | Average Yield/ Cost |
| Interest-earning assets: | | | | | | |
| Loans ⁽¹⁾ | \$153,736 | \$9,491 | 6.17% | \$165,807 | \$10,053 | 6.06% |
| Investment securities ⁽¹⁾ | 4,202 | 90 | 2.14 | 4,721 | 126 | 2.67 |
| Interest-earning deposits in banks | 981 | 8 | 0.82 | 818 | 5 | 0.61 |
| Total interest-earning assets | 158,919 | 9,589 | 6.03 | 171,346 | 10,184 | 5.94 |
| Allowance for loan losses | (2,107) | | | (2,349) | | |
| Cash and due from banks | 5,322 | | | 6,924 | | |
| Other assets | 10,150 | | | 8,709 | | |
| Total assets | \$172,284 | | | \$184,630 | | |
| Interest-bearing liabilities: | | | | | | |
| Deposits: | | | | | | |
| Interest-bearing demand | \$ 32,417 | \$ 26 | 0.08% | \$ 31,161 | \$ 54 | 0.17% |
| Money market | 27,117 | 88 | 0.32 | 30,295 | 218 | 0.72 |
| Savings | 19,328 | 26 | 0.13 | 18,243 | 47 | 0.26 |
| Certificates of deposit | 37,436 | 707 | 1.89 | 40,933 | 1,050 | 2.57 |
| Total interest-bearing deposits | 116,298 | 847 | 0.73 | 120,632 | 1,369 | 1.13 |
| Borrowings | 9,021 | 260 | 2.88 | 12,156 | 493 | 4.06 |
| Total interest-bearing liabilities | 125,319 | 1,107 | 0.88 | 132,788 | 1,862 | 1.40 |
| Noninterest-bearing demand deposits | 29,073 | | | 27,720 | | |
| Mortgage escrows | 1,202 | | | 1,227 | | |
| Other liabilities | (2,339) | | | 3,430 | | |
| Shareholders' equity | 19,029 | | | 19,465 | | |
| Total liabilities and shareholders' equity | \$172,284 | | | \$184,630 | | |
| Net interest income | | \$8,482 | | | \$8,322 | |
| Interest rate spread | | | 5.15% | | | 4.54% |
| Net interest margin: | | | | | | |
| On average interest-earning assets | | | 5.34% | | | 4.86% |
| On average total assets | | | 4.92 | | | 4.51 |
| Ratio of average interest-earning assets to average interest-bearing liabilities | 126.81% | | | 129.04% | | |

⁽¹⁾ Average loans include nonperforming loans and loans held for sale. Interest income does not include interest on nonaccrual loans. Average investment securities includes FHLB stock.

Rate/Volume Analysis

The following table sets forth the effects of changing rates and volumes on net interest income of the Company. Information is provided with respect to effects on interest income attributable to changes in volume, which are changes in volume multiplied by prior rate; effects on interest income attributable to changes in rate, which are changes in rate multiplied by prior volume; and changes in rate/volume, which is a change in rate multiplied by change in volume.

(in thousands)

| Year ended December 31, 2010 compared with year ended 2009 | Rate | Volume | Rate/ Volume | Total |
|--|-------|---------|-----------------|---------|
| Interest-earning assets: | | | | |
| Loans | \$183 | \$(732) | \$ (13) | \$(562) |
| Investment securities | (25) | (14) | 3 | (36) |
| Interest-earning deposits in banks | 2 | 1 | - | 3 |
| Total net change in interest income | 160 | (745) | (10) | (595) |
| Interest-bearing liabilities: | | | | |
| Interest-bearing demand accounts | (29) | 2 | (1) | (28) |
| Money market accounts | (120) | (23) | 13 | (130) |
| Savings accounts | (22) | 3 | (2) | (21) |
| Certificates of deposit | (277) | (90) | 24 | (343) |
| Borrowings | (143) | (127) | 37 | (233) |
| Total net change in interest expense | (591) | (235) | 71 | (755) |
| Net change in net interest income | \$751 | \$(510) | \$(81) | \$160 |

Yields Earned and Rates Paid

The following table sets forth, at the date and for the periods indicated, the weighted average yields earned on the Company's assets and the weighted average interest rates paid on the Company's liabilities, together with the net yield on interest-earning assets.

| | At December 31, 2010 | For the Year Ended December 31, 2010 2009 | |
|------------------------------------|----------------------------|---|-------|
| Weighted average yield on: | | | |
| Loans | 6.19% | 6.17% | 6.06% |
| Investment securities | 2.06 | 2.14 | 2.67 |
| Interest-earning deposits in banks | 1.44 | 0.82 | 0.61 |
| Total interest-earning assets | 6.00 | 6.03 | 5.94 |
| Weighted average rate paid on: | | | |
| Interest-bearing demand accounts | 0.04 | 0.08 | 0.17 |
| Money market accounts | 0.26 | 0.32 | 0.72 |
| Savings accounts | 0.06 | 0.13 | 0.26 |
| Certificates of deposit | 1.49 | 1.89 | 2.57 |
| Total interest-bearing deposits | 0.57 | 0.73 | 1.13 |
| Borrowings | 4.47 | 2.88 | 4.06 |
| Total interest-bearing liabilities | 0.72 | 0.88 | 1.40 |
| Interest rate spread | 5.28 | 5.15 | 4.54 |
| Net interest margin on: | | | |
| Average interest-earning assets | -- | 5.34 | 4.86 |
| Average total assets | -- | 4.92 | 4.51 |

Liquidity and Capital Resources

The Bank's primary sources of funds are deposits, proceeds from principal and interest payments on loans and mortgage-backed securities, and FHLB advances. While maturities and scheduled amortization of loans and mortgage-backed securities are a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

The primary investing activity of the Bank has been the origination of loans, including one-to-four-family mortgages, commercial real estate loans, commercial business loans, and consumer loans, deposits, FHLB borrowings, and principal repayments on loans and mortgage-backed securities were the primary means for funding these activities.

The Bank must maintain an adequate level of liquidity to ensure the availability of sufficient funds to support loan growth and deposit withdrawals, to satisfy financial commitments and to take advantage of investment opportunities. The Bank's sources of funds include deposits, principal and interest payments from loans and investments, and FHLB advances. During 2010 and 2009, the Bank used its sources of funds primarily to fund new loans and to pay maturing certificates and other deposit withdrawals. At December 31, 2010, the Bank had loan commitments including unused portions of lines of credit and undisbursed construction loans, of \$10.9 million.

At December 31, 2010, the Bank had \$90,000 of net unrealized gains on investment securities classified as available for sale, which represented 0.04% of the amortized cost (\$2.1 million) of the securities. This represented an increase of \$20,000 compared with \$70,000 of net unrealized gains at December 31, 2009,

primarily as a result of changes in market demand. Movements in market interest rates will continue to affect the unrealized gains and losses in these securities. However, assuming that the securities are held to their individual dates of maturity, even in periods of increasing market interest rates, as the securities approach their dates of maturity, any unrealized gains or losses will begin to decrease and will eventually be eliminated.

At December 31, 2010, certificates of deposit amounted to \$37.6 million, or 25.5% of the Bank's total deposits, including \$29.6 million scheduled to mature by December 31, 2011. Historically, the Bank has been able to retain a significant amount of its deposits as they mature. Management believes it has adequate resources to fund all loan commitments with deposits and, as needed, FHLB advances and sale of mortgage loans and that it can adjust the offering rates of certificates of deposits to retain deposits in changing interest rate environments. In addition, the Bank has available a line of credit with the FHLB generally equal to 25% of the Bank's total assets, or approximately \$43.6 million at December 31, 2010, of which \$37.6 million was unused. At December 31, 2010, there was \$5.0 million outstanding on the line and an additional \$1.0 million of the borrowing line was committed to secure public deposits.

Given these sources of liquidity and our expectations for cash needs, we believe our sources of liquidity to be sufficient in the foreseeable future. However, continued deterioration in the FHLB of Seattle's financial position may result in impairment in the value of our FHLB stock, the requirement that the Company contribute additional funds to recapitalize the FHLB of Seattle, or a reduction in the Company's ability to borrow funds from the FHLB of Seattle, impairing the Company's ability to meet liquidity demands.

The Bank is required to maintain specific amounts of capital pursuant to OTS requirements and the Orders. As of December 31, 2010, the Bank was in compliance with all regulatory capital requirements that were effective as of this date, including those effective by the Order, with tangible, core, and risk-based capital ratios of 11.24%, 11.24% and 16.29%, respectively. For further information, see Note 3 of the Notes to Consolidated Financial Statements included in Item 8 of this Form 10-K.

Recent Accounting Pronouncements

See "Item 8. Financial Statements and Supplementary Data -- Notes to Consolidated Financial Statements -- Note 1 Recent Accounting Pronouncements."

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Qualitative Analysis - Risks When Interest Rates Change. The Bank's profitability depends primarily on its net interest income, which is the difference between the income it receives on its loan and investment portfolios and its cost of funds, which consists of interest paid on deposits and borrowings. The relative amounts of interest-earning assets and interest-bearing liabilities also affect net interest income. When interest-earning assets equal or exceed interest-bearing liabilities, any positive interest rate spread will generate net interest income. The Bank's profitability is also affected by the level of noninterest income and expenses. Noninterest income includes service charges and fees and gain on sale of loans and investments. Noninterest expenses primarily include compensation and benefits, occupancy and equipment expenses, deposit insurance premiums and data processing expenses. General economic and competitive conditions, particularly changes in market interest rates, government legislation and regulation, and monetary and fiscal policies also significantly affect the Bank's results of operations.

Quantitative Analysis - How the Bank Measures Its Risk of Interest Rate Changes. The Bank does not maintain a trading account for any class of financial instrument nor does it engage in hedging activities or purchase high-risk derivative instruments. Furthermore, the Bank has no significant foreign currency exchange rate risk or commodity price risk.

The Bank has sought to reduce the exposure of its earnings to changes in market interest rates by attempting to manage the mismatch between asset and liability maturities and interest rates. Principal elements in achieving this objective include increasing the interest-rate sensitivity of the Bank's interest-earning assets by originating for its portfolio loans with interest rates that periodically adjust to market conditions, as well as continuing decisions to sell fixed-rate mortgage production versus keeping them in the portfolio. The Bank relies

on retail deposits as its primary source of funds. Historically, retail deposits, compared to brokered deposits and borrowed funds, tend to reduce the effects of interest rate fluctuations because they generally represent a more stable source of funds.

In order to encourage institutions to reduce interest rate risk, the OTS adopted a rule incorporating an interest rate risk component into its risk-based capital rules. Using data compiled by the OTS, the Bank receives a report that measures interest rate risk by modeling the change in net portfolio value over a variety of interest rate scenarios. Net portfolio value is the present value of expected cash flows from assets, liabilities and off-balance-sheet contracts. The calculation is intended to illustrate the change in net portfolio value that will occur upon an immediate change in interest rates of at least 200 basis points with no effect given to any steps that management might take to counter the effect of that interest rate movement. Under OTS regulations, an institution with a greater than “normal” level of interest rate risk takes a deduction from total capital for purposes of calculating its risk-based capital. The OTS, however, has delayed the implementation of this regulation. An institution with a “normal” level of interest rate risk is defined as one whose “measured interest rate risk” is less than 2.0%. Institutions with assets of less than \$300 million and a risk-based capital ratio of more than 12.0% are exempt. The Bank is exempt because of its asset size and risk-based capital ratio. Based on the Bank’s regulatory capital levels at December 31, 2010, the Bank believes that, if the proposed regulation had been implemented at that date, the Bank’s level of interest rate risk would not have caused it to be treated as an institution with greater than “normal” interest rate risk.

The following table illustrates the change in net portfolio value at December 31, 2010, based on OTS assumptions, that would occur in the event of an immediate change in interest rates, with no effect given to any steps which management might take to counter the effect of that interest rate movement.

(dollars in thousands)

| Basis Point (“bp”) Change in Rates | Net Portfolio Value | | | Net Portfolio as % of Portfolio Value of Assets | |
|------------------------------------|---------------------|------------------------------|----------------|---|-----------------------|
| | Dollar Amount | Dollar Change ⁽¹⁾ | Percent Change | Net Portfolio Value Ratio ⁽²⁾ | Change ⁽³⁾ |
| 300 bp | \$25,653 | \$(213) | (1)% | 14.28% | (3) bp |
| 200 | 26,005 | 139 | 1 | 14.42 | 11 |
| 100 | 26,098 | 233 | 1 | 14.45 | 14 |
| 0 | 25,865 | - | - | 14.31 | - |
| (50) | 25,147 | (719) | (3) | 13.96 | (35) |
| (100) | 26,260 | 395 | 2 | 14.48 | 17 |

⁽¹⁾ Represents the increase (decrease) of the estimated net portfolio value at the indicated change in interest rates compared to the net portfolio value assuming no change in interest rates.

⁽²⁾ Calculated as the estimated net portfolio value divided by the portfolio value of total assets.

⁽³⁾ Calculated as the increase (decrease) of the net portfolio value ratio assuming the indicated change in interest rates over the estimated net portfolio value ratio assuming no change in interest rates.

The above table illustrates, for example, that at December 31, 2010 an instantaneous 200 basis point increase in market interest rates would increase the Bank’s net portfolio value by \$139,000 million, or 1%, and an instantaneous 100 basis point decrease in market interest rates would increase the Bank’s net portfolio value by \$395,000.

The following table summarizes key exposure measures for the dates indicated. They measure the change in net portfolio value ratio for an adverse change in interest rates of 200 basis points (“bp”) upward.

| | December 31, 2010 | September 30, 2010 | December 31, 2009 |
|--------------------------------------|----------------------|-----------------------|----------------------|
| Pre-shock net portfolio value ratio | 14.31% | 13.75% | 14.54% |
| Post-shock net portfolio value ratio | 14.31% | 13.74% | 13.84% |
| Decline in net portfolio value ratio | 0 bp | 0 bp | 70 bp |

These measures indicate a relatively low level of interest-rate risk at the present time. Among other factors, this is attributable to management’s decisions in recent years to effect a relative decrease in fixed-rate mortgages and a gradual shift to earning assets that tend to reprice with greater frequency.

The OTS uses certain assumptions in assessing the interest rate risk of thrift institutions. These assumptions relate to interest rates, loan prepayment rates, deposit decay rates, and the market values of certain assets under differing interest rate scenarios, among others. As with any method of measuring interest rate risk, certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable rate mortgage loans, have features that restrict changes in interest rates on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, expected rates of prepayments on loans and early withdrawals from certificates of deposit could deviate significantly from those assumed in calculating the table.

Item 8. Financial Statements and Supplementary Data

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MOSS-ADAMS LLP
Certified Public Accountants | Business Consultants

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors
Alaska Pacific Bancshares, Inc. and Subsidiary
Juneau, Alaska

We have audited the accompanying consolidated balance sheets of Alaska Pacific Bancshares, Inc. and Subsidiary (the Company) as of December 31, 2010 and 2009, and the related consolidated statements of operations, changes in shareholders' equity and comprehensive income (loss), and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with 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 consolidated 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall 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 consolidated financial position of Alaska Pacific Bancshares, Inc. and Subsidiary as of December 31, 2010 and 2009, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.



Spokane, Washington
March 30, 2011

Alaska Pacific Bancshares, Inc. and Subsidiary
Consolidated Balance Sheets

| <i>(in thousands)</i> December 31, | 2010 | 2009 |
|--|------------------|------------------|
| Assets | | |
| Cash and due from banks | \$ 18,522 | \$ 6,273 |
| Interest-earning deposits in banks | 2,501 | 669 |
| Total cash and cash equivalents | 21,023 | 6,942 |
| Investment securities available for sale, at fair value (amortized cost: 2010 - \$2,065; 2009 - \$2,536) | 2,155 | 2,606 |
| Federal Home Loan Bank stock, at cost | 1,784 | 1,784 |
| Loans held for sale | 450 | 55 |
| Loans | 141,938 | 158,108 |
| Less allowance for loan losses | (1,583) | (1,786) |
| Loans, net | 140,355 | 156,322 |
| Accrued interest receivable | 604 | 698 |
| Premises and equipment, net | 2,585 | 2,816 |
| Real estate owned and repossessed assets | 1,791 | 2,598 |
| Mortgage servicing rights | 1,242 | 813 |
| Other assets | 2,380 | 3,674 |
| Total Assets | \$174,369 | \$178,308 |
| Liabilities and Shareholders' Equity | | |
| Deposits: | | |
| Noninterest-bearing demand | \$ 29,046 | \$ 27,416 |
| Interest-bearing demand | 34,103 | 32,474 |
| Money market | 26,949 | 28,982 |
| Savings | 19,824 | 19,170 |
| Certificates of deposit | 37,626 | 40,175 |
| Total deposits | 147,548 | 148,217 |
| Federal Home Loan Bank advances | 5,000 | 9,834 |
| Advance payments by borrowers for taxes and insurance | 695 | 751 |
| Accounts payable and accrued expenses | 883 | 379 |
| Accrued interest payable | 195 | 307 |
| Other liabilities | 269 | 140 |
| Total liabilities | 154,590 | 159,628 |
| Commitments and contingencies (Note 14) | | |
| Shareholders' Equity: | | |
| Preferred stock (\$0.01 par value; 1,000,000 shares authorized; Series A – Liquidation preference \$1,000 per share, 4,781 and 4,781 shares issued and outstanding at December 31, 2010 and December 31, 2009, respectively) | 4,562 | 4,497 |
| Common stock (\$0.01 par value; 20,000,000 shares authorized; 655,415 shares issued; 654,486 shares outstanding at December 31, 2010 and at December 31, 2009) | 7 | 7 |
| Additional paid-in capital | 6,470 | 6,446 |
| Treasury stock | (11) | (11) |
| Retained earnings | 8,659 | 7,699 |
| Accumulated other comprehensive income | 92 | 42 |
| Total shareholders' equity | 19,779 | 18,680 |
| Total Liabilities and Shareholders' Equity | \$174,369 | \$178,308 |

See notes to consolidated financial statements.

Alaska Pacific Bancshares, Inc. and Subsidiary
Consolidated Statements of Operations

| <i>(in thousands, except per share)</i> Year ended December 31, | 2010 | 2009 |
|---|---------|------------|
| Interest Income | | |
| Loans, including fees | \$9,491 | \$10,053 |
| Investment securities | 90 | 126 |
| Interest-earning deposits in banks | 8 | 5 |
| Total interest income | 9,589 | 10,184 |
| Interest Expense | | |
| Deposits | 847 | 1,369 |
| Federal Home Loan Bank advances | 260 | 493 |
| Total interest expense | 1,107 | 1,862 |
| Net Interest Income | 8,482 | 8,322 |
| Provision for loan losses | 899 | 2,947 |
| Net interest income after provision for loan losses | 7,583 | 5,375 |
| Noninterest Income | | |
| Mortgage servicing income | 287 | 186 |
| Service charges on deposit accounts | 664 | 729 |
| Other service charges and fees | 265 | 257 |
| Gain on sale of loans | 524 | 712 |
| Other noninterest income | 46 | - |
| Total noninterest income | 1,786 | 1,884 |
| Noninterest Expense | | |
| Compensation and benefits | 4,344 | 4,696 |
| Occupancy and equipment | 1,312 | 1,393 |
| Data processing | 244 | 258 |
| Professional and consulting fees | 702 | 541 |
| Marketing and public relations | 255 | 268 |
| Real estate owned and repossessed assets, net | 461 | 738 |
| Federal Deposit Insurance Corporation assessment | 380 | 387 |
| Other | 1,083 | 1,151 |
| Total noninterest expense | 8,781 | 9,432 |
| Income (loss) before income tax | 588 | (2,173) |
| Expense (benefit) for income tax | (255) | 18 |
| Net Income (loss) | \$ 843 | \$ (2,191) |
| Preferred stock dividend and discount accretion | | |
| Preferred stock dividend | \$ 239 | \$ 216 |
| Preferred stock discount accretion | 65 | 55 |
| Net income (loss) available to common shareholders | \$ 539 | \$ (2,462) |
| Net income (loss) per share: | | |
| Basic | \$0.82 | \$(3.76) |
| Diluted | 0.76 | (3.76) |

See notes to consolidated financial statements.

Alaska Pacific Bancshares, Inc. and Subsidiary

Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Income (Loss)

| <i>(in thousands)</i> | Preferred Stock | Common Stock | Additional Paid-In Capital | Treasury Stock | Retained Earnings | Accumulated Other Comprehensive Income | Total Share- holders' Equity |
|---|--------------------|-----------------|----------------------------------|-------------------|----------------------|---|------------------------------------|
| Balance, January 1, 2009 | \$- | \$7 | \$6,121 | \$(11) | \$10,161 | \$5 | \$16,283 |
| Comprehensive loss: | | | | | | | |
| Net loss | | | | | (2,191) | | (2,191) |
| Change in net unrealized gains on securities available for sale, net of related income tax effect | | | | | | 37 | 37 |
| Comprehensive loss | | | | | | | (2,154) |
| Stock compensation expense | | | 27 | | | | 27 |
| Issuance of preferred stock to U.S. Treasury | 4,442 | | | | | | 4,442 |
| Issuance of common stock warrants to U.S. Treasury | | | 339 | | | | 339 |
| Accretion of preferred stock discount | 55 | | | | (55) | | - |
| Preferred stock issuance costs | | | (41) | | | | (41) |
| Cash dividends on preferred stock | | | | | (216) | | (216) |
| Balance, December 31, 2009 | 4,497 | 7 | 6,446 | (11) | 7,699 | 42 | 18,680 |
| Cumulative-effect adjustment of change in accounting principle | | | | | 421 | | 421 |
| Comprehensive income: | | | | | | | |
| Net income | | | | | 843 | | 843 |
| Change in net unrealized gains on securities available for sale, net of related income tax effect | | | | | | 50 | 50 |
| Comprehensive income | | | | | | | 1,314 |
| Stock compensation expense | | | 24 | | | | 24 |
| Accretion of preferred stock discount | 65 | | | | (65) | | - |
| Cash dividends on preferred stock | | | | | (239) | | (239) |
| Balance, December 31, 2010 | \$4,562 | \$7 | \$6,470 | \$(11) | \$8,659 | \$92 | \$19,779 |

See notes to consolidated financial statements.

Alaska Pacific Bancshares, Inc. and Subsidiary
Consolidated Statements of Cash Flows

| <i>(in thousands)</i> Year ended December 31, | 2010 | 2009 |
|--|-----------------|----------------|
| Operating Activities | | |
| Net income (loss) | \$843 | \$(2,191) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Provision for loan losses | 899 | 2,947 |
| Provision (benefit) for deferred income tax assets | (434) | 905 |
| Gain on sale of loans | (524) | (712) |
| Fair value adjustment on mortgage servicing rights | (8) | - |
| Depreciation and amortization | 288 | 335 |
| Deferred income tax (benefit) expense | 179 | (421) |
| Amortization of fees, discounts, and premiums, net | (162) | (201) |
| Stock compensation expense | 24 | 27 |
| Loans originated for sale | (30,683) | (43,260) |
| Proceeds from sale of loans originated for sale | 30,812 | 46,503 |
| Loss on sale or impairment of real estate owned and repossessed assets | 224 | 503 |
| Cash provided by (used in) changes in operating assets and liabilities: | | |
| Accrued interest receivable | 94 | 124 |
| Other assets | 1,579 | (1,804) |
| Advance payments by borrowers for taxes and insurance | (56) | 18 |
| Accrued interest payable | (112) | (142) |
| Accounts payable and accrued expenses | 504 | (101) |
| Other liabilities | 10 | (302) |
| Net cash provided by operating activities | 3,477 | 2,228 |
| Investing Activities | | |
| Maturities and principal repayments of investment securities available for sale | 463 | 687 |
| Loan originations, net of principal repayments | 13,353 | 3,728 |
| Purchase of premises and equipment | (57) | (29) |
| Proceeds from sale of real estate owned and repossessed assets | 2,468 | 815 |
| Net cash provided by (used in) investing activities | 16,227 | (5,201) |
| Financing Activities | | |
| Cash dividends paid on preferred stock | (120) | (185) |
| Proceeds from issuance of preferred stock and common stock warrants | - | 4,781 |
| Stock issuance costs paid | - | (41) |
| Net decrease in Federal Home Loan Bank advances | (4,834) | (486) |
| Net increase in demand and savings deposits | 1,880 | 685 |
| Net decrease in certificates of deposit | (2,549) | (14,643) |
| Net cash used in financing activities | (5,623) | (9,889) |
| Increase (decrease) in cash and cash equivalents | 14,081 | (2,460) |
| Cash and cash equivalents at beginning of year | 6,942 | 9,402 |
| Cash and cash equivalents at end of year | \$21,023 | \$6,942 |

| | | |
|--|----------|----------|
| Supplemental information: | | |
| Cash paid for interest | \$ 1,219 | \$ 2,004 |
| Cash received from income taxes | (1,571) | (9) |
| Loans foreclosed and transferred to real estate owned and repossessed assets | 1,885 | 3,508 |
| Net change in unrealized gains and losses on securities available for sale, net of tax | 50 | 37 |
| Cumulative adjustment – change in accounting principle | 421 | - |
| Accrued preferred stock dividends | 150 | 31 |

See notes to consolidated financial statements.

Alaska Pacific Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Note 1 – Summary of Significant Accounting Policies

GENERAL: The accompanying consolidated financial statements include the accounts of Alaska Pacific Bancshares, Inc. (the “Company”) and its wholly owned subsidiary, Alaska Pacific Bank (the “Bank”). The Company and the Bank are collectively referred to as the “Company.” All significant intercompany transactions have been eliminated in consolidation.

The Company was formed in 1999 when the Bank converted from a federally chartered mutual savings bank to a federally chartered stock savings bank, issuing 655,415 shares in a subscription and community offering. Concurrent with the conversion, the Bank changed its name from Alaska Federal Savings Bank to Alaska Pacific Bank.

The Bank provides a range of financial services to individuals and small businesses in Southeast Alaska. The Bank’s financial services include accepting deposits from the general public and making residential and commercial real estate loans, consumer loans, and commercial loans. The Bank also originates, sells, and services residential mortgage loans under several federal and state mortgage-lending programs.

The Company has evaluated events and transactions for potential recognition and disclosure through the day the financial statements were issued.

Certain amounts in prior-period financial statements have been reclassified to conform to the current-period presentation. These reclassifications had no effect on net income (loss).

CASH AND CASH EQUIVALENTS: Cash equivalents are any highly liquid investment with a remaining maturity of three months or less at the date of purchase. The Company has cash and cash equivalents on deposit with other banks and financial institutions in amounts that periodically exceed the federal insurance limit. The Company evaluates the credit quality of these banks and financial institutions to mitigate its credit risk.

INVESTMENT SECURITIES: Securities available for sale, including mortgage-backed and related securities, are carried at fair value with unrealized gains and losses excluded from earnings and reported in a separate component of equity. Any security that management determines may not be held to maturity is classified as available for sale at the time the security is acquired. Any gains and losses realized on the sale of these securities are based on the specific identification method and included in earnings.

Purchase discounts and premiums on investment securities are amortized using the level yield method.

Prior to the adoption of the accounting guidance on April 1, 2009, management considered in determining whether other-than-temporary impairment exists, (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.

For equity securities, when the Company has decided to sell an impaired available-for-sale security and the entity does not expect the fair value of the security to fully recover before the expected time of sale, the security is deemed other-than-temporarily impaired in the period of which the decision to sell is made. The Company recognizes an impairment loss when the impairment is deemed other than temporary even if a decision to sell has not been made.

LOANS: Loans are reported at the principal amount outstanding, adjusted for net deferred loan fees and costs and other unamortized premiums or discounts.

Interest is accrued as earned unless management doubts the collectibility of the loan or the unpaid interest. Interest accrual is generally discontinued and loans are transferred to nonaccrual status when they become 90 days past due or earlier if the loan is impaired and collection is considered doubtful. All previously accrued but uncollected interest is deducted from interest income upon transfer to nonaccrual status. Income from nonaccrual loans is recorded only when interest payments are received.

Loans or portions of loans are charged off against the allowance for loan losses when considered uncollectible. Prior to charging a loan off, a loss allowance may be recognized on impaired loans for an estimated probable loss.

Loan origination fees and direct loan origination costs are deferred and recognized as an adjustment to interest income over the contractual life of the loan using the level yield method. When loans are sold, the related net unamortized loan fees and costs are included in the determination of the gain on sale of loans.

LOANS HELD FOR SALE: Loans held for sale consist primarily of residential mortgage loans and are individually valued at the lower of cost or fair value less estimated selling costs. Loans are recorded as sold when the loan documents are sent to the investor. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

ALLOWANCE FOR LOAN LOSSES: The allowance for loan losses is maintained at a level believed to be sufficient to absorb losses probable and inherent in the loan portfolio. Management's determination of the adequacy of the allowance is based on a number of factors, including the level of nonperforming loans, loan loss experience, collateral values, a review of the credit quality of the loan portfolio, and current economic conditions. Loans are categorized as either pass-graded or problem-graded based on periodic reviews of the loan portfolio. The allowance is evaluated quarterly based on an estimated range of probable loss comprised of two elements:

General component: The general allowance component is calculated by loan category as a range of estimated loss by applying various loss factors to pass-graded outstanding loans. The loss factors are based primarily on industry loss statistics, adjusted for the Bank's historical loss experience and other significant factors that, in management's judgment, affect the collectability of the portfolio as of the evaluation date.

Specific component: The specific allowance component is established in cases where management has identified conditions or circumstances related to a problem-graded loan that management believes indicate a probable loss. A range of estimated loss is established for each such loan.

Loans are deemed to be impaired when management determines that it is probable that all amounts due under the contractual terms of the loan agreements will not be collectible in accordance with the original loan agreement. All problem-graded loans are evaluated for impairment. Impairment is measured by comparing the fair value of the collateral or present value of future cash flows to the recorded investment in the loan. Impaired loans include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection.

MORTGAGE SERVICING RIGHTS: Effective January 1, 2010, the Company adopted ASC 860-50, *Servicing Assets and Liabilities*, which provides the option of making an irrevocable decision to subsequently measure a class of servicing assets at fair value at the beginning of any fiscal year, which was elected by the Company. The Company uses a model derived valuation methodology to estimate the fair value of mortgage servicing rights, ("MSR"), obtained from an independent broker on an annual basis. The model pools loans into buckets of homogeneous characteristics and performs a present value analysis of the future cash flows. The buckets are created by individual loan characteristics such as note rate, product type, and the remittance schedule. Current market rates are utilized for discounting the future cash flows. Significant assumptions used in the valuation of MSR include discount rates, projected prepayment speeds, escrow calculations, ancillary income, delinquencies and option adjusted spreads.

PREMISES AND EQUIPMENT: Bank premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed on the straight-line method over the estimated useful lives of the assets: 20 to 50

years for buildings, five to 10 years for leasehold improvements depending on lease term, and three to 10 years for furniture and equipment. Expenditures for improvements and major renewals are capitalized and ordinary maintenance and repairs are charged to operations as incurred.

Long-lived assets are assessed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In performing the review for recoverability, estimated future cash flows expected to result from the use of the asset and its eventual disposition are compared with the carrying value, and a direct writedown is recorded for the amount of impairment, if any.

REPOSSESSED ASSETS: Real estate or other collateral acquired in satisfaction of a loan is initially recorded in repossessed assets at the lower of cost or estimated fair value less estimated selling costs, with any difference from the loan balance charged to the allowance for loan losses. Subsequent changes in estimated fair value result in writing down the properties, directly or through valuation accounts. Such writedowns and gains and losses on disposal, as well as operating income and costs incurred during the period of ownership, are recognized currently in noninterest expense.

FEDERAL HOME LOAN BANK STOCK: The Bank's investment in Federal Home Loan Bank of Seattle ("FHLB") stock is carried at cost because there is no active market for the stock. As a member of the FHLB System, the Bank is required to maintain a minimum level of investment in FHLB stock based on specified percentages of its outstanding mortgages, total assets or FHLB advances. The Bank's minimum investment requirement was approximately \$273,100 and \$491,200 at December 31, 2010 and 2009, respectively. The Bank may request redemption at par value on any stock in excess of the amount the Bank is required to hold. Stock redemptions are granted at the discretion of the FHLB. This security is reported at par value, which represents the Company's cost. Management reviews for impairment based on the ultimate recoverability of the cost basis in the FHLB stock.

Management periodically evaluates FHLB stock for other-than-temporary or permanent impairment. Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB. As of December 31, 2010, management has concluded that the Bank's investment in FHLB stock is not impaired.

ADVERTISING EXPENSE: Advertising costs are expensed as incurred. Advertising expense was \$183,000 and \$185,000 for the years ended December 31, 2010 and 2009, respectively.

INCOME TAX: The Company accounts for income tax using the asset and liability method. The asset and liability method recognizes the amount of tax payable at the date of the financial statements as a result of all events that have been recognized in the financial statements, as measured by the provisions of current enacted tax laws and rates. Net deferred tax assets are evaluated and reduced through a valuation allowance to the extent that it is more likely than not that such assets will not be fully recovered in the future.

TREASURY STOCK: Treasury stock is accounted for on the basis of average cost, or \$12.375 per share at December 31, 2010 and 2009.

EMPLOYEE STOCK OWNERSHIP PLAN: Compensation expense under the Company's Employee Stock Ownership Plan ("ESOP") is based upon the number of shares allocated to employees each year multiplied by the average share price for the year. Expense is reduced by the amount of dividends paid on unallocated shares. No shares held by the ESOP were unallocated at December 31, 2010 and 2009. In computing earnings per share, shares outstanding are reduced by shares held by the ESOP that have not yet been allocated to employees.

STOCK OPTION PLAN: The Company accounts for its stock option plans in accordance with the provisions of FASB Accounting Standards Codification 718, Stock Compensation which establishes accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans and requires that the compensation cost relating to share-based payment transactions such as stock options be recognized in the Company's financial statements over the period the options are earned by employees. Compensation expense for the years ended December 31, 2010 and 2009 totaled \$24,000 and \$27,000, respectively.

FAIR VALUE OF FINANCIAL INSTRUMENTS: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. 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 these estimates.

USE OF ESTIMATES: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, loan servicing rights, fair value of financial instruments, deferred tax assets, and useful lives for depreciation of premises and equipment. Actual results could differ from these estimates.

STATEMENT OF CASH FLOWS: The statement of cash flows has been prepared using the "indirect" method for presenting cash flows from operating activities. For purposes of this statement, cash and cash equivalents include cash and due from banks and interest-bearing deposits with banks.

SEGMENT REPORTING: The Company has identified a single segment at the entity-wide level used by senior management to make operating decisions.

Other Comprehensive Income: The Company's only item of "other comprehensive income" is net unrealized gains or losses on investment securities available for sale. Comprehensive income is calculated in the following table:

| <i>(in thousands)</i> years ended | 2010 | 2009 |
|--|--------------|------------------|
| Net income (loss) available to common shareholders | \$539 | \$(2,462) |
| Other comprehensive income | 50 | 37 |
| Comprehensive income (loss) | \$589 | \$(2,425) |

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 (i) the assets have been isolated from the Corporation, (ii) 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 (iii) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

RECENT ACCOUNTING PRONOUNCEMENTS: Significant recent accounting pronouncements are described below.

On January 21, 2010, the FASB issued Accounting Standards Update ("ASU" or the "Update") 2010-06, *Improving Disclosures About Fair Value Measurements*. The Update amends ASC 820, *Fair Value Measurements and Disclosures*, to add new requirements for disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair values. The guidance in ASU 2010-06 is effective for the first reporting period beginning after December 15, 2009. ASU 2009-05 did not have a material impact on the Company's financial condition or results of operations.

On February 24, 2010, the FASB issued ASU 2010-09, *Amendments to Certain Recognition and Disclosure Requirements*. The Update amends Accounting Standards Codification 855, *Subsequent Events*, to address certain implementation issues related to an entity's requirement to perform and disclose subsequent-events procedures. ASU 2010-09 requires SEC filers and other certain entities to evaluate subsequent events through the date the financial statements are issued. The Update exempts SEC filers from disclosing the date through which subsequent events have been evaluated. The guidance in ASU 2010-09 is effective immediately for financial statements that are (1) issued or are available to be issued or (2) revised. ASU 2010-09 did not have a material impact on the Company's financial condition or results of operations.

In April 2010, the FASB issued ASU 2010-18, *Receivables (Topic 310) – Effect of a Loan Modification When the Loan is Part of a Pool That is Accounted for as a Single Asset*. The Update clarifies that modifications of acquired loans accounted for within a pool under ASC 310-30 do not result in the removal of those loans from the pool even if the modifications would otherwise be considered a troubled-debt restructuring. The guidance in ASU 2010-18 is effective for modifications of loans accounted for within pools occurring in the first interim or annual period ending on or after July 15, 2010. ASU 2010-18 did not have a material impact on the Company's financial condition or results of operations.

In July 2010, the FASB issued ASU 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. The ASU expands existing disclosures to require an entity to provide additional information in its disclosures about the credit quality of its financing receivables and the credit reserves held against them. Specifically, entities will be required to present a rollforward of activity in the allowance for credit losses, the nonaccrual status of financing receivables by class of financing receivables, and impaired financing receivables by class of financing receivables, all on a disaggregated basis. The ASU also requires an entity to provide additional disclosures on credit quality indicators of financing receivables at the end of the reporting period by class of financing receivables, the aging of past due financing receivables at the end of the reporting period by class of financing receivables, the nature and extent of troubled debt restructurings that occurred during the period by class of financing receivables and their effect on the allowance for credit losses, the nature and extent of financing receivables modified as troubled debt restructurings within the previous 12 months that defaulted during the reporting period by class of financing receivables and their effect on the allowance for credit losses, and significant purchases and sales of financing receivables during the reporting period disaggregated by portfolio segment. For public entities, the disclosures of period-end balances are effective for interim and annual reporting periods ending after December 15, 2010. For public entities, the disclosures of activity are effective for interim and annual reporting periods beginning on or after December 15, 2010. The effective date for troubled debt restructuring disclosures was temporarily deferred to be concurrent with the effective date for the proposed ASU, "*Receivables: Clarifications to Accounting for Troubled Debt Restructurings by Creditors.*" ASU 2010-20 did not have a material impact on the Company's financial condition or results of operations.

In December 2010, the FASB issued ASU 2010-28, "*Intangibles – Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts.*" The ASU modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For public entities, the ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. ASU 2010-28 is not expected to have a material impact on the Company's financial condition or results of operations.

In December 2010, the FASB issued ASU No. 2010-29, "*Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations.*" The ASU affects only public companies and is intended to address diversity in practice about the interpretation of the pro forma revenue and earnings disclosure for business combinations. The ASU specifies that if a public entity presents comparative financial statements, those statements should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual periods only. The amendments also expand the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The ASU 2010 is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. ASU 2010-29 is not expected to have a material impact on the Company's financial condition or results of operations.

Note 2 – Cash and Cash Equivalents

The Company is required to maintain prescribed reserves with the Federal Reserve Bank of San Francisco in the form of cash. Cash reserve requirements are computed by applying prescribed percentages to various types of deposits. The Company is required to maintain a \$25,000 minimum average daily balance with the Federal Reserve Bank for purposes of settling financial transactions and charges for Federal Reserve Bank services. The Company is also required to maintain cash balances or deposits with the Federal Reserve Bank sufficient to meet its statutory reserve requirements. The average reserve requirement for years ended, December 31, 2010 and 2009 was \$539,000 and \$1.3 million, respectively.

Note 3 – Regulatory Capital Requirements and Restrictions

The Bank is restricted on the amount of dividends it may pay to the Company. It is generally limited to the net income of the current fiscal year and that of the two previous fiscal years, less dividends already paid during those periods. Based on this calculation, at December 31, 2010, none of the Bank's retained earnings were available for dividends to the Company. However, payment of dividends may be further restricted by the Bank's regulatory agency if such payment would reduce the Bank's capital ratios below required minimums or would otherwise be considered to adversely affect the safety and soundness of the institution.

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action ("PCA"), the Bank must meet specific capital guidelines that involve 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 are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The Company and the Bank each signed agreements with the Office of Thrift Supervision ("OTS"), to consent to the issuance of an Order to Cease and Desist (individually an "Order" and collectively the "Orders") effective September 30, 2010. The Orders are formal actions by the OTS requiring the Company and the Bank to continue to take corrective measures in a number of areas to strengthen their financial condition and operations.

Pursuant to the Order the Bank is required to maintain its Tier 1 (Core) Capital Ratio equal to or greater than 8% after providing for an adequate allowance for loan and lease losses and Total Risk-Based Capital Ratio equal to or greater than 12%. See Item 1. "Business – Regulatory Matters" for additional information regarding the Orders.

At December 31, 2010, the Bank exceeded each of the Capital Ratio requirements of the Order, however, under the OTS regulations an institution that enters into a written order (such as the Order) is automatically considered to be not "well capitalized" and therefore the Bank is deemed "adequately capitalized" for OTS purposes.

The following table summarizes the Bank's regulatory capital position and minimum requirements of the Order at December 31, 2010:

(dollars in thousands)

| December 31, 2010: | | |
|---------------------------|----------|--------|
| Core Capital: | | |
| Actual | \$19,535 | 11.24% |
| Required by the Order | 13,902 | 8.00 |
| Excess | \$5,633 | 3.24% |
| Total Risk-Based Capital: | | |
| Actual | \$20,808 | 16.29% |
| Required by the Order | 15,330 | 12.00 |
| Excess | \$ 5,478 | 4.29% |

During the second quarter of 2010, pursuant to restrictions imposed on the Company and the Bank by the OTS, the Company suspended its dividend payments on its Series A Preferred Stock issued under the TARP Capital Purchase Program and its common stock and continued to defer these payments through December 31, 2010. At December 31, 2010 accumulated deferred dividend payments on Series A Preferred Stock were \$150,000. There can be no assurances that our regulators will approve such payments or dividends in the future.

At December 31, 2010, the Bank exceeded each of the three current minimum quantitative regulatory capital requirements under the “prompt corrective action” regulatory framework. The following table summarizes the Bank's regulatory capital position and minimum requirements under the “prompt corrective action” regulatory framework at December 31, 2010 and December 31, 2009:

(dollars in thousands)

December 31, 2010:

Tangible Capital:

| | | |
|----------|----------|--------|
| Actual | \$19,535 | 11.24% |
| Required | 2,607 | 1.50 |
| Excess | \$16,928 | 9.74% |

Core Capital:

| | | |
|----------|----------|--------|
| Actual | \$19,535 | 11.24% |
| Required | 6,951 | 4.00 |
| Excess | \$12,584 | 7.24% |

Total Risk-Based Capital:

| | | |
|----------|-----------|--------|
| Actual | \$20,808 | 16.29% |
| Required | 10,220 | 8.00 |
| Excess | \$ 10,588 | 8.29% |

December 31, 2009:

Tangible Capital:

| | | |
|----------|----------|-------|
| Actual | \$17,237 | 9.70% |
| Required | 2,666 | 1.50 |
| Excess | \$14,571 | 8.20% |

Core Capital:

| | | |
|----------|----------|-------|
| Actual | \$17,237 | 9.70% |
| Required | 7,110 | 4.00 |
| Excess | \$10,127 | 5.70% |

Total Risk-Based Capital:

| | | |
|----------|----------|--------|
| Actual | \$18,508 | 12.84% |
| Required | 11,531 | 8.00 |
| Excess | \$ 6,977 | 4.84% |

Note 4 – Investment Securities Available for Sale

Amortized cost and fair values of investment securities available for sale, including mortgage-backed securities, are summarized as follows:

| <i>(in thousands)</i> | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|-----------------------------|-------------------|------------------------------|-------------------------------|----------------|
| December 31, 2010: | | | | |
| Mortgage-backed securities: | \$1,982 | \$89 | \$(1) | \$2,070 |
| U.S. government agencies | 83 | 2 | - | 85 |
| Total | \$2,065 | \$91 | \$(1) | \$2,155 |
| December 31, 2009: | | | | |
| Mortgage-backed securities: | \$2,445 | \$81 | \$(12) | \$2,514 |
| U.S. government agencies | 91 | 1 | - | 92 |
| Total | \$2,536 | \$82 | \$(12) | \$2,606 |

Available for sale securities at December 31, 2010 that have been in a continuous unrealized loss position are as follows:

| <i>(in thousands)</i> | Impaired less than 12 months | | Impaired 12 months or more | | Total | |
|----------------------------|---------------------------------|----------------------|-------------------------------|----------------------|--------------|----------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Mortgage-backed securities | \$219 | - | \$146 | \$(1) | \$365 | \$(1) |
| U.S. government agencies | - | - | - | - | - | - |
| Total | \$219 | - | \$146 | \$(1) | \$365 | \$(1) |

Available for sale securities at December 31, 2009 that have been in a continuous unrealized loss position are as follows:

| <i>(in thousands)</i> | Impaired less than 12 months | | Impaired 12 months or more | | Total | |
|----------------------------|---------------------------------|----------------------|-------------------------------|----------------------|--------------|----------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Mortgage-backed securities | \$12 | \$(1) | \$571 | \$(11) | \$583 | \$(12) |
| Total | \$12 | \$(1) | \$571 | \$(11) | \$583 | \$(12) |

Five and four securities with unrealized losses at December 31, 2010 and 2009, respectively, were mortgage-backed or other securities issued by the U.S. government and agencies; collectability of principal and interest is considered to be reasonably assured. The fair values of individual securities fluctuate significantly with interest rates and with market demand for securities with specific structures and characteristics. Management does not consider these unrealized losses to be other than temporary.

No securities were designated as held to maturity at December 31, 2010 or 2009.

The amortized cost of investment securities at December 31, 2010 is presented below by contractual maturity. Actual maturities may vary due to prepayment of the underlying loans.

| <i>(in thousands)</i> | Fair Value Mortgage backed Securities | Costs Mortgage backed securities | Fair Value U.S government agencies | Costs Mortgage backed securities |
|---------------------------------------|---|-------------------------------------|--|-------------------------------------|
| Maturing within 1 to 5 years | \$12 | \$12 | \$85 | \$83 |
| Maturing between 5 and 10 years | 169 | 168 | - | - |
| Maturing beyond 10 years | 1,889 | 1,802 | - | \$83 |
| Total | \$2070 | \$1982 | \$85 | \$83 |

The amortized cost and market value of investment securities pledged to secure public funds deposited with the Bank at December 31, 2010 was \$2.1 million and \$2.2 million, respectively. The amortized cost and market value of investment securities pledged to secure public funds deposited with the Bank at December 31, 2009 was \$2.5 million and \$2.6 million, respectively.

There were no sales of securities during 2010 or 2009.

Note 5 – Loans

Loans are summarized as follows:

| <i>(in thousands)</i> December 31, | 2010 | 2009 |
|------------------------------------|------------------|------------------|
| Real estate: | | |
| Permanent: | | |
| One- to four-family | \$ 25,194 | \$ 33,787 |
| Multifamily | 1,959 | 1,736 |
| Commercial nonresidential | 66,084 | 64,453 |
| Land | 6,463 | 9,697 |
| Construction: | | |
| One- to four-family | 1,819 | 3,050 |
| Commercial nonresidential | 1,227 | 2,637 |
| Commercial business | 19,365 | 19,856 |
| Consumer: | | |
| Home equity | 13,509 | 16,522 |
| Boat | 4,242 | 4,287 |
| Automobile | 1,167 | 1,269 |
| Other | 909 | 814 |
| Total loans | \$141,938 | \$158,108 |
| | | |
| Loans held for sale | \$450 | \$55 |

Loans are net of deferred loan fees and other discounts amounting to \$495,000 and \$567,000 at December 31, 2010 and 2009, respectively.

Loans include overdrawn balances of deposit accounts of \$24,000 and \$35,000 at December 31, 2010 and 2009, respectively.

Interest income from tax-exempt loans was \$27,000 and \$35,000 in 2010 and 2009, respectively.

Real estate loans are secured primarily by properties located in Southeast Alaska. Commercial real estate loans are generally secured by warehouse, retail, and other improved commercial properties. Commercial business loans are generally secured by equipment, inventory, accounts receivable, or other business assets.

Impaired Loans. Loans are deemed to be impaired when management determines that it is probable that all amounts due under the contractual terms of the loan agreements will not be collectible in accordance with the original loan agreement. All problem-graded loans are evaluated for impairment. Impairment is measured by comparing the fair value of the collateral or present value of future cash flows to the recorded investment in the loan. Impaired loans include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection.

Impaired loans are set forth in the following table for the year ended December 31.

| | Interest Income Recognized | Unpaid Contractual Principal Balance | Recorded Investment With No Allowance | Recorded Investment With Allowance | Total Recorded Investment | Related Allowance | Average Recorded Investment |
|------------------------------|----------------------------------|---|--|---|---------------------------------|----------------------|-----------------------------------|
| 2010 | | | | | | | |
| Real estate: | | | | | | | |
| Permanent: | | | | | | | |
| One- to four-family | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 300 |
| Multifamily | - | - | - | - | - | - | - |
| Commercial nonresidential | 531 | 6,855 | 3,561 | 2,757 | 6,855 | 267 | 7,027 |
| Land | 97 | 2,021 | 2,021 | - | 2,021 | - | 2,957 |
| Construction: | | | | | | | |
| One- to four-family | - | - | - | - | - | - | - |
| Commercial nonresidential | - | - | - | - | - | - | 187 |
| Commercial business | 48 | 683 | 260 | 423 | 683 | 43 | 452 |
| Consumer: | | | | | | | |
| Home equity | - | - | - | - | - | - | - |
| Boat | - | - | - | - | - | - | 30 |
| Automobile | - | - | - | - | - | - | - |
| Other | 3 | 42 | 42 | - | 42 | - | 32 |
| Total | \$ 679 | \$ 9,601 | \$ 5,884 | \$ 3,180 | \$ 9,601 | \$ 310 | \$ 10,985 |

Impaired loans as December 31, 2009 are summarized as follows:

| <i>(in thousands)</i> Year ended December 31, | 2009 |
|---|---------|
| Impaired loans at end of year | \$5,342 |
| Impaired loans at end of year for which specific valuation allowances have been provided | 1,922 |
| Amount of allowances at end of year | 514 |

Additional impaired loan information for 2009 is as follows:

| <i>(in thousands)</i> Year ended December 31, | 2009 |
|--|----------|
| Average investment in impaired loans | \$11,503 |
| Interest income recognized on impaired loans | 151 |
| Interest income recognized on a cash basis on impaired loans | 151 |

Included in impaired loans were certain loans that are troubled debt restructurings and classified as impaired. At December 31, 2010 and 2009, the Company had \$7.1 million and \$845,000, respectively, of loans that were modified in troubled debt restructurings and considered impaired. Included in these amounts, the Company had \$4.6 million and \$538,000 of troubled debt restructurings as of December 31, 2010 and 2009, respectively, that were performing in accordance with their modified loan terms. The Company has not committed any amounts to lend to these borrowers with loans considered to be troubled debt restructurings.

Nonaccrual loans were \$448,000 and \$2.9 million at December 31, 2010 and 2009, respectively. As of December 31, 2010 and 2009, approximately \$13,000 and \$789,000, respectively, of interest would have been recorded if these loans had been current according to their original terms and had been outstanding throughout the year.

Year end non-accrual loans, segregated by class of loans, were as follows:

| <i>(in thousands)</i> At December 31, | 2010 | 2009 |
|--|--------------|----------------|
| Consumer | \$ - | \$ 78 |
| Commercial business | 448 | 236 |
| Real Estate: | | |
| Permanent one- to four-family | - | 155 |
| Commercial nonresidential | - | 636 |
| Land | - | 1,361 |
| Commercial construction nonresidential | - | 209 |
| Construction one- to four-family | - | 180 |
| Total | \$448 | \$2,855 |

An age analysis of past due loans, segregated by class of loans, as of December 31, 2010 were as follows:

| <i>(in thousands)</i> | Loans 30-89 Days Past Due | Loans 90 or More Days Past Due | Total Past Due Loans | Current Loans | Total Loans | Accruing Loans 90 or More Days Past Due |
|---------------------------|---------------------------------|---|-------------------------|------------------|----------------|---|
| Real estate: | | | | | | |
| Permanent: | | | | | | |
| One- to four-family | \$ 444 | \$ - | \$444 | \$24,750 | \$25,194 | \$ - |
| Multifamily | - | - | - | 1,959 | 1,959 | - |
| Commercial nonresidential | 167 | - | 167 | 65,917 | 66,084 | - |
| Land | - | - | - | 6,463 | 6,463 | - |
| Construction: | | | | | | |
| One- to four-family | - | - | - | 1,819 | 1,819 | - |
| Commercial nonresidential | - | - | - | 1,227 | 1,227 | - |
| Commercial business | 12 | - | 12 | 19,353 | 19,365 | - |
| Consumer: | | | | | | |
| Home equity | - | - | - | 13,509 | 13,509 | - |
| Boat | - | - | - | 4,242 | 4,242 | - |
| Automobile | - | - | - | 1,167 | 1,167 | - |
| Other | - | - | - | 909 | 909 | - |
| Total | \$ 623 | \$ - | \$ 623 | \$ 141,315 | \$141,938 | - |

Credit Quality / Risk Rating System: The Bank utilizes a risk rating system to segment the risk profile of its loan portfolio. As part of this on-going monitoring system of the credit quality of the Company's loan portfolio, management tracks certain credit quality indicators including trends in past due and nonaccrual loans, gross and net charge-offs, and movement in loan balances within the risk classifications. The Bank's risk rating system is comprised of nine ranges (1-9) based upon industry best practice and regulator definitions. A brief summary of the general characteristics of the nine risk classes is as follows:

- **Ratings 1-2:** Include loans with the highest credit quality based upon financial performance, high net worth borrowers, an industry category with very positive trends, collateral of readily marketable government securities, time certificates or cash value of life insurance, and other strong financial performance ratios.
- **Ratings 3-4:** Include loans with satisfactory financial performance, adequate liquidity and compare favorably to industry performance measurements. Loans in these categories are typically secured by real estate, inventory, accounts receivable or other collateral that may not be as easily converted to cash. Loans graded in the lower of the two categories (4) might be loans where the company's business is tied to a cyclical or seasonal industry such as tourism and fishing.
- **Rating 5:** This is a "Pass/Watch" category requiring additional management attention. These are performing loans where there is still no perception of unwarranted or undue credit risk, but because of external events in the marketplace, management change, a shift in financial performance or other conditions, which if not addressed could cause further problems. This is typically a temporary classification.
- **Rating 6:** These are "Special Mention" loans which are currently performing as agreed but have developed a financial weakness, which if not corrected, pose unwarranted risk to the bank. This classification is used when the degree of risk initially evaluated has increased beyond conditions that would have prevented the loan from being made in the beginning. Prompt corrective action is needed.

- **Rating 7:** These are “*Substandard*” loans which are no longer protected by adequate cash flow, net work, or collateral. There is a well-defined weakness that jeopardizes the repayment of the debt and subjects the institution to the possibility of loss. Loans in this category may or may not have specific valuation allowance assigned to the loan depending on conditions.
- **Ratings 8:** These are loans classified as “*Doubtful*” which, based upon a variety of negative conditions, will more than likely result in a loss if a set of events do not occur. These loans have specific valuation allowance to the extent of the calculated impairment.
- **Ratings 9:** These are loans classified as “*Loss*”. They are to be charged-off or charged-down based upon the fact that repayment is uncertain or when the timing or value of payments cannot be determined. This classification does not imply that the loan will never be paid, nor does it imply that there has been a forgiveness of debt, but does indicate that the value will not be carried on the books of the institution as an earning asset.

The loan portfolio, segmented by risk range at December 31, 2010, is shown below:

| (in thousands) | Weighted Average Risk Grade | | | |
|---------------------------|-----------------------------|-----------------|-----------------|-------------------|
| | 1 - 4 | 5 - 6 | 7 - 9 | Total Loans |
| Real estate: | | | | |
| Permanent: | | | | |
| One- to four-family | \$ 25,142 | \$ 52 | \$ - | \$ 25,194 |
| Multifamily | 1,959 | - | - | 1,959 |
| Commercial nonresidential | 59,086 | 1,017 | 5,981 | 66,084 |
| Land | 4,107 | 335 | 2,021 | 6,463 |
| Construction: | | | | |
| One- to four-family | 1,819 | - | - | 1,819 |
| Commercial nonresidential | 1,227 | - | - | 1,227 |
| Commercial business | 15,970 | 2,755 | 640 | 19,365 |
| Consumer: | | | | |
| Home equity | 13,509 | - | - | 13,509 |
| Boat | 4,242 | - | - | 4,242 |
| Automobile | 1,167 | - | - | 1,167 |
| Other | 909 | - | - | 909 |
| Total | \$ 129,137 | \$ 4,159 | \$ 8,642 | \$ 141,938 |

The Company’s *Asset Classification Policy* requires an ongoing quarterly assessment of the probable estimated losses in the portfolios. The Asset Classification Committee reviews the following information to analyze the credit risk inherent in the Company’s portfolio:

- *All loans classified during the previous analysis.* Current information as to payment history or actions taken to correct the deficiency is reviewed, and if justified, the loan is no longer classified. If conditions have not improved, the loan classification is reviewed to ensure that the appropriate action is being taken to mitigate loss.
- *Growth and composition of the portfolio.* The Committee considers changes in composition of loan portfolio and the relative risk of these loan portfolios in assessing the adequacy of the allowance.
- *Historical loan losses.* The Committee reviews the Bank’s historical loan losses and historical industry losses in considering losses inherent in the loan portfolio.

- *Past due loans.* The Committee reviews loans that are past due 30 days or more, taking into consideration the borrower, nature of the collateral and its value, the circumstances that have caused the delinquency, and the likelihood of the borrower correcting the conditions that have resulted in the delinquent status. The Committee may recommend more aggressive collection activity, inspection of the collateral, or no change in its classification.
- *Reports from the Bank's managers and analysis of potential problem loans.* Lending managers may be aware of a borrower's circumstances that have not yet resulted in any past due payments but has the potential for problems in the future. Each lending manager reviews their respective lending unit's loans and identifies any that may have developing weaknesses. This "self identification" process is an important component of maintaining credit quality, as each lender is accountable for monitoring as well as originating loans.
- *Current economic conditions.* The Bank takes into consideration economic conditions in its market area, the state's economy, and national economic factors that could influence the quality of the loan portfolio in general. The unique, isolated geography of the Bank's market area of Southeast Alaska requires that each community's economic activity be reviewed. The Bank also reviews out of market economic data associated with participation loans and their respective markets.
- *Trends in the Bank's delinquencies.* The Bank's market area has seasonal trends and as a result, the portfolio tends to have similar fluctuations. Prior period statistics are reviewed and evaluated to determine if the current conditions exceed expected trends.

The amount that is to be added to allowance for loan losses is based upon a variety of factors. An important component is a loss percentage set for each major category of loan that is based upon the Bank's past loss experience. In certain instances, the Bank's own loss experience has been minimal, and the related loss factor is modified based on consideration of published national loan loss data. The loss percentages are also influenced by economic factors as well as management experience.

Each individual loan, previously classified by management or newly classified during the quarterly review, is evaluated for loss potential, and any specific estimates of impairment are added to the overall required reserve amount. As a result of the size of the institution, the size of the portfolio, and the relatively small number of classified loans, most members of the asset classification committee are often directly familiar with the borrower, the collateral or the circumstances giving rise to the concerns. For the remaining portion of the portfolio, comprised of "pass" loans, the loss percentages discussed above are applied to each loan category.

The calculated amount is compared to the actual amount recorded in the allowance at the end of each quarter, and a determination is made as to whether the allowance is adequate or needs to be increased. Management increases the amount of the allowance for loan losses by charges to income and decreases it by loans charged off (net of recoveries).

The following table details activity in the allowance for loan losses by portfolio segment for the year ended December 31, 2010. Allocation of a portion of the allowance to one segment of loans does not preclude its availability to absorb losses in other categories.

| | Beginning balance | Provision for loan losses | Net loans charged off and recoveries | Ending balance | Period end allowance amount allocated to: | |
|---------------------------------|-------------------|---------------------------|--------------------------------------|-----------------|---|---|
| | | | | | Loans individually evaluated for impairment | Loans collectively evaluated for impairment |
| 2010 (in thousands) | | | | | | |
| Real estate: | | | | | | |
| Permanent: | | | | | | |
| One-to-four-family | \$ 56 | \$ 228 | \$ (211) | \$ 73 | \$- | \$ 73 |
| Multifamily | 13 | 1 | - | 14 | - | 14 |
| Commercial non-residential | 444 | 414 | - | 858 | 267 | 591 |
| Land | 56 | 619 | (664) | 11 | - | 11 |
| Construction: | | | | | | |
| One-to-four-family | 144 | 40 | (180) | 4 | - | 4 |
| Multifamily | - | - | - | - | - | - |
| Commercial nonresidential | 236 | (24) | (209) | 3 | - | 3 |
| Commercial | 615 | (312) | 234 | 537 | 43 | 494 |
| Consumer: | | | | | | |
| Home equity | 114 | (91) | - | 23 | - | 23 |
| Boat | 87 | - | (58) | 29 | - | 29 |
| Automobile | 2 | 16 | (14) | 4 | - | 4 |
| Other | 19 | (16) | - | 3 | - | 3 |
| Unallocated | - | 24 | - | 24 | - | 24 |
| Total allowance for loan losses | <u>\$ 1,786</u> | <u>\$ 899</u> | <u>\$ (1,102)</u> | <u>\$ 1,583</u> | <u>\$ 310</u> | <u>\$ 1,273</u> |

Following is an analysis of the changes in the allowance for loan losses:

| (in thousands) Year ended December 31, | 2010 | 2009 |
|--|----------------|----------------|
| Balance at beginning of year | \$1,786 | \$2,688 |
| Provision for loan losses | 899 | 2,947 |
| Loans charged off | (1,367) | (3,875) |
| Recoveries | 265 | 26 |
| Balance at end of year | <u>\$1,583</u> | <u>\$1,786</u> |

The Company's recorded investment in loans as of December 31, 2010 related to each balance in the allowance for loan losses by portfolio segment and disaggregated on the basis of the Company's impairment methodology was as follows:

| 2010 (in thousands) | Loans individually evaluated for impairment | Loans collectively evaluated for impairment | Ending Balance |
|----------------------------|---|--|-------------------|
| Real estate: | | | |
| Permanent: | | | |
| One-to-four-family | \$ - | \$ 25,194 | \$ 25,194 |
| Multifamily | - | 1,959 | 1,959 |
| Commercial non-residential | 6,855 | 59,229 | 66,084 |
| Land | 2,021 | 4,442 | 6,463 |
| Construction: | | | |
| One-to-four-family | - | 1,819 | 1,819 |
| Multifamily | - | - | - |
| Commercial nonresidential | - | 1,227 | 1,227 |
| Commercial | 683 | 18,682 | 19,365 |
| Consumer: | | | |
| Home equity | - | 13,509 | 13,509 |
| Boat | - | 4,242 | 4,242 |
| Automobile | - | 1,167 | 1,167 |
| Other | 42 | 867 | 909 |
| Unallocated | - | - | - |
| Total loans | <u>\$ 9,601</u> | <u>\$ 132,337</u> | <u>\$ 141,938</u> |

RELATED PARTY LOANS: In the ordinary course of business, the Company makes loans to executive officers and directors of the Company and to their affiliates. These loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions. The aggregate dollar amount of these loans was \$4.5 million and \$3.2 million at December 31, 2010 and 2009, respectively. During the years ended December 31, 2010 and 2009, new loans of this type were \$5.7 million and \$388,000, respectively, and repayments were \$4.4 million and \$359,000, respectively.

REAL ESTATE OWNED AND REPOSSESSED ASSETS: The Company held real estate owned and repossessed assets of \$1.8 million and \$2.6 million at December 31, 2010 and 2009, respectively. During 2010, the Company received \$2.5 million in proceeds from the sale of real estate owned and repossessed assets and recognized \$224,000 of net losses on sales. During 2009, the Company received \$815,000 in proceeds from the sale of real estate owned and repossessed assets and recognized \$503,000 of net losses on sales. The Company also incurred \$237,000 and \$235,000 in operating expenses related to real estate owned and repossessed assets in 2010 and 2009, respectively.

Note 6 – Mortgage Loan Servicing

The Company generally retains the right to service mortgage loans sold to others. Loans serviced for others at December 31, 2010 and 2009 was \$129.1 million and \$119.3 million, respectively. Prior to January 1, 2010, the

Company accounted for mortgage servicing rights retained as a separate asset and, amortized the mortgage servicing rights retained in proportion to and over the period of estimated net servicing income.

Effective January 1, 2010, the Company adopted ASC 860-50, *Servicing Assets and Liabilities*, which provides the option of making an irrevocable decision to subsequently measure a class of servicing assets at fair value at the beginning of any fiscal year, which was elected by the Company in order to improve consistency and comparability in financial reporting. Subsequent changes in fair value will be reported in earnings in the period in which the change occurs. Upon adoption, management determined the carrying value of servicing assets was approximately \$421,000 lower than the fair value. The Company uses a model derived valuation methodology to estimate the fair value of mortgage servicing rights (MSR) obtained from an independent financial advisor on an annual basis. The model pools loans into buckets of homogeneous characteristics and performs a present value analysis of the future cash flows. The buckets are created by individual loan characteristics such as note rate, product type, and the remittance schedule. Current market rates are utilized for discounting the future cash flows. Significant assumptions used in the valuation of MSR include discount rates, projected prepayment speeds, escrow calculations, ancillary income, delinquencies and option adjusted spreads. A cumulative effect adjustment of \$421,000 was recorded to retained earnings effective January 1, 2010 for this change in accounting principle. The balance of retained earnings as of January 1, 2010 as restated was \$19.1 million. Upon adoption, there was no impact to net income, earnings per share, or any prior years retained earnings. During the year ended December 31, 2009, the change in carrying value was reported in earnings, and is included under the caption "Other service charges and fees" in the accompanying Consolidated Statements of Operations. As of December 31, 2010 and 2009, mortgage servicing assets were reported in assets and are included under the caption "Other assets" in the accompanying Consolidated Balance Sheets. Related servicing income amounted to \$287,000 and \$186,000 for 2010 and 2009, respectively. Custodial escrow balances maintained for loans serviced for others was \$533,000 and \$530,000 at December 31, 2010 and December 31, 2009, respectively. The change in the balance of mortgage servicing assets is included in the following table:

| <i>(in thousands)</i> | Year ended December 31, 2010 |
|-------------------------------|------------------------------------|
| Balance beginning of period | \$813 |
| Additions to servicing assets | 172 |
| Disposals of servicing assets | (222) |
| Fair value adjustment | 479 |
| Balance end of period | \$1,242 |

Note 7 – Premises and Equipment

Following is a summary of premises and equipment:

| <i>(in thousands)</i> December 31, | 2010 | 2009 |
|--|---------|---------|
| Land | \$ 424 | \$ 424 |
| Buildings | 2,254 | 2,254 |
| Leasehold improvements | 3,670 | 3,670 |
| Furniture, fixtures and equipment | 3,076 | 3,021 |
| | 9,424 | 9,369 |
| Less accumulated depreciation and amortization | (6,839) | (6,553) |
| | \$2,585 | \$2,816 |

Depreciation and amortization expense for the years ended December 31, 2010 and 2009 amounted to \$288,000 and \$335,000, respectively.

Note 8 – Deposits

Certificates of deposit of \$100,000 and more at December 31, 2010 and 2009 were \$10.1 million and \$12.9 million, respectively.

The scheduled maturities of certificates of deposit as of December 31, 2010, are as follows:

| <i>(in thousands)</i> Year ending December 31, | |
|--|-----------------|
| 2011 | \$29,598 |
| 2012 | 5,215 |
| 2013 | 1,227 |
| 2014 | 426 |
| 2015 and thereafter | 1,160 |
| | <u>\$37,626</u> |

Interest expense on deposits consists of the following:

| <i>(in thousands)</i> Year ended December 31, | 2010 | 2009 |
|---|--------------|----------------|
| Interest-bearing demand | \$ 26 | \$ 54 |
| Money market | 88 | 218 |
| Savings | 26 | 47 |
| Certificates of deposit | 707 | 1,050 |
| | <u>\$847</u> | <u>\$1,369</u> |

The weighted averages interest rates paid on deposits are as follows:

| Year ended December 31, | 2010 | 2009 |
|-------------------------|-------|-------|
| Interest-bearing demand | 0.08% | 0.17% |
| Money market | 0.32 | 0.50 |
| Savings | 0.13 | 0.23 |
| Certificates of deposit | 1.89 | 2.36 |

Deposits from the Company's executive officers, directors, and their related companies were \$4.5 million and \$2.9 at December 31, 2010 and 2009, respectively.

Note 9 – Federal Home Loan Bank Advances

FHLB advances consist of the following:

| <i>(dollars in thousands)</i> December 31, | 2010 | 2009 |
|--|----------------|----------------|
| Overnight advances, 0.64% | \$- | \$4,800 |
| Seven-year amortizing advance, final maturity in 2010, 3.62% | - | 34 |
| Four-year advance, maturing in 2010, fixed 5.24% | - | 1,500 |
| Five-year advance, maturing in 2011, fixed 5.26% | 2,000 | 2,000 |
| Three-year advance, maturing in 2013 fixed 2.15% | 1,500 | - |
| Seven-year advance, maturing in 2013, fixed 5.30% | 1,500 | 1,500 |
| | <u>\$5,000</u> | <u>\$9,834</u> |

FHLB advances at December 31, 2010 with final maturities of more than one year have scheduled maturities as follows:

(in thousands)

| Year ending December 31, | |
|--------------------------|---------|
| 2011 | 2,000 |
| 2012 | - |
| 2013 | 3,000 |
| Total | \$5,000 |

The average balance of FHLB advances outstanding during 2010 and 2009 was \$9.0 million and \$12.2 million, respectively. The maximum amount of advances outstanding at any month end during 2010 and 2009 was \$13.2 million and \$13.4 million, respectively. Under a blanket pledge agreement, all funds on deposit at the FHLB, as well as all unencumbered qualifying loans and investment securities, are available to collateralize FHLB advances.

The Bank has available a line of credit with the FHLB generally equal to 25% of the Bank's total assets, or approximately \$43.6 million at December 31, 2010. The line is secured by a blanket pledge of the Company's assets. At December 31, 2010, there was \$5.0 million outstanding on the line and an additional \$1.0 million of the borrowing line was committed to secure public deposits.

Note 10 – Stock-Based Compensation

STOCK OPTION PLAN: In previous years, the Board of Directors, upon stockholder approval, approved two stock option plans (the "Plans"); one for key employees and one for directors of the Company. The Incentive and Director Stock Option Plan permits the grant of stock options to authorized key employees for up to 65,574 shares of common stock plus (i) the number of shares repurchased by the Company in the open market or otherwise with an aggregate price no greater than the cash proceeds received by the Company from the exercise of options granted under the Plan; plus (ii) any shares surrendered to the Company in payment of the exercise price of options granted under the Plan. The Committee of the Plans shall determine the time or times at which an option may be exercised. Previous option awards generally vest based on five years of continuous service. The term of each option award shall be no greater than 10 years in the case of an Incentive Stock Option or 15 years in the case of a Non-Qualified Stock Option. Option awards under the Plans shall not be less than 100% of the Market Value (as defined in the Plans) of a share on the date of grant of such option. Stock options granted are eligible for adjustment in the event that the outstanding common stock of the Company changes as a result of a stock dividend, stock split, or other changes to existing stock. The 2000 Stock Option Plan terminated on July 2, 2010 and the 2003 Stock Option Plan will terminate on May 22, 2013.

In 2000, the Company's shareholders approved the 2000 Stock Option Plan, providing for the granting of options for up to 65,542 shares. Options for 65,542 shares were granted in 2000, with an exercise price equal to the market price of the stock at the date of grant, or \$9.75. Options on 3,400 shares were granted in 2003, replacing forfeitures, with an exercise price of \$17.50.

In 2003, the Company's shareholders approved the 2003 Stock Option Plan, providing for the granting of options for up to 32,000 shares. Options for 22,600 shares were granted in 2007, with an exercise price equal to the market price of the stock at the date of grant, or \$25.50. Options become exercisable in five equal annual installments commencing one year after the date of grant, and unexercised options expire ten years after the date of grant.

The expected volatility is based on historical volatility. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life is based on historical exercise experience. The dividend yield assumption is based on the Company's history and expectation of dividend payouts.

Following is a summary of the changes in stock options:

(in thousands)

| Year ended December 31, | 2010 | | 2009 | |
|--|----------------------|---------------------------------------|----------------------|---------------------------------------|
| | Number of Options | Weighted Average Exercise Price | Number of Options | Weighted Average Exercise Price |
| Stock options outstanding at beginning of year | 54,188 | \$16.08 | 54,188 | \$16.08 |
| Granted | - | - | - | - |
| Exercised | - | - | - | - |
| Forfeited/Expired | 31,188 | 9.75 | - | - |
| Stock options outstanding at end of year | 23,000 | \$24.67 | 54,188 | \$16.08 |
| Options exercisable at end of year | 18,120 | \$24.44 | 45,288 | \$14.23 |

There were no options exercised during the years ended December 31, 2010 and 2009. Stock options outstanding at December 31, 2010 are summarized as follows:

| Weighted-Average Exercise Price | Number Outstanding at End of Year | Weighted-Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value | Exercisable | |
|---------------------------------------|---|--|---------------------------------|---------------------|---------------------------------|
| | | | | Number of Shares | Aggregate Intrinsic Value |
| \$17.50 | 2,400 | 2.1 | \$- | 2,400 | \$- |
| 25.50 | 20,600 | 6.7 | \$- | 15,720 | \$- |
| \$24.67 | 23,000 | 6.2 | \$- | 18,120 | \$- |

ASC 718 requires all share-based payments to employees, including grants of employee stock options, to be recognized in the consolidated income statement based on their fair values. Compensation cost is recorded as if each vesting portion of the award is a separate award. The adoption of this standard, as of January 1, 2006, using the modified prospective method, resulted in \$24,000 and \$27,000 of compensation expense for the years ended December 31, 2010 and 2009, related to the unvested portion of options granted in prior years. Net of taxes for the years ended December 31, 2010 and 2009; this reduced net income by \$10,000 and \$11,000, respectively. The basic and diluted earnings per share basis effect at December 31, 2010 and 2009, was zero. There was \$27,000 in unamortized stock-based compensation expense at December 31, 2010 with a weighted average expense period of 1.6 years.

ASC 718 requires the recognition of stock-based compensation for the number of awards that are expected to vest. Recognized stock compensation expense was not reduced by estimated forfeitures because management believes the future effect to be minimal. Estimated forfeitures will be continually evaluated in subsequent periods and may change based on new facts and circumstances.

Note 11 – Retirement Plans

The Bank has a salary deferral 401(k) plan. Employees who are at least 18 years of age and have completed three months of service are eligible to participate in the plan. Employees may contribute on a pretax basis a portion of their annual salary up to a maximum limit under the law. Since 2006, the Bank has matched 100% of employee contributions of up to 4% of compensation. For the years ended December 31, 2010 and 2009, the Bank contributed \$107,000 and \$111,000, respectively, to the plan, including administrative expenses.

The Company has an Employee Stock Ownership Plan (“ESOP”) that was established in connection with the mutual to stock conversion. Eight percent of the shares issued in the conversion, or 52,433 shares, were purchased by the ESOP in exchange for a note payable to the Company. The shares are allocated to employees over a ten-year period in proportion to the principal and interest paid on the note at the end of each year. All employees who have completed one year’s service automatically participate in the plan, and each year’s allocation is distributed in proportion to total compensation of employees. Employees are vested in the plan over a seven-year period. Dividends paid on allocated shares are credited to employee’s accounts, but dividends on unallocated shares are used to reduce the expense of the plan. At December 31, 2010 and 2009, 52,433 shares were allocated to employees. The Company’s expense for the plan, including administrative expenses, amounted to \$13,000 and \$13,000 for the years ended December 31, 2010 and 2009, respectively.

Note 12 – Operating Leases

The Bank leases certain of its premises and equipment under noncancelable operating leases with terms in excess of one year. Future minimum lease payments under these leases at December 31, 2010, are summarized as follows:

| <i>(in thousands)</i> Year ending December 31, 2010 | |
|---|----------------|
| 2011 | 456 |
| 2012 | 457 |
| 2013 | 380 |
| 2014 | 271 |
| 2015 | 271 |
| 2016 and thereafter | 836 |
| | <u>\$2,671</u> |

Rent expense was \$502,000 and \$498,000 for the years ended December 31, 2010 and 2009, respectively. Rental income on owned premises amounted to \$35,000 and \$19,000 for the years ended December 31, 2010 and 2009, respectively.

Note 13 – Income Tax

The expense (benefit) for income tax consisted of the following:

| <i>(in thousands)</i> Year ended December 31, | 2010 | 2009 |
|---|----------------|-------------|
| Current tax expense (benefit): | | |
| Federal | \$- | \$(397) |
| State | - | (70) |
| Total current | - | (467) |
| Deferred tax expense (benefit): | | |
| Federal | 135 | (357) |
| State | 44 | (63) |
| Total deferred | 179 | (420) |
| Increase (decrease) in deferred tax valuation allowance | (434) | 905 |
| Expense (Benefit) for income tax | <u>\$(255)</u> | <u>\$18</u> |

A reconciliation of taxes computed at federal statutory corporate tax rates (34% in 2010 and 2009) to tax expense, as shown in the accompanying statements of operations and changes in shareholders' equity and comprehensive income (loss), is as follows:

| <i>(in thousands)</i> Year ended December 31, | 2010 | 2009 |
|---|---------|---------|
| Income tax expense (benefit) at statutory rate | \$200 | \$(739) |
| Income tax effect of: | | |
| State income tax | (42) | (134) |
| Tax-exempt interest | (9) | (12) |
| Increase (decrease) in deferred tax valuation allowance | (434) | 905 |
| Other | 30 | (2) |
| Expense (Benefit) for income tax | \$(255) | \$18 |
| Effective tax rate | (43%) | (1%) |

Deferred federal income tax is provided for the temporary differences between the tax basis and financial statement carrying amounts of assets and liabilities. Components of the Company's net deferred tax assets consisted of the following:

| <i>(in thousands)</i> December 31, | 2010 | 2009 |
|---|-------|-------|
| Deferred tax assets: | | |
| Bad debt reserves | \$878 | \$929 |
| Nonaccrual loan interest | 5 | 308 |
| Premises and equipment | 147 | 128 |
| Accrued vacation | 69 | 68 |
| Nondeductible REO write-down | 173 | 21 |
| Net operating loss carry-forward | 584 | 524 |
| Other | 28 | 29 |
| Gross deferred tax assets | 1,884 | 2,007 |
| Deferred tax liabilities: | | |
| Deferred loan fees, net | (70) | (48) |
| FHLB stock dividends | (628) | (610) |
| Prepays | (96) | (94) |
| Unrecognized gain (loss) on available for sale securities | (61) | (27) |
| Other | (14) | - |
| Gross deferred tax liabilities | (869) | (779) |
| Net deferred tax assets | 1,015 | 1,228 |
| Valuation allowance for deferred tax asset | (471) | (905) |
| Net deferred tax assets after valuation allowance | \$544 | \$323 |

In August 1996, the Small Business Job Protection Act of 1996 ("the Act") was signed into law. Under the Act, the percentage of taxable income method of accounting for tax basis bad debts is no longer available effective for the years ending after December 31, 1995. As a result, the Bank is required to use the experience method of accounting for tax basis bad debts for 1998 and later years. In addition, the Act requires the recapture of post-1987 (the base year) additions to the tax bad debt reserves made pursuant to the percentage of taxable income method. The Bank is not subject to this recapture in 2010 or 2009, as its tax bad debt reserves do not exceed its base year reserve. As a result of the bad debt deductions, shareholders' equity as of December 31, 2010, includes accumulated earnings of approximately \$1.8 million for which federal income tax has not been provided. If, in the future, this portion of retained earnings is used for any purpose other than to absorb losses on loans or on property acquired through foreclosure, federal income tax may be imposed at then-applicable rates.

On January 1, 2007, the Bank adopted FASB ASC 740, *Income Taxes*. ASC 740 provides guidance on derecognition, classification, interest and penalties, and accounting in interim periods; and requires expanded disclosure with respect to the Company's methodology for estimating and reporting uncertain tax positions.

Currently, the Company is subject to U.S. federal income tax and income tax in the state of Alaska. The federal and state income taxes paid for the calendar years ending December 31, 2010, 2009, 2008, and 2007 may remain subject to examination by the applicable authorities. The Company recognizes interest and penalties related to unrecognized tax benefits as income tax expense in the Statements of operations. During the years ended December 31, 2010 and 2009, the Company recognized no interest and penalties.

The Company believes that it has appropriate support for the income tax positions taken and to be taken on its tax returns and that its accruals for tax liabilities are adequate for the open years based on an assessment of many factors, including past experience and interpretations of tax law. The Company had no unrecognized tax benefits which would require an adjustment to the January 1, 2010, beginning balance of retained earnings. The Company had no unrecognized tax benefits at December 31, 2010 or 2009.

Note 14 – Commitments and Contingencies

COMMITMENTS: Commitments to extend credit, including unused lines of credit, totaled \$9.5 million and \$11.4 million at December 31, 2010 and 2009, respectively. Commitments to extend credit, generally at a variable interest rate, are arrangements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee by the customer. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates creditworthiness for commitments on an individual customer basis.

There are no commitments to lend additional funds to debtors' loans whose terms have been modified in troubled debt restructurings.

Undisbursed loan proceeds, primarily for real estate construction loans, totaled \$1.4 million and \$3.6 million at December 31, 2010 and 2009, respectively. These amounts are excluded from the balance of loans at year end.

CONCENTRATIONS: More than 75% of all loans in the Bank's portfolio are secured by real estate located in communities of Southeast Alaska.

Note 15 – Preferred Stock

On February 6, 2009, as part of the Troubled Asset Relief Program ("TARP") Capital Purchase Program, the Company entered into a Letter Agreement and Securities Purchase Agreement (collectively, the "Purchase Agreement") with the United States Department of the Treasury ("Treasury"), pursuant to which the Company sold (i) 4,781 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") and (ii) a warrant (the "Warrant") to purchase 175,772 shares of the Company's common stock, par value \$0.01 per share (the "Common Stock"), for an aggregate issuance price of \$4.8 million in cash.

The Series A Preferred Stock qualifies as Tier 1 capital and is entitled to cumulative dividends at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Series A Preferred Stock may be redeemed by the Company after three years. Prior to the end of three years, the Series A Preferred Stock may be redeemed by the Company only with proceeds from the sale of qualifying equity securities of the Company (a "Qualified Equity Offering"). The restrictions on redemption are set forth in the Certificate of Designation attached to the Statement of Establishment and Designation of Series of Preferred Stock, which amends the Company's Articles of Incorporation (the "Certificate of Designation").

The Warrant has a 10-year term and is immediately exercisable upon its issuance, with an exercise price, subject to anti-dilution adjustments, equal to \$4.08 per share of the Common Stock. Treasury has agreed not to exercise voting power with respect to any shares of Common Stock issued upon exercise of the Warrant that it holds.

Pursuant to the terms of the Purchase Agreement, the ability of the Company to declare or pay dividends or distributions on, or purchase, redeem or otherwise acquire for consideration, shares of its Junior Stock (as defined below) and Parity Stock (as defined below) is be subject to restrictions, including a restriction against increasing dividends from the last quarterly cash dividend per share (\$0.10) declared on the Common Stock prior to February 6, 2009. The redemption, purchase or other acquisition of trust preferred securities of the Company or its affiliates also is restricted. These restrictions will terminate on the earlier of (a) the third anniversary of the date of issuance of the Series A Preferred Stock, (b) the date on which the Series A Preferred Stock has been redeemed in whole, and (c) the date Treasury has transferred all of the Series A Preferred Stock to third parties.

In addition, pursuant to the Certificate of Designation, the ability of the Company to declare or pay dividends or distributions on, or repurchase, redeem or otherwise acquire for consideration, shares of its Junior Stock and Parity Stock will be subject to restrictions in the event that the Company fails to declare and pay full dividends (or declare and set aside a sum sufficient for payment thereof) on its Series A Preferred Stock.

“Junior Stock” means the Common Stock and any other class or series of stock of the Company the terms of which expressly provide that it ranks junior to the Series A Preferred Stock as to dividend rights and/or rights on liquidation, dissolution or winding up of the Company. “Parity Stock” means any class or series of stock of the Company the terms of which do not expressly provide that such class or series will rank senior or junior to the Series A Preferred Stock as to dividend rights and/or rights on liquidation, dissolution or winding up of the Company (in each case without regard to whether dividends accrue cumulatively or non-cumulatively).

In accordance with the relevant accounting pronouncements, the Company recorded the Series A Preferred Stock and Warrants within Stockholders' Equity on the Consolidated Balance Sheets. The Series A Preferred Stock and Warrants were initially recognized based on their relative fair values at the date of issuance. As a result, the Series A Preferred Stock's carrying value is at a discount to the liquidation value or stated value. In accordance with the SEC's Staff Accounting Bulletin No. 68, Increasing Rate Preferred Stock, the discount is considered an unstated dividend cost that is amortized over the period preceding commencement of the perpetual dividend using the effective interest method, by charging the imputed dividend cost against retained earnings and increasing the carrying amount of the Series A Preferred Stock by a corresponding amount. The discount is therefore being amortized over five years using a 6.71% effective interest rate. The total stated dividends (whether or not declared) and unstated dividend cost combined represents a period's total preferred stock dividend, which is deducted from net income (loss) to arrive at net income (loss) available to common shareholders on the Consolidated Statements of Operations.

The Series A Preferred Stock and Warrants were initially recognized based on their relative fair values at the date of issuance in accordance with ASU 470-20, Debt with Conversion and Other Topics. As a result, the value allocated to the Warrant is different than the estimated fair value of the Warrant as of the grant date. The following assumptions were used to determine the fair value of the Warrant as of the grant date:

Dividend yield 1.50%
Expected life (years) 10.0
Expected volatility 37%
Risk-free rate 3.05%
Fair value per warrant at grant date \$ 4.15

Note 16 – Earnings (Loss) per Share

Basic earnings (loss) per share (“EPS”) is computed by dividing net income (loss) by the weighted-average number of common shares outstanding during the period less treasury stock, unvested stock awards under the Management Recognition Plan (“unvested stock awards”), and unallocated and not yet committed to be released Employee Stock

Ownership Plan shares (“unearned ESOP shares”). Diluted EPS is calculated by dividing net income (loss) by the weighted-average number of common shares used to compute basic EPS plus the incremental amount of potential common stock from unvested stock awards and stock options, determined by the treasury stock method. The following table shows the calculation of basic and diluted EPS.

| <i>(dollars in thousands)</i> December 31, | 2010 | 2009 |
|--|----------------|-------------------|
| Net income (loss) | \$ 843 | \$ (2,191) |
| Preferred stock dividend accrual | (239) | (216) |
| Preferred stock discount accretion | (65) | (55) |
| Net loss available to common shareholders | <u>\$ 539</u> | <u>\$ (2,462)</u> |
| | | |
| Average shares issued | 655,415 | 655,415 |
| Less treasury stock | (929) | (929) |
| Less unallocated ESOP shares | - | - |
| Basic weighted average shares outstanding | <u>654,486</u> | <u>654,486</u> |
| | | |
| Net incremental shares | <u>53,501</u> | <u>-</u> |
| Weighted incremental shares | <u>707,987</u> | <u>654,486</u> |
| | | |
| Income (Loss) per common share | | |
| Basic | \$ 0.82 | \$ (3.76) |
| Diluted | \$ 0.76 | \$ (3.76) |

Options to purchase an additional 23,000 and shares of common stock were not included in the computation of diluted earnings per share as of December 31, 2010 and 2009 because their exercise price resulted in them being anti-dilutive and consideration to options was not given as the impact would be anti-dilutive. The warrant issued to the U.S. Treasury to purchase up to 175,772 shares of common stock was included in the computation of diluted EPS for the year ended December 31, 2010 because the warrant’s exercise price was less than the average market price of the Company’s common shares during the period.

Note 17 – Fair Value of Financial Instruments

The Company has elected to record certain assets and liabilities at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The GAAP standard (ASC 820) establishes a consistent framework for measuring fair value and disclosure requirements about fair value measurements. The standard requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company’s market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1 - Unadjusted quoted prices for identical instruments in active markets;

Level 2 - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable; and

Level 3 - Instruments whose significant value drivers are unobservable.

An asset or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The following table sets forth the Company's assets and liabilities by level within the fair value hierarchy that were measured at fair value on a recurring and non-recurring basis at December 31, 2010.

| | Fair Value Measurements Using | | | | Gain/(Loss) for Year Ended |
|---|-------------------------------|--|--|---|----------------------------------|
| | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| <i>(in thousands)</i> | | | | | |
| December 31, 2010: | | | | | |
| Recurring: | | | | | |
| Available for sale securities: | | | | | |
| Mortgage backed securities | \$ 2,070 | \$ - | \$ 2,070 | \$ - | \$ - |
| U.S. government agencies | 85 | - | 85 | - | - |
| Mortgage servicing rights | 1,242 | - | - | 1,242 | (8) |
| Non-recurring: | | | | | |
| Impaired loans | 2,857 | - | - | 2,857 | (310) |
| Other real estate owned and repossessed assets | 1,791 | - | - | 1,791 | 224 |
| December 31, 2009: | | | | | |
| Recurring: | | | | | |
| Available for sale securities: | | | | | |
| Mortgage backed securities | \$ 2,514 | \$ - | \$ 2,514 | \$ - | \$ - |
| U.S. government agencies | 92 | - | 92 | - | - |
| Mortgage servicing rights | 1,234 | - | 1,234 | - | - |
| Non-recurring: | | | | | |
| Impaired loans | 1,408 | - | - | 1,408 | (514) |
| Other real estate owned and repossessed assets | 2,598 | - | 2,598 | - | 503 |

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Securities: The fair value of investment securities is based upon estimated market prices obtained from independent safekeeping agents. Securities available-for-sale are recorded at fair value on a recurring basis. Fair values are based on quoted market prices, where available. If quoted market prices are not available, fair values are estimated based on quoted market prices of comparable instruments with similar characteristics or discounted cash flows. Changes in fair market value are recorded in other comprehensive income, as the securities are available for sale.

Mortgage servicing rights: MSR are measured at fair value on a recurring basis. These assets are classified as Level 3 as quoted prices are not available and the Company uses a model derived valuation methodology to estimate the fair value of MSR obtained from an independent financial advisor on an annual basis. The model pools loans into buckets of homogeneous characteristics and performs a present value analysis of the future cash flows. The buckets are created by individual loan characteristics such as note rate, product type, and the remittance schedule. Current market rate assumptions are utilized for discounting the future cash flows. Significant assumptions used in the valuation of MSR include discount rates, projected prepayment speeds, escrow calculations, ancillary income, delinquencies and option adjusted spreads. These assets are recorded at fair value.

Impaired loans: Impaired loans are measured at fair value on a non-recurring basis. These assets are classified as Level 3 where significant value drivers are unobservable. The fair value of impaired loans are determined using the fair value of each loan's collateral for collateral-dependent loans as determined, when possible, by an appraisal of the property, less estimated costs related to liquidation of the collateral. The appraisal amount may also be adjusted for current market conditions. Impaired loans were \$3.2 million and \$5.3 million at December 31, 2010 and 2009, respectively, with estimated reserves for impairment of \$310,000 and \$514,000, respectively.

Real estate owned and repossessed assets: The \$1.8 million in real estate owned and repossessed assets reflected in the table above represents impaired real estate and repossessed assets that has been adjusted to fair value. Real estate owned and repossessed assets primarily represents real estate and other assets which the Bank has taken control of in partial or full satisfaction of loans. At the time of foreclosure, other real estate owned and repossessed assets are recorded at the lower of the carrying amount of the loan or fair value less costs to sell, which becomes the property's new basis. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan and lease losses. After foreclosure, management periodically performs valuations when possible, by an appraisal of the property, such that the real estate is carried at the lower of its new cost basis or fair value, net of estimated costs to sell. Fair value adjustments on other real estate owned and repossessed assets are recognized within results of operations.

The following table sets forth the estimated fair values of the Company's financial instruments at December 31, 2010 and 2009:

| <i>(in thousands)</i> December 31, | 2010 | | 2009 | |
|--|--------------------|----------------------------|--------------------|----------------------------|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial Assets | | | | |
| Cash and cash equivalents | \$ 21,023 | \$ 21,023 | \$ 6,942 | \$ 6,942 |
| Investment securities available for sale | 2,155 | 2,155 | 2,606 | 2,606 |
| FHLB stock | 1,784 | 1,784 | 1,784 | 1,784 |
| Loans, including held for sale | 142,388 | 124,239 | 158,163 | 166,184 |
| Accrued interest receivable | 604 | 604 | 698 | 698 |
| Mortgage servicing rights | 1,242 | 1,242 | 813 | 1,234 |
| Financial Liabilities | | | | |
| Demand and savings deposits | 109,922 | 109,922 | 108,042 | 108,042 |
| Certificates of deposit | 37,626 | 38,067 | 40,175 | 40,230 |
| FHLB Advances | 5,000 | 5,206 | 9,834 | 10,082 |
| Accrued interest payable | 195 | 195 | 307 | 307 |

Cash and cash equivalents: The fair value of cash and cash equivalents and accrued interest receivable is estimated to be equal to the carrying value, due to their short-term nature.

FHLB stock: The fair value of FHLB stock is considered to be equal to its carrying value, since it may be redeemed at that value.

Loans: The fair value of loans is estimated using present value methods which discount the estimated cash flows, including prepayments as well as contractual principal and interest, using current interest rates appropriate for the type and maturity of the loans.

Deposits and other liabilities: For demand and savings deposits and accrued interest payable, fair value is considered to be carrying value.

Certificates of Deposit: The fair values of fixed-rate certificates of deposit are estimated using present value methods and current offering rates for such deposits.

FHLB Advances: The estimated fair value approximates carrying value for short-term borrowings. The fair value of long-term fixed-rate borrowings is estimated by discounting future cash flows using current interest rates for similar financial instruments.

Note 18 – Parent Company Financial Information

Summarized financial information for Alaska Pacific Bancshares, Inc. (parent company only) is presented below:

PARENT COMPANY CONDENSED BALANCE SHEET

| <i>(in thousands)</i> December 31, | 2010 | 2009 |
|---|-----------------|-----------------|
| Assets | | |
| Cash | \$ 308 | \$ 1,431 |
| Investment in subsidiary | 19,627 | 17,280 |
| Total Assets | \$19,935 | \$18,711 |
| Liabilities and Shareholders' Equity | | |
| Other liabilities | \$ 156 | \$ 31 |
| Shareholders' equity | 19,779 | 18,680 |
| Total Liabilities and Shareholders' Equity | \$19,935 | \$18,711 |

PARENT COMPANY CONDENSED INCOME STATEMENT

| <i>(in thousands)</i> Year ended December 31, | 2010 | 2009 |
|---|--------------|------------------|
| Equity (Deficit) in earnings of subsidiary | \$1,052 | \$(2,043) |
| Total income (loss) | 1,052 | (2,043) |
| Operating expenses, net | 209 | 148 |
| Net income (loss) | \$843 | \$(2,191) |

PARENT COMPANY CONDENSED STATEMENT OF CASH FLOWS

| <i>(in thousands)</i> Year ended December 31, | 2010 | 2009 |
|---|---------|-----------|
| Cash flows from operating activities: | | |
| Net income (loss) | \$843 | \$(2,191) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Deficit (equity) in earnings of subsidiary | (1,052) | 2,043 |
| Change in operating assets and liabilities | 6 | - |
| Net cash used in operating activities | (203) | (148) |
| Cash flows from investing activities: | | |
| Investment in subsidiary | (800) | (3,200) |
| Net cash used in investing activities | (800) | (3,200) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of preferred stock and common stock warrants | - | 4,781 |
| Stock issuance costs paid | - | (41) |
| Cash dividends paid on preferred stock | (120) | (185) |
| Net cash provided by (used in) financing activities | (120) | 4,555 |
| Net increase (decrease) in cash | (1,123) | 1,207 |
| Cash at beginning of year | 1,431 | 224 |
| Cash at end of year | \$308 | \$1,431 |

Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure

No disagreement with the Company's independent accountants on accounting and financial disclosure has occurred during the two most recent fiscal years.

Item 9A. Controls and Procedures

(a) **Evaluation of Disclosure Controls and Procedures:** An evaluation of the Company's disclosure controls and procedures (as defined in Section 13(a)-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act")) was carried out under the supervision and with the participation of the Company's Chief Executive Officer, Chief Financial Officer and several other members of the Company's senior management within the 90-day period preceding the filing date of this annual report. The Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures as currently in effect are effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is (i) accumulated and communicated to the Company's management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

(b) **Report of Management on Internal Control over Financial Reporting:** Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934). The Company's internal control over financial reporting is a process designed under the supervision of the Company's management, including its Chief Executive Officer and its Chief Financial Officer, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with generally accepted accounting principles in the United States of America.

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

Management recognizes that there are inherent limitations in the effectiveness of any system of internal control and, accordingly, even effective internal control can provide only reasonable assurance with respect to financial statement preparation and fair presentation. Further, because of changes in conditions, the effectiveness of internal control may vary over time.

Under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, the Company conducted an assessment of the effectiveness of the Company's internal control over financial reporting based on the framework established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management has determined that the Company's internal control over financial reporting as of December 31, 2010 is effective.

/s/ Craig E. Dahl
Craig E. Dahl
President and Chief Executive Officer
(Principal Executive Officer)

/s/ Julie M. Pierce
Julie M. Pierce
Senior Vice President, Chief Financial Officer
(Principal Financial and Accounting Officer)

(c) Changes in Internal Controls: For the year ended December 31, 2010, the Company did not make any significant changes in, nor take any corrective actions regarding, its internal controls or other factors that could significantly affect these controls.

(d) Attestation report: 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 temporary rules of the Securities and Exchange Commission that permit the company to provide only management's report in this annual report.

Item 9B. Other Information

There was no information to be disclosed by the Company in a report on Form 8-K during the fourth quarter of fiscal 2010 that was not so disclosed.

PART III

Item 10. Directors, Executive Officers, and Corporate Governance

The information contained under the section captioned "Proposal I -- Election of Directors" in the Company's Definitive Proxy Statement for the 2010 Annual Meeting of Stockholders ("Proxy Statement") is incorporated herein by reference. For information regarding the executive officers of the Company, see "Item 1. Business - Executive Officers."

Audit Committee Financial Expert

The Audit Committee consisting of Directors Milner (Chairman), Thomas, Corbus and Rule is responsible for reviewing the internal auditors' report and results of their examination prior to review by and with the entire Board of Directors and retains and establishes the scope of the engagement of the Company's independent auditors. The Board of Directors has designated Director Milner as the Audit Committee financial expert, as defined by the SEC, by the Bank's Board of Directors. Although the Company's common stock is not listed on NASDAQ, its Board of Directors has chosen to apply the definition of "independent" under the NASDAQ rules. Using this definition, the Board has determined that Director Milner is independent.

Compliance with Section 16(a)

Section 16(a) of the Exchange Act requires Company directors and executive officers, and persons who own more than 10% of a registered class of its equity securities, to file with the SEC initial reports of ownership and reports of changes in ownership of common stock and other equity securities of the Company. Officers, directors and greater than 10% stockholders are required by SEC regulation to furnish the Company with copies of all Section 16(a) forms they file.

Reference is made to the cover page of this Annual Report on Form 10-K, and the information under the section captioned "Compliance with Section 16(a) of the Exchange Act" in the Proxy Statement is incorporated herein by reference, with regard to compliance with Section 16(a) of the Exchange Act.

Code of Ethics

The Board of Directors adopted a Code of Ethics for the Company's officers (including its senior financial officers), directors, and employees, which is included as Exhibit 14 hereto. The Code of Ethics requires the Company's officers, directors, and employees to maintain the highest standards of professional conduct. The Company has elected to provide a copy of its Code of Ethics without charge to anyone who requests it.

Shareholder Recommendations for Board Nominations

No material changes have been made to the procedures by which security holders may recommend nominees to the Company's Board of Directors. See the sections captioned "Meetings and Committees of the Board of Directors and Corporate Governance Matters -- Committees and Committee Charters" and "Stockholder Proposals" in the Proxy Statement, which are incorporated herein by reference.

Item 11. Executive Compensation

The information contained under the sections captioned "Executive Compensation" in the Proxy Statement is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

(a) Security Ownership of Certain Beneficial Owners: Information required by this item is incorporated herein by reference to the section captioned "Security Ownership of Certain Beneficial Owners and Management" in the Proxy Statement.

(b) Security Ownership of Management: Information required by this item is incorporated herein by reference to the sections captioned and "Security Ownership of Certain Beneficial Owners and Management" and "Proposal I - Election of Directors" in the Proxy Statement.

(c) Changes in Control: The Company is not aware of any 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 Plan Information: The following table summarizes share and exercise price information about the Company's equity compensation plans as of December 31, 2010.

| <i>Plan category</i> | <i>(a)</i> <i>Number of securities to be issued upon exercise of outstanding options, warrants and rights</i> | <i>(b)</i> <i>Weighted-average exercise price of outstanding options, warrants, and rights</i> | <i>(c)</i> <i>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</i> |
|--|--|---|--|
| Equity compensation plans approved by security holders | | | |
| Option plan | 18,120 | \$24.67 | 12,000 |
| Equity compensation plans not approved by security holders | - | | - |
| Total | 18,120 | \$24.67 | 12,000 |

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item is incorporated herein by reference to the section captioned "Meetings and Committees of the Board of Directors and Corporate Governance Matters – Corporate Governance – Related Party Transactions" and "Meetings and Committees of the Board of Directors and Corporate Governance Matters – Corporate Governance –Director Independence" in the Proxy Statement.

Item 14. Principal Accounting Fees and Services

The information set forth under the section captioned "Proposal II – Ratification of Appointment of Independent Auditors" in the Proxy Statement is incorporated herein by reference.

Item 15. Exhibits, Financial Statement Schedules

- (a) Exhibits
- 3.1 Articles of Incorporation of Alaska Pacific Bancshares, Inc. (1)
 - 3.2 Statement of Establishment and Designations of Series of Preferred Stock for the Series A Preferred Stock (2)
 - 3.3 Bylaws of Alaska Pacific Bancshares, Inc. (3)
 - 4.1 Warrant For Purchase of Shares of Common Stock (2)
 - 4.2 Letter Agreement dated February 6, 2009 between Alaska Pacific Bancshares, Inc. and United States Department of the Treasury, will respect to the issuance and sale of the Series A Preferred Stock and the Warrant(2)
 - 10.1 Employment Agreement with Craig E. Dahl (4)
 - 10.2 Severance Agreement with Julie M. Pierce (9)
 - 10.3 Severance Agreement with Thomas C. Sullivan (4)
 - 10.4 Severance Agreement with Tammi L. Knight (4)
 - 10.5 Severance Agreement with John E. Robertson (6)
 - 10.6 Severance Agreement with Leslie D. Dahl (9)
 - 10.7 Severance Agreement with Christopher P. Bourque (98)
 - 10.8 Alaska Federal Savings Bank 401(k) Plan (1)
 - 10.9 Alaska Pacific Bancshares, Inc. Employee Stock Ownership Plan (4)
 - 10.10 Alaska Pacific Bancshares, Inc. Employee Severance Compensation Plan (4)
 - 10.11 Alaska Pacific Bancshares, Inc. 2000 Stock Option Plan (5)
 - 10.12 Alaska Pacific Bancshares, Inc. 2003 Stock Option Plan (7)
 - 10.13 Form of Compensation Modification Agreement (2)
 - 14 Code of Ethics (8)
 - 21 Subsidiaries of the Registrant
 - 23 Consent of Independent Registered Public Accounting Firm
 - 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
 - 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
 - 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
 - 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
 - 99.1 Certification of Principal Executive Officer of Alaska Pacific Bancshares, Inc. to Chief Compliance Officer of the Troubled Asset Relief Program Pursuant to 31 CFR § 30.15
 - 99.2 Certification of Principal Financial Officer of Alaska Pacific Bancshares, Inc. to Chief Compliance Officer of the Troubled Asset Relief Program Pursuant to 31 CFR § 30.15

-
- (1) Incorporated by reference to the registrant's Registration Statement on Form SB-2 (333-74827).
 - (2) Incorporated by reference to the registrant's current report on Form 8-K filed on February 6, 2009.
 - (3) Incorporated by reference to the registrant's Registration Statement on Form SB-2 (333-74827), except for amended Article III, Section 2, which was incorporated by reference to the registrant's quarterly report on Form 10-QSB for the quarterly period ended March 31, 2004.
 - (4) Incorporated by reference to the registrant's Annual Report on Form 10-KSB for the year ended December 31, 1999.
 - (5) Incorporated by reference to the registrant's annual meeting proxy statement dated May 5, 2000.
 - (6) Incorporated by reference to the registrant's quarterly report on Form 10-QSB for the quarterly period ended March 31, 2004.

- (7) Incorporated by reference to the registrant's annual meeting proxy statement dated April 10, 2004.
- (8) Incorporated by reference to the registrant's Annual Report on Form 10-KSB for the year ended December 31, 2005
- (9) Incorporated by reference to the registrant's quarterly report on Form 10-QSB for the quarterly period ended September 30, 2007.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ALASKA PACIFIC BANCSHARES, INC.

Date: March 30, 2011

/s/ Craig E. Dahl

Craig E. Dahl

President and Chief Executive Officer

(Duly Authorized Representative)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Craig E. Dahl

Craig E. Dahl

President and Chief Executive Officer

(Principal Executive Officer)

March 30, 2011

Date

/s/ Julie M. Pierce

Julie M. Pierce

Senior Vice President, Chief Financial Officer

(Principal Financial and Accounting Officer)

March 30, 2011

Date

/s/ William A. Corbus

William A. Corbus

Director

March 30, 2011

Date

/s/ BethAnn Chapman

BethAnn Chapman

Director

March 30, 2011

Date

/s/ Scott C. Milner

Scott C. Milner

Director

March 30, 2011

Date

/s/ William J. Schmitz

William J. Schmitz

Director

March 30, 2011

Date

/s/ Hugh N. Grant

Hugh N. Grant

Director

March 30, 2011

Date

/s/ Linda C. Thomas
Linda Thomas
Director

March 30, 2011
Date

/s/ Maxwell S. Rule
Maxwell S. Rule
Director

March 30, 2011
Date

/s/ Doug Andrew
Doug Andrew
Director

March 30, 2011
Date

Exhibit Index

| Exhibit No. | Description |
|-------------|---|
| 21 | Subsidiaries of the Registrant |
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Exhibit 21

Subsidiaries of the Registrant

Parent

Alaska Pacific Bancshares, Inc.

| <u>Subsidiaries (a)</u> | <u>Percentage of Ownership</u> | <u>Jurisdiction or State of Incorporation</u> |
|-------------------------|------------------------------------|---|
| Alaska Pacific Bank | 100% | United States |

- (a) The operation of the Company's wholly owned subsidiary is included in the Company's Consolidated Financial Statements contained in Item 8 of this report on Form 10-K.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Alaska Pacific Bancshares, Inc. and Subsidiary
Juneau, Alaska

We consent to the incorporation by reference in Registration Statements No. 333-58798 and 333-147444 on Form S-8 of Alaska Pacific Bancshares, Inc. of our report dated March 30, 2011, with respect to the consolidated balance sheets of Alaska Pacific Bancshares, Inc. and Subsidiary as of December 31, 2010 and 2009, and the related consolidated statements of operations, changes in shareholders' equity and comprehensive income (loss), and cash flows for the years then ended, which appear in the December 31, 2010, annual report on Form 10-K of Alaska Pacific Bancshares, Inc.

Moss Adams LLP

Spokane, Washington
March 30, 2011

Exhibit 31.1

Certification Required

By Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934

I, Craig E. Dahl, President and Chief Executive Officer, certify that:

1. I have reviewed this Annual Report on Form 10-K of Alaska Pacific Bancshares, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 30, 2011

/s/Craig E. Dahl
Craig E. Dahl
President and
Chief Executive Officer

Exhibit 31.2

Certification Required

By Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934

I, Julie M. Pierce, Senior Vice President and Chief Financial Officer, certify that:

1. I have reviewed this Annual Report on Form 10-K of Alaska Pacific Bancshares, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (e) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 30, 2011

/s/Julie M. Pierce
Julie M. Pierce
Senior Vice President and
Chief Financial Officer

Exhibit 32.1

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
OF ALASKA PACIFIC BANCSHARES, INC.
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned in his capacity as an officer of Alaska Pacific Bancshares, Inc. hereby certifies pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and in connection with the Company's Annual Report on Form 10-K, that:

- The report fully complies with the requirements of Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, and
- The information contained in the report fairly presents, in all material respects, the Company's financial condition and results of operations.

March 30, 2011

Date

/s/Craig E. Dahl

Craig E. Dahl

President and

Chief Executive Officer

Exhibit 32.2

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
OF ALASKA PACIFIC BANCSHARES, INC.
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

The undersigned in her capacity as an officer of Alaska Pacific Bancshares, Inc. hereby certifies pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and in connection with the Company's Annual Report on Form 10-K, that:

- The report fully complies with the requirements of Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, and
- The information contained in the report fairly presents, in all material respects, the Company's financial condition and results of operations.

March 30, 2011

Date

/s/ Julie M. Pierce

Julie M. Pierce
Senior Vice President and
Chief Financial Officer

**Appendix B-IFR Section 30.15-Certification for Years following First Fiscal Year
Alaska Pacific Bancshares, Inc. UST #644**

I, Craig E. Dahl, the President and Chief Executive Officer of Alaska Pacific Bancshares, Inc., (“Alaska Pacific”) certify, based on my knowledge, that:

(i) The compensation committee of Alaska Pacific has discussed, reviewed, and evaluated with senior risk officers at least every six months during any part of the most recently completed fiscal year that was a TARP period, senior executive officer (“SEO”) compensation plans and employee compensation plans and the risks these plans pose to Alaska Pacific;

(ii) The compensation committee of Alaska Pacific has identified and limited during any part of the most recently completed fiscal year that was a TARP period any features of the SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of Alaska Pacific and has identified any features of the employee compensation plans that pose risks to Alaska Pacific and has limited those features to ensure that Alaska Pacific is not unnecessarily exposed to risks;

(iii) The compensation committee has reviewed, at least every six months during any part of the most recently completed fiscal year that was a TARP period, the terms of each employee compensation plan and identified any features of the plan that could encourage the manipulation of reported earnings of Alaska Pacific to enhance the compensation of an employee, and has limited any such features;

(iv) The compensation committee of Alaska Pacific will certify to the reviews of the SEO compensation plans and employee compensation plans required under (i) and (iii) above;

(v) The compensation committee of Alaska Pacific will provide a narrative description of how it limited during any part of the most recently completed fiscal year that was a TARP period the features in:

(A) SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of Alaska Pacific;

(B) Employee compensation plans that unnecessarily expose Alaska Pacific to risks; and

(C) Employee compensation plans that could encourage the manipulation of reported earnings of Alaska Pacific to enhance the compensation of an employee;

(vi) Alaska Pacific has required that bonus payments to SEOs or any of the next twenty most highly compensated employees, as defined in the regulations and guidance established under section 111 of EESA (bonus payments), be subject to a recovery or “clawback” provision during any part of the most recently completed fiscal year that was a TARP period if the bonus payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria;

(vii) Alaska Pacific has prohibited any golden parachute payment, as defined in the regulations and guidance established under section 111 of EESA, to a SEO or any of the next five most highly compensated employees during any part of the most recently completed fiscal year that was a TARP period;

(viii) Alaska Pacific has limited bonus payments to its applicable employees in accordance with section 111 of EESA and the regulations and guidance established thereunder during any part of the most recently completed fiscal year that was a TARP period;

(ix) Alaska Pacific and its employees have complied with the excessive or luxury expenditures policy, as defined in the regulations and guidance established under section 111 of EESA during any part of the most recently completed fiscal year that was a TARP period; and any expenses that, pursuant to the policy, required approval of the board of directors, a committee of the board of directors, an SEO, or an executive officer with a similar level of responsibility were properly approved;

(x) Alaska Pacific will permit a non-binding shareholder resolution in compliance with any applicable federal securities rules and regulations on the disclosures provided under the federal securities laws related to SEO compensation paid or accrued during any part of the most recently completed fiscal year that was a TARP period;

(xi) Alaska Pacific will disclose the amount, nature, and justification for the offering, during any part of the most recently completed fiscal year that was a TARP period, of any perquisites, as defined in the regulations and guidance established under section 111 of EESA, whose total value exceeds \$25,000 for any employee who is subject to the bonus payment limitations identified in paragraph (viii);

(xii) Alaska Pacific will disclose whether Alaska Pacific, the board of directors of Alaska Pacific, or the compensation committee of Alaska Pacific has engaged during any part of the most recently completed fiscal year that was a TARP period a compensation consultant; and the services the compensation consultant or any affiliate of the compensation consultant provided during this period;

(xiii) Alaska Pacific has prohibited the payment of any gross-ups, as defined in the regulations and guidance established under section 111 of EESA, to the SEOs and the next twenty most highly compensated employees during any part of the most recently completed fiscal year that was a TARP period;

(xiv) Alaska Pacific has substantially complied with all other requirements related to employee compensation that are provided in the agreement between Alaska Pacific and Treasury, including any amendments;

(xv) Alaska Pacific has submitted to Treasury a complete and accurate list of the SEOs and the twenty next most highly compensated employees for the current fiscal year, with the non-SEO ranked in **descending** order of level of annual compensation, and with the name, title, and employer of each SEO and most highly compensated employee identified; and

(xvi) I understand that a knowing and willful false or fraudulent statement made in connection with this certification may be punished by fine, imprisonment, or both (See, for example, 18 USC 1001).

Date: March 24, 2011

By: /s/Craig E. Dahl
Craig E. Dahl
Principal Executive Officer

**Appendix B-IFR Section 30.15-Certification for Years following First Fiscal Year
Alaska Pacific Bancshares, Inc. UST #644**

I, Julie M. Pierce, the Senior Vice President and Chief Financial Officer of Alaska Pacific Bancshares, Inc. (“Alaska Pacific”), certify, based on my knowledge, that:

(i) The compensation committee of Alaska Pacific has discussed, reviewed, and evaluated with senior risk officers at least every six months during any part of the most recently completed fiscal year that was a TARP period, senior executive officer (“SEO”) compensation plans and employee compensation plans and the risks these plans pose to Alaska Pacific;

(ii) The compensation committee of Alaska Pacific has identified and limited during any part of the most recently completed fiscal year that was a TARP period any features of the SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of Alaska Pacific and has identified any features of the employee compensation plans that pose risks to Alaska Pacific and has limited those features to ensure that Alaska Pacific is not unnecessarily exposed to risks;

(iii) The compensation committee has reviewed, at least every six months during any part of the most recently completed fiscal year that was a TARP period, the terms of each employee compensation plan and identified any features of the plan that could encourage the manipulation of reported earnings of Alaska Pacific to enhance the compensation of an employee, and has limited any such features;

(iv) The compensation committee of Alaska Pacific will certify to the reviews of the SEO compensation plans and employee compensation plans required under (i) and (iii) above;

(v) The compensation committee of Alaska Pacific will provide a narrative description of how it limited during any part of the most recently completed fiscal year that was a TARP period the features in:

(A) SEO compensation plans that could lead SEOs to take unnecessary and excessive risks that could threaten the value of Alaska Pacific;

(B) Employee compensation plans that unnecessarily expose Alaska Pacific to risks; and

(C) Employee compensation plans that could encourage the manipulation of reported earnings of Alaska Pacific to enhance the compensation of an employee;

(vi) Alaska Pacific has required that bonus payments to SEOs or any of the next twenty most highly compensated employees, as defined in the regulations and guidance established under section 111 of EESA (bonus payments), be subject to a recovery or “clawback” provision during any part of the most recently completed fiscal year that was a TARP period if the bonus payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria;

(vii) Alaska Pacific has prohibited any golden parachute payment, as defined in the regulations and guidance established under section 111 of EESA, to a SEO or any of the next five most highly compensated employees during any part of the most recently completed fiscal year that was a TARP period;

(viii) Alaska Pacific has limited bonus payments to its applicable employees in accordance with section 111 of EESA and the regulations and guidance established thereunder during any part of the most recently completed fiscal year that was a TARP period;

(ix) Alaska Pacific and its employees have complied with the excessive or luxury expenditures policy, as defined in the regulations and guidance established under section 111 of EESA during any part of the most recently completed fiscal year that was a TARP period; and any expenses that, pursuant to the policy, required approval of the board of directors, a committee of the board of directors, an SEO, or an executive officer with a similar level of responsibility were properly approved;

(x) Alaska Pacific will permit a non-binding shareholder resolution in compliance with any applicable federal securities rules and regulations on the disclosures provided under the federal securities laws related to SEO compensation paid or accrued during any part of the most recently completed fiscal year that was a TARP period;

(xi) Alaska Pacific will disclose the amount, nature, and justification for the offering, during any part of the most recently completed fiscal year that was a TARP period, of any perquisites, as defined in the regulations and guidance established under section 111 of EESA, whose total value exceeds \$25,000 for any employee who is subject to the bonus payment limitations identified in paragraph (viii);

(xii) Alaska Pacific will disclose whether Alaska Pacific, the board of directors of Alaska Pacific, or the compensation committee of Alaska Pacific has engaged during any part of the most recently completed fiscal year that was a TARP period a compensation consultant; and the services the compensation consultant or any affiliate of the compensation consultant provided during this period;

(xiii) Alaska Pacific has prohibited the payment of any gross-ups, as defined in the regulations and guidance established under section 111 of EESA, to the SEOs and the next twenty most highly compensated employees during any part of the most recently completed fiscal year that was a TARP period;

(xiv) Alaska Pacific has substantially complied with all other requirements related to employee compensation that are provided in the agreement between Alaska Pacific and Treasury, including any amendments;

(xv) Alaska Pacific has submitted to Treasury a complete and accurate list of the SEOs and the twenty next most highly compensated employees for the current fiscal year, with the non-SEO ranked in **descending** order of level of annual compensation, and with the name, title, and employer of each SEO and most highly compensated employee identified; and

(xvi) I understand that a knowing and willful false or fraudulent statement made in connection with this certification may be punished by fine, imprisonment, or both (See, for example, 18 USC 1001).

Date: March 24, 2011

By: /s/ Julie M. Pierce
Julie M. Pierce
Principal Financial Officer