Ottawa Savings Bancorp, Inc.
Form 10KSB
March 29, 2007
Table of Contents

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-KSB

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

For the fiscal year ended December 31, 2006

or

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

For transition period from to

Commission File Number 0-51367

# OTTAWA SAVINGS BANCORP, INC.

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

| | |
|---|---|
| **United States** | **20-3074627** |
| **(State or Other Jurisdiction of Incorporation)** | **(I.R.S. Employer Identification No.)** |
| **925 LaSalle Street, Ottawa, Illinois** | **61350** |
| **(Address of Principal Executive Offices)** | **(Zip Code)** |

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

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

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

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

**(Title of Class)**

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 x No ¨.

Check if there is no disclosure of delinquent filers pursuant to Item 405 of Regulation S-B contained in this form, and no disclosure will 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-KSB or any amendment to this Form 10-KSB. x

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

The Registrant s revenues for its most recent fiscal year were $10,604,035.

As of March 14, 2007, the aggregate market value of the voting common equity held by non-affiliates of the registrant was approximately $11,231,826 (based on the last sale price of the common stock on the OTC Bulletin Board of $13.25 per share).

The number of shares of Common Stock of the registrant issued and outstanding as of March 14, 2007 was 2,224,911.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant s definitive proxy statement for its 2007 Annual Meeting of Stockholders to be filled with the Securities and Exchange Commission pursuant to SEC Regulation 14A are incorporated by reference into Part III, Items 9-12 and Item 14.

Transitional Small Business Disclosure Format (Check one): Yes ¨ No x.

Table of Contents

**OTTAWA SAVINGS BANCORP, INC.**

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

**December 31, 2006**

**TABLE OF CONTENTS**


| | | Page |
|---|---|---|
| **PART I** | | |
| Item 1. | Description of Business | 1 |
| Item 2. | Description of Property | 29 |
| Item 3. | Legal Proceedings | 29 |
| Item 4. | Submission of Matters to a Vote of Security Holders | 29 |
| **PART II** | | |
| Item 5. | Market for Common Equity and Related Stockholder Matters | 30 |
| Item 6. | Management s Discussion and Analysis of Results of Operations and Financial Condition | 31 |
| Item 7. | Financial Statements | 42 |
| Item 8. | Changes in and Disagreements with Accountants on Accounting and Financial Disclosure | 42 |
| Item 8A. | Controls and Procedures | 42 |
| Item 8B. | Other Information | 42 |
| **PART III** | | |
| Item 9. | Directors, Executive Officers, Promoters, Control Persons and Corporate Governance: Compliance with Section 16(a) of the Exchange Act | 43 |
| Item 10. | Executive Compensation | 43 |
| Item 11. | Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters | 43 |
| Item 12. | Certain Relationships and Related Transactions, and Director Independence | 43 |
| Item 13. | Exhibits | 43 |
| Item 14. | Principal Accountant Fees and Services | 44 |
| **INDEX TO FINANCIAL STATEMENTS** | | F-1 |
| **SIGNATURES** | | S-1 |
| **EXHIBIT INDEX** | | |

Table of Contents

## PART I

**Forward-Looking Statements**

*This report includes forward-looking statements, including statements regarding our strategy, effectiveness of investment programs, evaluations of future interest rate trends and liquidity, expectations as to growth in assets, deposits and results of operations, future operations, market position, financial position, and prospects, plans and objectives of management. These forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, can generally be identified by use of the words believe, expect, intend, anticipate, estimate, project, or similar expressions. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain and actual results may differ materially from those predicted in such forward-looking statements. Factors that could have a material adverse effect on the operations and future prospects of the Company and the Bank include, but are not limited to, changes in: interest rates; the economic health of the local real estate market; general economic conditions; legislative/regulatory provisions; monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board; the quality or composition of the loan and securities portfolios; demand for loan products; deposit flows; competition; demand for financial services in the Company s market area; and accounting principles, policies, and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements, and undue reliance should not be placed on such statements.*

## ITEM 1. DESCRIPTION OF BUSINESS

***Risk Factors***

**Rising interest rates may hurt our profits.**

While in recent years interest rates have been at or near historically low levels. However, since June 30, 2004, the U.S. Federal Reserve has increased its target for the federal funds rate seventeen times, from 1.00% to 5.25%. While these short-term market interest rates (which we use as a guide to price our deposits) have increased, longer-term market interest rates (which we use as a guide to price our longer-term loans) have not. This flattening of the market yield curve has resulted in our net interest margin declining from 2.69% for 2004 to 2.45% for 2006. Our interest rate spread (the difference between the average yield earned on our interest-earning assets and the average rate paid on our interest-bearing liabilities) was 2.26% for the year ended December 31, 2006 compared to 2.44% for the year ended December 31, 2005. Our net interest margin (net interest income as a percentage of average interest-earning assets) was 2.45% for the year ended December 31, 2006 compared to 2.52% for the year ended December 31, 2005. If short-term interest rates continue to rise, and if rates on our deposits and borrowings continue to reprice upwards faster than the rates on our long-term loans and investments, we would experience further compression of our interest rate spread and net interest margin, which would have a negative effect on our profitability.

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

We face intense competition both in making loans and attracting deposits. This competition has made it more difficult for us to make new loans and at times has forced us to offer higher deposit rates. Price competition for loans and deposits might result in us earning less on our loans and paying more on our deposits, which reduces net interest income. According to data obtained from the Federal Deposit Insurance Corporation ( FDIC ), as of June 30, 2006, we held approximately 26.44% of all bank and thrift deposits in Ottawa, Illinois, which was the second largest market share of deposits out of six financial institutions (excluding credit unions) in city of Ottawa. Notwithstanding our market share, we face substantial competition from the other financial institutions that operate in our market area, most of which have substantially greater resources and lending limits than we have and may offer services that we do not provide. We expect competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Our profitability depends upon our continued ability to compete successfully in our market area.

Table of Contents

**Our origination or purchase of commercial real estate, multifamily or construction loans may expose us to increased lending risks.**

Our loan portfolio includes commercial real estate, multifamily and construction loans. We intend to continue to emphasize these types of lending. These types of loans generally expose a lender to greater risk of non-payment and loss than one- to four-family residential mortgage loans because repayment of the loans often depends on the successful operation of the property and the income stream of the borrowers. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one- to four-family residential mortgage loans. Also, many of these types of borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan.

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

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

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

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

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

As of December 31, 2006, most of our total loans were to individuals and/or secured by properties located in our primary market area of LaSalle County in Illinois. As a result, our revenues and profitability are subject to prevailing economic, regulatory, demographic and other conditions in LaSalle County. Because our business is concentrated in this area, adverse economic, regulatory, demographic or other developments that are limited to this area may have a disproportionately greater effect on us than they would have if we did business in markets outside that particular geographic area.

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

With most of our loans concentrated in LaSalle County, Illinois, a decline in local economic conditions could adversely affect the value of the real estate collateral securing our loans. A decline in property values would diminish our ability to recover on defaulted loans by selling the real estate collateral, making it more likely that we would suffer losses on defaulted loans. Additionally, a decrease in asset quality could require additions to our allowance for loan losses through increased provisions for loan losses, which would hurt our profits. Also, a decline in local economic conditions may have a greater effect on our earnings and capital than

Table of Contents

on the earnings and capital of larger financial institutions whose real estate loan portfolios are more geographically diverse. Real estate values are affected by various factors in addition to local economic conditions, including, among other things, changes in general or regional economic conditions, governmental rules or policies and natural disasters.

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

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

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

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

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

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

We are subject to extensive regulation, supervision and examination by the OTS, our chartering authority, the FDIC, as insurer of our deposits and Ottawa Savings Bancorp MHC, Ottawa Savings Bancorp, Inc. and Ottawa Savings Bank are all subject to regulation and supervision by the OTS. Such regulation and supervision governs the activities in which an institution and its holding company may engage, and are intended primarily for the protection of the insurance fund and depositors. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on our operations, the classification of our assets and determination of the level of

our allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on our operations.

Table of Contents

**General**

Ottawa Savings Bancorp, Inc. (the Company ) was incorporated under the laws of the United States on July 11, 2005, for the purpose of serving as the holding company of Ottawa Savings Bank (the Bank ), as part of the Bank s conversion from a mutual to a stock form of organization.

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

**Business Strategy**

The Company s business strategy is to operate as a well-capitalized and profitable community savings bank dedicated to providing quality customer service and innovative new products. In addition, Ottawa Savings Bank completed its building expansion in May 2005, adding two drive-up lanes, a separate ATM drive-up, and an additional 7,800 square feet of office space which enhances our ability to provide quality customer service and increases our presence in the community.

Highlights of our business strategy are as follows:

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

**Market Area and Competition**

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

The Bank faces significant competition for the attraction of deposits and origination of loans. Our most direct competition for deposits and loans has historically come from the several financial institutions operating in our market area and, to a lesser extent, from other financial service companies, such as brokerage firms, credit unions, mortgage companies and mortgage brokers. Our main competitors include a number of significant independent banks. In addition the Bank faces competition for investors funds from money market funds and other corporate and government securities. Competition for loans also comes from the increasing number of non-depository financial service companies entering the mortgage and consumer credit market, such as securities companies and specialty finance companies.

**Lending Activities**

*General*. Our loan portfolio consists primarily of one- to four-family residential mortgage loans. To a lesser extent, our loan portfolio includes multi-family and commercial real estate, construction and consumer loans.

Table of Contents

Substantially all of our loans are made within LaSalle County. Information for the fiscal year ended 2002 could not be prepared without unwarranted burden or expense.

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

| | At December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | | 2005 | | 2004 | | 2003 | |
| | Amount | Percent Of Total | Amount | Percent Of Total | Amount | Percent Of Total | Amount | Percent Of Total |
| | (Dollars in Thousands) | | | | | | | |
| One-to four-family | $ 87,469 | 59.56% | $ 75,846 | 58.21% | $ 66,513 | 55.43% | $ 66,734 | 58.70% |
| Multi-family | 8,063 | 5.49% | 11,836 | 9.09% | 14,195 | 11.83% | 12,479 | 10.98% |
| Lines of credit | 8,596 | 5.85% | 9,774 | 7.50% | 9,047 | 7.54% | 8,468 | 7.45% |
| Non-residential real estate | 22,072 | 15.03% | 11,945 | 9.17% | 8,456 | 7.05% | 8,089 | 7.11% |
| Commercial | 888 | 0.60% | | | | | | |
| Construction | 7,767 | 5.29% | 11,827 | 9.08% | 13,411 | 11.18% | 9,112 | 8.01% |
| Consumer | 12,012 | 8.18% | 9,052 | 6.95% | 8,357 | 6.97% | 8,813 | 7.75% |
| Total loans, gross | 146,867 | 100.00% | 130,280 | 100.00% | $ 119,979 | 100.00% | $ 113,695 | 100.00% |
| Undisbursed portion of construction loan funds | (3,895) | | (5,008) | | (4,888) | | (3,936) | |
| Allowance for loan losses | (420) | | (391) | | (439) | | (383) | |
| Deferred loan costs (fees), net | (15) | | 58 | | 174 | | 191 | |
| Total loans, net | $ 142,537 | | $ 124,939 | | $ 114,826 | | $ 109,567 | |

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

| | At December 31, | | | |
|---|---|---|---|---|
| | 2006 | 2005 | 2004 | 2003 |
| | (In Thousands) | | | |
| One-to four-family | $ 766 | $ 979 | $ 379 | $ 1,592 |
| Multifamily | 6,375 | 9,132 | 12,185 | 12,129 |
| Lines of Credit | | | 158 | 500 |
| Non-residential real estate | 11,440 | 5,296 | 4,641 | 5,078 |
| Consumer | 10,156 | 7,742 | 7,377 | 7,904 |
| Total | $ 28,737 | $ 23,149 | $ 24,740 | $ 27,203 |

Table of Contents

*Maturity of Loan Portfolio*. The following tables show the remaining contractual maturity of our loans at December 31, 2006. The tables do not include the effect of possible prepayments or due on sale clause payments.

| | At December 31, 2006 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | One-to-four family | Multifamily | Lines of credit | Non-residential real estate | Commercial | Construction | Consumer | Total |
| | (In Thousands) | | | | | | | |
| Amounts due one year or less | $ 43 | $ | $ 124 | $ 5,841 | $ 18 | $ 7,767 | $ 281 | $ 14,074 |
| After one year | | | | | | | | |
| More than one year to three years | 234 | 3,321 | 31 | 4,094 | | | 2,599 | 10,279 |
| More than three years to five years | 315 | | 69 | 2,337 | 106 | | 6,675 | 9,502 |
| More than five years to ten years | 5,925 | 2,879 | 1,878 | 1,103 | 764 | | 2,457 | 15,006 |
| More than ten years to twenty years | 32,509 | 819 | 6,400 | 3,241 | | | | 42,969 |
| More than twenty years | 48,443 | 1,044 | 94 | 5,456 | | | | 55,037 |
| Total due after December 31, 2007 | 87,426 | 8,063 | 8,472 | 16,231 | 870 | | 11,731 | 132,793 |
| Gross Loans Receivable | $ 87,469 | $ 8,063 | $ 8,596 | $ 22,072 | $ 888 | $ 7,767 | $ 12,012 | $ 146,867 |
| Less: | | | | | | | | |
| Loans in process | | | | | | | | (3,895) |
| Allowance for loan losses | | | | | | | | (420) |
| Plus: Deferred loan costs (fees) | | | | | | | | (15) |
| Total loans, net | | | | | | | | $ 142,537 |

| | Due After December 31, 2007 | | |
|---|---|---|---|
| | Fixed | Adjustable | Total |
| | (In Thousands) | | |
| One-to-four family | $ 39,420 | $ 48,006 | $ 87,426 |
| Multifamily | 2,409 | 5,654 | 8,063 |
| Lines of credit | 41 | 8,431 | 8,472 |
| Non-residential real estate | 8,190 | 8,041 | 16,231 |
| Commercial | 870 | | 870 |
| Consumer | 11,731 | | 11,731 |
| Total | $ 62,661 | $ 70,132 | $ 132,793 |

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

**Table of Contents**

We offer fixed rate loans with terms of either 15, 20 or up to 30 years. We traditionally sell 30-year fixed rate loans into the secondary market, resulting in a fixed rate loan portfolio primarily composed of loans with less than 15 to 20 year terms. Our adjustable-rate mortgage loans are based on either a 15, 20 or up to 30 year amortization schedule and interest rates and payments on our adjustable-rate mortgage loans adjust every one, three or five years. Interest rates and payments on our adjustable-rate loans generally are adjusted to a rate that is based on the National Monthly Median cost of funds ratio for all Deposit Insurance Fund ( DIF )-insured institutions. The maximum amount by which the interest rate may be increased or decreased is generally 1% to 2% per adjustment period, depending on the type of loan, and the lifetime interest rate ceiling is generally 5% over the initial interest rate of the loan. The initial and floor rates for owner occupied properties are 6.25%, 6.50% and 6.75% for the 1, 3 and 5 year adjustable rate loans, respectively, and 7.25%, 7.50% and 7.75% for non-owner occupied one-to-four family properties, respectively, at this time. Initial and floor rates on multi-family and commercial properties are generally at prime, currently 8.25%.

Due to historically low interest rate levels, borrowers generally have preferred fixed-rate loans in recent years. While we anticipate that our adjustable-rate loans will better offset the adverse effects on our net interest income of an increase in interest rates as compared to fixed-rate mortgages, the increased mortgage payments required of adjustable-rate loans in a rising interest rate environment could cause an increase in delinquencies and defaults. The marketability of the underlying property also may be adversely affected in a high interest rate environment. In addition, although adjustable-rate mortgage loans help make our asset base more responsive to changes in interest rates, the extent of this interest rate sensitivity is limited by the annual and lifetime interest rate adjustment limits.

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

We generally do not make conventional loans with loan-to-value ratios exceeding 90%. Loans with loan-to-value ratios in excess of 85% generally require private mortgage insurance or additional collateral. We require all properties securing mortgage loans to be appraised by an independent appraiser approved by our Board of Directors and licensed by the State of Illinois. We require title insurance on all first mortgage loans. Borrowers must obtain hazard insurance, or flood insurance for loans on property located in a flood zone, before closing the loan.

We participate with the USDA Rural Development Company to offer loans to qualifying customers. Loans are granted up to 100% of appraised value and the USDA guarantees up to 90% of the loan. These loans require no down payment but are subject to maximum income limitations.

*Lines of Credit*. We offer lines of credit, principally home equity lines of credit, which have adjustable rates of interest that are indexed to the prime rate as published in The Wall Street Journal for terms of up to 15 years. These loans are originated with maximum loan-to-value ratios of 85% of the appraised value of the property, and we require that we have a second lien position on the property. We also offer secured and unsecured lines of credit for well-qualified individuals and small businesses.

*Purchased Loan Participations*. Presently Ottawa Savings Bank may purchase loan participations from other institutions, inside or outside of our primary market area when the underwriting and credit quality is at least equal to those loans made directly by us. The originating lead lender is responsible for monitoring the credit and regularly provides Ottawa Savings Bank with current credit reviews, including updated financial statements. A review of all documents to support the participation is conducted prior to the approval and funding by Ottawa Savings Bank. We protect our position in the loan agreement by any means legally available. We only purchase loan participations from companies that are fully regulated by a banking agency, including, but not limited to, the

**Table of Contents**

Office of Thrift Supervision or the Illinois Department of Financial and Professional Regulation Division of Banking (IDFPR). Our overall exposure to any one originating financial institution or any one individual at any time is limited to 50% and 15%, respectively, of our capital as of the previous quarter-end.

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

We originate and purchase multi-family and non-residential real estate loans with terms generally up to 25 years. Interest rates and payments on adjustable-rate loans adjust every one, three or five years. Interest rates and payments on our adjustable rate loans generally are adjusted to a rate typically equal to the interest rate used for one-to-four family loan products, plus 50 basis points to 100 basis points based on credit-worthiness and risk. The adjustment per period is 1% to 2% based on the loan contract, to a lifetime cap of 5%. Loan amounts generally do not exceed 85% of the appraised value for well-qualified borrowers.

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

*Construction and Land Development Loans*. We originate loans to individuals and purchase loans that finance the construction of residential dwellings for personal use and land development loans for personal or commercial use. Our construction loans generally provide for the payment of interest only during the construction phase, which is usually ten months. At the end of the construction phase, most of our loans automatically convert to permanent mortgage loans. Construction loans generally can be made with a maximum loan to value ratio of 85% of the appraised value with maximum terms of 30 years. Land development loans generally can be made with maximum loan to value ratio of 80% and maximum term up to 10 years. The largest outstanding residential construction loan at December 31, 2006 was $520,000, $63,000 of which was disbursed. The largest outstanding land development loan at December 31, 2006 was $1.5 million, of which $651,000 was disbursed. These loans were performing according to their terms at December 31, 2006. We also make commercial construction loans for commercial development projects including condominiums, apartment buildings, single-family subdivisions, single-family speculation loans, as well as owner-occupied properties used for business. These loans provide for payment of interest only during the construction phase and may, in the case of an apartment or commercial building, convert to a permanent mortgage loan. In the case of a single family subdivision or construction or builder loan, as individual lots are sold, the principal balance is reduced by a minimum of 80% of the net lot sales price. In the case of a commercial construction loan, the construction period may be from nine months to two years. Loans are generally made to a maximum of 80% of the appraised value as determined by an appraisal of the property made by an independent licensed appraiser. We also require periodic inspections of the property during the term of the construction loan for both residential and commercial construction loans. The largest outstanding commercial construction loan at December 31, 2006 was $320,000, of which no funds have been disbursed. This loan was performing according to its terms at December 31, 2006.

Construction financing is generally considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate. Risk of a loss on a construction loan depends largely upon the accuracy of the initial estimate of the property s value at completion of construction or development and the

**Table of Contents**

estimated cost (including interest) of construction. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, we may be required to advance funds beyond the amount originally committed to permit completion of the development. If the estimate of value proves to be inaccurate, we may be confronted, at or before the maturity of the loan, with a project having a value which is insufficient to assure full repayment. As a result of the foregoing, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of the borrower or guarantor to repay principal and interest. If we are forced to foreclose on a project before or at completion due to a default, there can be no assurance that we will be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

We originate and purchase land loans to individuals on approved residential building lots for personal use for terms of up to 15 years and to a maximum loan to value ratio of 80% of the appraisal value. Our land loans are adjustable loans with adjustments occurring every 1, 3 or 5 years, based on the original contract. Interest rate adjustments are based on the National Monthly Median cost of funds.

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

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

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

*Auto Loan Participations*. Ottawa Savings Bank purchases auto loan participations from regulated financial institutions. At December 31, 2006, and 2005, we had $10.1 million, and $7.7 million of loans outstanding, respectively. These types of loans are primarily low balance individual auto loans. We have the opportunity to review the loans at least three days prior to our purchase and we have a right to refuse any specific loan within thirty days of the sale of any given loan pool.

*Loan Origination, Purchases and Sales*. Loan originations come from a number of sources. The primary source of loan originations are our in-house loan originators, and to a lesser extent, advertising and referrals from customers. We occasionally purchase loans or participation interests in loans. As of December 31, 2006, we had an aggregate of $28.7 million in loan participations outstanding, including the auto loans purchased as discussed in the previous paragraph. The largest outstanding loan participation as of December 31, 2006 was $2.0 million, of which the entire amount was disbursed.

Historically, we have originated and purchased loans for investment purposes only. However, as the low interest rate environment continued, we determined to consider loan sales as part of our interest rate risk management efforts. Beginning in 2003, we began selling some of the longer-term fixed-rate loans that we originate. We sell these loans in the secondary market based on prevailing market interest rate conditions, an analysis of the composition and risk of the loan portfolio, liquidity needs and interest rate risk management goals.

**Table of Contents**

Generally, loans are sold without recourse and with servicing retained. We sold $1.7 million, and $1.8 million of loans in the years ended December 31, 2006, and 2005, respectively. We occasionally sell participation interests in loans and may sell loan participations in the future.

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

| | For The Years Ended December 31, | | | |
|---|---|---|---|---|
| | **2006** | **2005** | **2004** | **2003** |
| | (In Thousands) | | | |
| Beginning balance, net | $ 124,939 | $ 114,826 | $ 109,567 | $ 99,840 |
| Loans originated | | | | |
| One-to-four family | 21,908 | 22,299 | 14,678 | 20,188 |
| Multifamily | | 450 | 160 | 1,147 |
| Lines of credit | 1,571 | 5,898 | 4,858 | 249 |
| Non-residential real estate | 3,682 | 1,717 | 3,653 | 635 |
| Commercial | 50 | | | |
| Construction | 6,979 | 6,351 | 10,574 | 8,495 |
| Consumer | 1,651 | 1,168 | 735 | 835 |
| Total loans originated | 35,841 | 37,883 | 34,658 | 31,549 |
| Loans purchased | | | | |
| One- to four-family | | 731 | 1,133 | 1,357 |
| Multifamily | 2,737 | 4,879 | 6,980 | 7,677 |
| Lines of credit | | | | 500 |
| Non-residential real estate | 7,712 | 3,434 | 4,374 | 3,318 |
| Commercial | 928 | | | |
| Consumer | 6,194 | 4,183 | 2,698 | 6,480 |
| Total loans purchased | 17,571 | 13,227 | 15,185 | 19,332 |
| Loan sales(1) | (1,735) | (1,809) | (5,681) | (12,334) |
| Principal payments | (35,148) | (39,000) | (37,878) | (26,621) |
| Change in allowance for loan losses | 29 | 48 | (56) | (135) |
| Change in undisbursed loan funds | 1,113 | (120) | (952) | (2,019) |
| Change in deferred loan costs (fees) | (73) | (116) | (17) | (45) |
| Ending balance, net | $ 142,537 | $ 124,939 | $ 114,826 | $ 109,567 |

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

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

For one-to-four family loans and owner occupied residential loans, our President may approve loans up to $400,000 and two members of our Board of Directors must approve loans over $400,000. Secured commercial loans and commercial construction loans require the approval of a majority of the members of the Board. Our loan officers have been delegated authority to approve consumer loans up to specified limits which vary according to the product.

*Loans to One Borrower*. The maximum amount that we may lend to one borrower and the borrower s related entities is limited by regulations to generally 15% of our stated capital and reserves. At December 31, 2006, our regulatory limit on loans to one borrower was $2.7 million. At that date, our largest lending relationship was $2.0 million and included residential mortgage, home equity lines of credit and construction loans, all of which were performing according to the original repayment terms at December 31, 2006.

Table of Contents

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

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

Management informs the Board of Directors on a monthly basis of the amount of loans delinquent more than 60 days, all loans in foreclosure and all foreclosed and repossessed property that we own. All loans in excess of 90 days past due, with the exception of lines of credit are placed on non-accrual.

**Delinquent Loans**

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

| | December 31, 2006 | | | | | |
|---|---|---|---|---|---|---|
| | 60-89 Days | | 90 Days of More | | Total | |
| | Number of Loans | Principal Balance | Number of Loans | Principal Balance | Number of Loans | Principal Balance |
| | (Dollars in Thousands) | | | | | |
| One-to-four family | 10 | $ 790 | 8 | $ 957 | 18 | $ 1,747 |
| Lines of credit | 2 | 19 | 1 | 45 | 3 | 64 |
| Non-residential real estate | 1 | 133 | 2 | 105 | 3 | 238 |
| Construction | 1 | 80 | | | 1 | 80 |
| Consumer | 2 | 42 | 3 | 8 | 5 | 50 |
| Total | 16 | $ 1,064 | 14 | $ 1,115 | 30 | $ 2,179 |

| | December 31, 2005 | | | | | |
|---|---|---|---|---|---|---|
| | 60-89 Days | | 90 Days of More | | Total | |
| | Number of Loans | Principal Balance | Number of Loans | Principal Balance | Number of Loans | Principal Balance |
| | (Dollars in Thousands) | | | | | |
| One-to-four family | 12 | $ 644 | 12 | $ 944 | 24 | $ 1,588 |
| Lines of credit | | | 5 | 97 | 5 | 97 |
| Non-residential real estate | 2 | 289 | 2 | 179 | 4 | 468 |
| Construction | | | 3 | 401 | 3 | 401 |
| Consumer | 6 | 72 | 9 | 83 | 15 | 155 |
| Total | 20 | $ 1,005 | 31 | $ 1,704 | 51 | $ 2,709 |

Table of Contents

| | December 31, 2004 | | | | | |
|---|---|---|---|---|---|---|
| | 60-89 Days | | 90 Days of More | | Total | |
| | Number of Loans | Principal Balance | Number of Loans | Principal Balance | Number of Loans | Principal Balance |
| | (Dollars in Thousands) | | | | | |
| One-to-four family | 7 | $ 394 | 7 | $ 547 | 14 | $ 941 |
| Multifamily | | | | | | |
| Lines of credit | 3 | 67 | 2 | 35 | 5 | 102 |
| Non-residential real estate | | | | | | |
| Construction | | | | | | |
| Consumer | 4 | 28 | 5 | 42 | 9 | 70 |
| Total | 14 | $ 489 | 14 | $ 624 | 28 | $ 1,113 |

| | December 31, 2003 | | | | | |
|---|---|---|---|---|---|---|
| | 60-89 Days | | 90 Days of More | | Total | |
| | Number of Loans | Principal Balance | Number of Loans | Principal Balance | Number of Loans | Principal Balance |
| | (Dollars in Thousands) | | | | | |
| One-to-four family | 5 | $ 416 | 6 | $ 451 | 11 | $ 867 |
| Multifamily | | | | | | |
| Lines of credit | 1 | 1 | 3 | 44 | 4 | 48 |
| Non-residential real estate | | | | | | |
| Construction | | | | | | |
| Consumer | 2 | 31 | 6 | 16 | 8 | 47 |
| Total | 8 | $ 448 | 15 | $ 511 | 23 | $ 962 |

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

An insured institution is required to establish general allowances for loan losses in an amount deemed prudent by management for loans classified substandard or doubtful, as well as for other problem loans. General allowances represent loss allowances which have been established to recognize the inherent losses associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies problem assets as loss, it is required either to establish a specific allowance for losses equal to 100% of the amount of the asset so classified or to charge off such amount. An institution s determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the Office of Thrift Supervision.

On the basis of management s review of its assets, at December 31, 2006, and 2005 we had classified $928,000 and $1,061,000, respectively, of our assets as special mention and $1,302,000 and $178,000,

Table of Contents

respectively, of our assets as substandard. We had classified $2,000 and none of our assets as doubtful at December 31, 2006 and 2005, respectively. There were no assets classified as loss for the years ended December 31, 2006 or 2005. The increase in assets classified as substandard was primarily due to changes in the Company s classified asset policy. The loan portfolio is reviewed on a regular basis to determine whether any loans require classification in accordance with applicable regulations. Not all classified assets constitute non-performing assets.

We have no other loans of concern other than as set forth in the table below:

**Nonperforming Assets**

| | December 31, | | | |
|---|---|---|---|---|
| | 2006 | 2005 | 2004 | 2003 |
| | (In Thousands) | | | |
| Non-accrual: | | | | |
| One-to-four family | $ 957 | $ 944 | $ 547 | $ 451 |
| Non-residential real estate | 105 | 179 | | |
| Construction | | 401 | | |
| Consumer | 8 | 83 | 42 | 16 |
| Total non-accrual loans | 1,070 | 1,607 | 589 | 467 |
| Past due greater than 90 days and still accruing: | | | | |
| Lines of credit | 45 | 97 | 35 | 44 |
| Total nonperforming loans | 1,115 | 1,704 | 624 | 511 |
| Foreclosed real estate | | | 210 | |
| Total nonperforming assets | $ 1,115 | $ 1,704 | $ 834 | $ 511 |

**Ratios**

| | December 31, | | | |
|---|---|---|---|---|
| | 2006 | 2005 | 2004 | 2003 |
| Allowance for loan losses as a percent of gross loans receivable | 0.29% | 0.30% | 0.37% | 0.34% |
| Allowance for loan losses as a percent of total nonperforming loans | 37.67% | 22.95% | 70.35% | 74.95% |
| Nonperforming loans as a percent of gross loans receivable | 0.76% | 1.31% | 0.52% | 0.45% |
| Nonperforming loans as a percent of total assets | 0.54% | 0.92% | 0.37% | 0.33% |

The total amount of non-accrual loans decreased to $1.1 million from $1.6 million for the years ended December 31, 2006 and 2005, respectively. The decrease is primarily due to having no non-performing construction loans at December 31, 2006, compared to three non-performing construction loans in the amount of $401,000 at December 31, 2005. The decrease in nonperforming consumer loans is primarily the result of decreases in purchased auto loans. For the years ended December 31, 2006, and 2005, gross interest income of $19,000 and $37,000, respectively, would have been recorded had the non-accrual loans at the end of the period been on accrual status throughout the period. No interest income was recognized on these loans.

**Allowance for Loan Losses**

Our allowance for loan losses is maintained at a level necessary to absorb loan losses which are both probable and reasonably estimable. Management, in determining the allowance for loan losses, considers the losses inherent in its loan portfolio and changes in the nature and volume of loan activities, along with the general economic and real estate market conditions. We utilize a two-tier approach: (1) identification of impaired loans and establishment of specific loss allowances on such loans; and (2) establishment of general valuation

13

**Table of Contents**

allowances on the remainder of our loan portfolio. We maintain a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. Specific loan loss allowances are established for identified losses based on a review of such information. A loan evaluated for impairment is considered to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. We do not aggregate such loans for evaluation purposes. Loan impairment is measured based on the present value of expected future cash flows discounted at the loan s effective interest rate or, as a practical expedient, at the loan s observable market price or the fair value of the collateral if the loan is collateral dependent. General loan loss allowances are based upon a combination of factors including, but not limited to management s judgment and losses which are probable and reasonably estimable. The allowance is increased through provisions charged against current earnings and recoveries of previously charged-off loans. Loans which are determined to be uncollectible are charged against the allowance. While management uses available information to recognize probable and reasonably estimable loan losses, future loss provisions may be necessary based on changing economic conditions. Payments received on impaired loans are applied first to accrued interest receivable and then to principal. The allowance for loan losses as of December 31, 2006 is maintained at a level that represents management s best estimate of losses inherent in the loan portfolio, and such losses were both probable and reasonably estimable.

In addition, the Office of Thrift Supervision, as an integral part of its examination process, periodically reviews our allowance for loan losses.

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

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2006 | 2005 | 2004 | 2003 |
| | (Dollars in Thousands) | | | |
| Balance at beginning of year | $ 391 | $ 439 | $ 383 | $ 248 |
| Chargeoffs: | | | | |
| One-to-four family | 1 | 1 | 1,876 | 1,188 |
| Multifamily | | | 3,331 | 788 |
| Non-residential real estate | | | 2,123 | |
| Consumer | 41 | 53 | 16 | 13 |
| | 42 | 54 | 7,346 | 1,989 |
| Recoveries: | | | | |
| One-to-four family | 5 | | | |
| Multifamily | 1,308 | 190 | | |
| Consumer | 21 | 6 | 11 | 17 |
| | 1,334 | 196 | 11 | 17 |
| Net Charge-offs (recoveries) | (1,292) | (142) | 7,335 | 1,972 |
| Additions charged to operations | (1,263) | (190) | 7,391 | 2,107 |
| Balance at end of year | $ 420 | $ 391 | $ 439 | $ 383 |
| Net Charge-offs (recoveries) to average gross loans outstanding | (0.96)% | (0.12)% | 6.04% | 1.89% |

Table of Contents

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

| | 2006 | | |
|---|---|---|---|
| | Amount | Percent Of Allowance To Total Allowance | Percent Of Gross Loans In Each Category To Total Gross Loans |
| | (Dollars in Thousands) | | |
| One-to-four family | 131 | 31.19% | 59.56% |
| Multifamily | 41 | 9.76% | 5.49% |
| Lines of credit | | % | 5.85% |
| Non-residential real estate | 172 | 40.95% | 15.03% |
| Commercial | 10 | 2.38% | 0.60% |
| Construction | | % | 5.29% |
| Consumer | 64 | 15.24% | 8.18% |
| Unallocated | 2 | 0.48% | % |
| Total allowance for loan losses | $ 420 | 100.00% | 100.00% |

| | 2005 | | |
|---|---|---|---|
| | Amount | Percent Of Allowance To Total Allowance | Percent Of Gross Loans In Each Category To Total Gross Loans |
| | (Dollars in Thousands) | | |
| One-to-four family | 104 | 26.60% | 58.21% |
| Multifamily | 59 | 15.09% | 9.09% |
| Lines of credit | | % | 7.50% |
| Non-residential real estate | 124 | 31.71% | 9.17% |
| Construction | | % | 9.08% |
| Consumer | 83 | 21.23% | 6.95% |
| Unallocated | 21 | 5.37% | % |
| Total allowance for loan losses | $ 391 | 100.00% | 100.00% |

| | 2004 | | |
|---|---|---|---|
| | Amount | Percent Of Allowance To Total Allowance | Percent Of Gross Loans In Each Category To Total Gross Loans |
| | (Dollars in Thousands) | | |
| One-to-four family | 103 | 23.46% | 55.43% |
| Multifamily | 81 | 18.45% | 11.83% |
| Lines of credit | | % | 7.54% |
| Non-residential real estate | 116 | 26.42% | 7.05% |
| Construction | | % | 11.18% |
| Consumer | 74 | 16.86% | 6.97% |
| Unallocated | 65 | 14.81% | % |
| Total allowance for loan losses | $ 439 | 100.00% | 100.00% |

Table of Contents

| | 2003 | | |
|---|---|---|---|
| | Amount | Percent Of Allowance To Total Allowance | Percent Of Gross Loans In Each Category To Total Gross Loans |
| | (Dollars in Thousands) | | |
| One-to-four family | 103 | 26.89% | 58.70% |
| Multifamily | 73 | 19.06% | 10.98% |
| Lines of credit | | % | 7.45% |
| Non-residential real estate | 78 | 20.37% | 7.11% |
| Construction | | % | 8.01% |
| Consumer | 69 | 18.02% | 7.75% |
| Unallocated | 60 | 15.66% | % |
| Total allowance for loan losses | $ 383 | 100.00% | 100.00% |

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

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

**Investment Activities**

We have legal authority to invest in various types of liquid assets, including U.S. Treasury obligations, securities of various federal agencies and of state and municipal governments, mortgage-backed securities and certificates of deposit of federally insured institutions. We are also required to maintain an investment in Federal Home Loan Bank of Chicago stock.

At December 31, 2006, our investment portfolio consisted primarily of U.S. agency securities with maturities of five years or less, mortgage-backed securities issued by Fannie Mae, Freddie Mac and Ginnie Mae with stated final maturities of 30 years or less, and Federal Home Loan Bank of Chicago stock.

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

Table of Contents

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

| | December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | 2005 | | 2004 | |
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (In Thousands) | | | | | |
| **Held-to-maturity** | | | | | | |
| Mortgage-Backed Securities | $ 1,183 | $ 1,171 | $ 1,405 | $ 1,393 | $ 1,818 | $ 1,760 |
| **Available-for-sale** | | | | | | |
| US Agency Securities | 15,715 | 15,715 | 16,641 | 16,641 | 11,690 | 11,690 |
| Mortgage-Backed Securities | 21,071 | 21,071 | 21,279 | 21,279 | 18,950 | 18,950 |
| Total Available-for-sale | $ 36,786 | $ 36,786 | $ 37,920 | $ 37,920 | $ 30,640 | $ 30,640 |

*Portfolio Maturities and Yields*. The composition and maturities of the investment securities portfolio at December 31, 2006 are summarized in the following table. Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur. Certain mortgage-backed securities have interest rates that are adjustable and will re-price annually within the various maturity ranges. These re-pricing schedules are not reflected in the table below.

| | At December 31, 2006 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | One Year or Less | | More than One Year Through Five Years | | More than Five Years Through Ten Years | | More than Ten Years | | Total Securities | |
| | Carrying Value | Weighted Carrying Yield | Carrying Value | Weighted Average Yield | Carrying Value | Weighted Average Yield | Carrying Value | Weighted Average Yield | Carrying Value | Weighted Average Yield |
| | (Dollars in Thousands) | | | | | | | | | |
| Held to Maturity Debt Securities: | | | | | | | | | | |
| Mortgage-backed securities | $ 1 | 34.03% | $ | | $ 10 | 6.46% | $ 1,172 | 5.43% | $ 1,183 | 5.46% |
| Available for Sale Debt Securities: | | | | | | | | | | |
| U.S agency securities | $ 4,480 | 3.47% | $ 11,235 | 3.62% | $ | | $ | | $ 15,715 | 3.58% |
| Mortgage-backed securities | | | 1,831 | 5.00% | 119 | 6.41% | 19,121 | 4.97% | 21,071 | 4.99% |
| Total debt securities available for sale | $ 4,480 | 3.47% | $ 13,066 | 3.81% | $ 119 | 6.41% | $ 19,121 | 4.97% | $ 36,786 | 4.39% |

**Deposit Activities and Other Sources of Funds**

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

*Deposit Accounts*. The vast majority of our depositors are residents of LaSalle County. Deposits are attracted from within our primary market area through the offering of a broad selection of deposit instruments, including checking accounts, money market accounts, regular savings accounts, club savings accounts, certificate accounts and various retirement accounts. The Bank also is a member of the Certificate of Deposit Registry Service (CDARS), which allows the Bank to retain high deposit relationships with its depository customer base, while still allowing the customer to enjoy FDIC deposit insurance on amounts larger than $100,000. Other than our relationship with CDARS, we do not utilize brokered funds. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit, and the interest rate, among other factors. In determining the terms of our deposit accounts, we consider the rates offered by our competition, profitability to us, matching deposit and loan products and customer preferences and concerns. We generally review our deposit mix and pricing weekly. Our current strategy is to offer competitive rates but not be the market leader in every type and maturity.

17

Table of Contents

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

| | December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | 2005 | | 2004 | |
| | Amount | Percent Of Total | Amount | Percent Of Total | Amount | Percent Of Total |
| | (Dollars In Thousands) | | | | | |
| Non-Interest Bearing Checking | $ 2,460 | 1.35% | $ 2,339 | 1.42% | $ 1,615 | 1.03% |
| Interest Bearing Checking | 8,679 | 4.75% | 9,783 | 5.93% | 8,900 | 5.68% |
| Money Market accounts | 8,443 | 4.62% | 10,207 | 6.19% | 5,505 | 3.51% |
| Passbook accounts | 10,593 | 5.79% | 10,761 | 6.53% | 12,120 | 7.74% |
| Certificates of Deposit accounts | 152,682 | 83.49% | 131,791 | 79.93% | 128,514 | 82.04% |
| Total deposit accounts | $ 182,857 | 100.00% | $ 164,881 | 100.00% | $ 156,654 | 100.00% |
| Certificate Accounts | | | | | | |
| 1.00% to 1.99% | $ 37 | 0.02% | $ 2,352 | 1.79% | $ 11,266 | 8.77% |
| 2.00% to 2.99% | 4,776 | 3.13% | 13,369 | 10.14% | 42,213 | 32.85% |
| 3.00% to 3.99% | 20,359 | 13.34% | 56,026 | 42.51% | 50,805 | 39.53% |
| 4.00% to 4.99% | 47,930 | 31.39% | 58,740 | 44.57% | 22,759 | 17.71% |
| 5.00% to 5.99% | 79,470 | 52.05% | 1,304 | 0.99% | 1,471 | 1.14% |
| 6.00% to 6.99% | 110 | 0.07% | | 0.00% | | 0.00% |
| Total Certificate Accounts | $ 152,682 | 100.00% | $ 131,791 | 100.00% | $ 128,514 | 100.00% |

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

| | December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | 2005 | | 2004 | |
| | Weighted Avg. Rate | Average Amount | Weighted Avg. Rate | Average Amount | Weighted Avg. Rate | Average Amount |
| | (Dollars In Thousands) | | | | | |
| Non-Interest Bearing Checking | 0.00% | $ 2,317 | 0.00% | $ 2,289 | 0.00% | $ 1,475 |
| Interest Bearing Checking | 0.58% | 8,967 | 1.04% | 9,065 | 1.04% | 7,817 |
| Money Market accounts | 2.40% | 10,346 | 2.49% | 9,020 | 1.30% | 6,055 |
| Passbook accounts | 0.50% | 10,988 | 1.00% | 11,871 | 0.99% | 11,687 |
| Certificate of Deposit accounts | 4.77% | 136,352 | 3.81% | 129,441 | 3.11% | 121,817 |
| Total | 4.44% | $ 168,970 | 3.37% | $ 161,686 | 2.76% | $ 148,851 |

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

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| | (In Thousands) | | |
| Beginning of period | $ 164,881 | $ 156,654 | $ 140,621 |
| Net deposits (withdrawals) | 12,387 | 4,135 | 12,535 |
| Interest credited on deposit accounts | 5,428 | 4,092 | 3,498 |

| | | | |
|---|---|---|---|
| End of period | $ 182,857 | $ 164,881 | $ 156,654 |
| Percent increase | 10.90% | 5.25% | 11.40% |

18

Table of Contents

The following table indicates the amount of certificates of deposit as of December 31, 2006, by time remaining until maturity.

| | Three Months Or Less | Over Three To Six Months | Over Six To Twelve Months (In Thousands) | Over Twelve Months | Total |
|---|---|---|---|---|---|
| Less than $100,000 | $ 18,232 | $ 27,403 | $ 54,096 | $ 13,093 | $ 112,824 |
| $100,000 or more | 6,431 | 9,843 | 19,431 | 4,153 | 39,858 |
| Total | $ 24,663 | $ 37,246 | $ 73,527 | $ 17,246 | $ 152,682 |

| | Less than 1 year | 1 to 2 years | 2 to 3 years (In Thousands) | 3 to 4 years | 4 to 5 years | Total |
|---|---|---|---|---|---|---|
| 1.00% to 1.99% | $ 37 | $ | $ | $ | $ | $ 37 |
| 2.00% to 2.99% | 3,915 | 831 | 30 | | | 4,776 |
| 3.00% to 3.99% | 10,503 | 5,506 | 3,291 | 1,009 | 50 | 20,359 |
| 4.00% to 4.99% | 45,216 | 1,788 | 390 | 121 | 415 | 47,930 |
| 5.00% to 5.99% | 75,655 | 2,030 | 1,362 | 100 | 323 | 79,470 |
| 6.00% to 6.99% | 110 | | | | | 110 |
| Total | $ 135,436 | $ 10,155 | $ 5,073 | $ 1,230 | $ 788 | $ 152,682 |

*Borrowings*. If necessary, we borrow from the Federal Home Loan Bank of Chicago to supplement our supply of lendable funds and to meet deposit withdrawal requirements. The Federal Home Loan Bank functions as a central reserve bank providing credit for member financial institutions. As a member, we are required to own capital stock in the Federal Home Loan Bank of Chicago and are authorized to apply for advances on the security of such stock and certain of our mortgage loans and other assets (principally securities which are obligations of, or guaranteed by, the United States), provided certain standards related to credit-worthiness have been met. Advances are made under several different programs, each having its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based either on a fixed percentage of an institution s net worth or on the Federal Home Loan Bank s assessment of the institution s credit-worthiness. Under its current credit policies, the Federal Home Loan Bank generally limits advances to 25% of a member s assets, and short-term borrowings of less than one year may not exceed 10% of the institution s assets. The Federal Home Loan Bank determines specific lines of credit for each member institution.

**Personnel**

At December 31, 2006, we had 22 full-time employees and 4 part-time employees, none of whom is represented by a collective bargaining unit. We believe our relationship with our employees is good.

**Subsidiaries**

The Company s only subsidiary is Ottawa Savings Bank.

Table of Contents

## REGULATION AND SUPERVISION

### General

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

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

### Regulation of Federal Savings Banks

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

*Branching*. Federal savings banks are authorized to establish branch offices in any state or states of the United States and its territories, subject to the approval of the OTS.

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

The risk-based capital standard requires federal savings institutions to maintain Tier 1 (core) and total capital (which is defined as core capital and supplementary capital) to risk-weighted assets of at least 4% and

Table of Contents

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

The OTS also has authority to establish individual minimum capital requirements in appropriate cases upon a determination that an institution s capital level is or may become inadequate in light of the particular circumstances. At December 31, 2006, the Bank met each of its capital requirements.

*Prompt Corrective Regulatory Action*. The OTS is required to take certain supervisory actions against undercapitalized institutions, the severity of which depends upon the institution s degree of undercapitalization. Generally, a savings institution that has a ratio of total capital to risk weighted assets of less than 8%, a ratio of Tier 1 (core) capital to risk-weighted assets of less than 4% or a ratio of core capital to total assets of less than 4% (3% or less for institutions with the highest examination rating) is considered to be undercapitalized. A savings institution that has a total risk-based capital ratio less than 6%, a Tier 1 capital ratio of less than 3% or a leverage ratio that is less than 3% is considered to be significantly undercapitalized and a savings institution that has a tangible capital to assets ratio equal to or less than 2% is deemed to be critically undercapitalized. Subject to a narrow exception, the OTS is required to appoint a receiver or conservator within specified time frames for an institution that is critically undercapitalized. An institution must file a capital restoration plan with the OTS within 45 days of the date it receives notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. Compliance with the plan must be guaranteed by any parent holding company in an amount of up to the lesser of 5% of the institution s total assets when it became undercapitalized, or the amount necessary to achieve full compliance with capital requirements. In addition, numerous mandatory supervisory actions become immediately applicable to an undercapitalized institution, including, but not limited to, increased monitoring by regulators and restrictions on growth, capital distributions and expansion. Significantly undercapitalized and critically undercapitalized institutions are subject to more extensive mandatory regulatory actions. The OTS could also take any one of a number of discretionary supervisory actions, including the issuance of a capital directive and the replacement of senior executive officers and directors.

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

*Standards for Safety and Soundness*. As required by statute, the federal banking agencies have adopted Interagency Guidelines prescribing Standards for Safety and Soundness. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. If the OTS determines that a savings institution fails to meet any standard prescribed by the guidelines, the OTS may require the institution to submit an acceptable plan to achieve compliance with the standard. Ottawa Savings Bank has not received any notice that it has failed to meet any standard prescribed by the guidelines.

Table of Contents

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

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

A savings institution that fails the qualified thrift lender test is subject to certain operating restrictions and may be required to convert to a bank charter. Recent legislation has expanded the extent to which education loans, credit card loans and small business loans may be considered qualified thrift investments. As of December 31, 2006, Ottawa Savings Bank maintained 94.2% of its portfolio assets in qualified thrift investments and, therefore, met the qualified thrift lender test.

*Transactions with Related Parties*. Federal law limits Ottawa Savings Bank s authority to lend to, and engage in certain other transactions (collectively, covered transactions ) with affiliates (e.g., any company that controls or is under common control with an institution, including Ottawa Savings Bancorp, Inc., Ottawa Savings Bancorp MHC and their non-savings institution subsidiaries). The aggregate amount of covered transactions with any individual affiliate is limited to 10% of the capital and surplus of the savings institution. The aggregate amount of covered transactions with all affiliates is limited to 20% of the savings institution s capital and surplus. Loans and other specified transactions with affiliates are required to be secured by collateral in an amount and of a type described in federal law. The purchase of low quality assets from affiliates is generally prohibited. Transactions with affiliates must be on terms and under circumstances that are at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated companies. In addition, savings 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, that act contains a specific exception for loans by a depository institution to its executive officers and directors in compliance with federal banking laws. Under such laws, Ottawa Savings Bank s authority to extend credit to executive officers, directors and 10% stockholders ( insiders ), as well as entities such person s have control, is limited. The law restricts both the individual and aggregate amount of loans Ottawa Savings Bank may make to insiders based, in part, on Ottawa Savings Bank s capital position and requires certain board approval procedures to be followed. 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. Additional restrictions apply to loans to executive officers.

**Table of Contents**

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

*Assessments*. Federal savings banks are required to pay assessments to the OTS to fund its operations. The general assessments, paid on a semi-annual basis, are based upon the savings institution s total assets, including consolidated subsidiaries, as reported in the institution s latest quarterly thrift financial report, its financial condition and the complexity of its portfolio.

*Insurance of Deposit Accounts*. The Bank s deposits are insured up to applicable limits by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation. The Deposit Insurance Fund is the successor to the Bank Insurance Fund and the Savings Association Insurance Fund, which were merged in 2006. The Federal Deposit Insurance Corporation recently amended its risk-based assessment system for 2007 to implement authority granted by the Federal Deposit Insurance Reform Act of 2005 ( Reform Act ). Under the revised system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors. An institution s assessment rate depends upon the category to which it is assigned. Risk category I, which contains the least risky depository institutions, is expected to include more than 90% of all institutions. Unlike the other categories, Risk Category I contains further risk differentiation based on the Federal Deposit Insurance Corporation s analysis of financial ratios, examination component ratings and other information. Assessment rates are determined by the Federal Deposit Insurance Corporation and currently range from five to seven basis points for the healthiest institutions (Risk Category I) to 43 basis points of assessable deposits for the riskiest (Risk Category IV). The Federal Deposit Insurance Corporation may adjust rates uniformly from one quarter to the next, except that no single adjustment can exceed three basis points. No institution may pay a dividend if in default of the FDIC assessment.

The Reform Act also provided for a one-time credit for eligible institutions based on their assessment base as of December 31, 1996. Subject to certain limitations with respect to institutions that are exhibiting weaknesses, credits can be used to offset assessments until exhausted. The Bank s one-time credit is expected to approximate $112,000. The Reform Act also provided for the possibility that the Federal Deposit Insurance Corporation may pay dividends to insured institutions once the Deposit Insurance fund reserve ratio equals or exceeds 1.35% of estimated insured deposits.

In addition to the assessment for deposit insurance, institutions are required to make payments on bonds issued in the late 1980s by the Financing Corporation to recapitalize a predecessor deposit insurance fund. This payment is established quarterly and during the calendar year ending December 31, 2006 averaged 1.28 basis points of assessable deposits.

The Reform Act provided the Federal Deposit Insurance Corporation with authority to adjust the Deposit Insurance Fund ratio to insured deposits within a range of 1.15% and 1.50%, in contrast to the prior statutorily fixed ratio of 1.25%. The ratio, which is viewed by the Federal Deposit Insurance Corporation as the level that the fund should achieve, was established by the agency at 1.25% for 2007.

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

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

*Federal Home Loan Bank System*. Ottawa Savings Bank is a member of the Federal Home Loan Bank System, which consists of twelve regional Federal Home Loan Banks. The Federal Home Loan Bank provides a central credit facility primarily for member institutions. Ottawa Savings Bank, as a member of the Federal Home Loan Bank of Chicago, is required to acquire and hold shares of capital stock in that Federal Home Loan Bank. Ottawa Savings Bank had an investment in Federal Home Loan Bank stock at December 31, 2006 of $2.35 million.

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

*Community Reinvestment Act*. Under the Community Reinvestment Act, as implemented by OTS regulations, a savings bank has a continuing and affirmative obligation consistent with its safe and sound operation 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 its examination of a savings 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 by such institution.

The Community Reinvestment Act requires public disclosure of an institution s rating and requires the OTS to provide a written evaluation of a bank s Community Reinvestment Act performance utilizing a four-tiered descriptive rating system.

Ottawa Savings Bank received a satisfactory rating as a result of its most recent Community Reinvestment Act assessment.

**Holding Company Regulation**

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

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

Table of Contents

Recent legislation, which authorized mutual holding companies to engage in activities permitted for financial holding companies, expanded the authorized activities. Financial holding companies may engage in a broad array of financial service activities including insurance and securities.

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

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

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

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

*Waivers of Dividends*. Office of Thrift Supervision regulations require mutual holding companies to notify the Office of Thrift Supervision if they propose to waive receipt of dividends from their stock holding company subsidiary. The Office of Thrift Supervision reviews dividend waiver notices on a case-by-case basis, and, in general, does not object to a waiver if: (i) the waiver would not be detrimental to the safe and sound operation of the savings association; and (ii) the mutual holding company s board of directors determines that their waiver is consistent with such directors fiduciary duties to the mutual holding company s members. We anticipate that Ottawa Savings Bancorp MHC will waive dividends that Ottawa Savings Bancorp, Inc. may pay, if any.

*Acquisition of Control*. Under the federal Change in Bank Control Act, a notice must be submitted to the OTS if any person (including a company), or group acting in concert, seeks to acquire control of a savings and loan holding company or savings bank. An acquisition of control can occur upon the acquisition of 10% or more of the voting stock of a savings and loan holding company or savings institution or as otherwise defined by the OTS. Under the Change in Bank Control Act, the OTS has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the anti-trust effects of the acquisition. Any company that so acquires control would then be subject to regulation as a savings and loan holding company.

**Federal Securities Laws**

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

Table of Contents

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

**Sarbanes-Oxley Act of 2002**

On July 30, 2002, the President signed into law the Sarbanes-Oxley Act of 2002, which implemented legislative reforms intended to address corporate and accounting fraud. The Sarbanes-Oxley Act restricts the scope of services that may be provided by accounting firms to their public company audit clients and any non-audit services being provided to a public company audit client will require preapproval by the company s audit committee. In addition, the Sarbanes-Oxley Act requires chief executive officers and chief financial officers, or their equivalent, to certify to the accuracy of periodic reports filed with the Securities and Exchange Commission, subject to civil and criminal penalties if they knowingly or willingly violate this certification requirement.

Under the Sarbanes-Oxley Act, bonuses issued to top executives before restatement of a company s financial statements are now subject to disgorgement if such restatement was due to corporate misconduct. Executives are also prohibited from insider trading during retirement plan blackout periods, and loans to company executives (other than loans by financial institutions permitted by federal rules and regulations) are restricted. The legislation accelerates the time frame for disclosures by public companies of changes in ownership in a company s securities by directors and executive officers.

The Sarbanes-Oxley Act also increases the oversight of, and codifies certain requirements relating to audit committees of public companies and how they interact with the company s registered public accounting firm. Among other requirements, companies must disclose whether at least one member of the audit committee is a financial expert (as such term is defined by the Securities and Exchange Commission) and if not, why not.

Although we anticipate that we will incur additional expense in complying with the provisions of the Sarbanes-Oxley Act and the resulting regulations, management does not expect that such compliance will have a material impact on our results of operations or financial condition.

**Privacy Requirements of the GLBA**

The Gramm-Leach-Bliley Act of 1999 provided for sweeping financial modernization for commercial banks, savings banks, securities firms, insurance companies, and other financial institutions operating in the United States. Among other provisions, the Gramm-Leach-Bliley Act places limitations on the sharing of consumer financial information with unaffiliated third parties. Specifically, the Gramm-Leach-Bliley Act requires all financial institutions offering financial products or services to retail customers to provide such customers with the financial institution s privacy policy and provide such customers the opportunity to opt out of the sharing of personal financial information with unaffiliated third parties.

**Anti-Money Laundering**

On October 26, 2001, in response to the events of September 11, 2001, the President of the United States signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept

Table of Contents

and Obstruct Terrorism Act of 2001 (referred to as the USA PATRIOT Act ). The USA PATRIOT Act significantly expands the responsibilities of financial institutions, including savings and loan associations, in preventing the use of the U.S. financial system to fund terrorist activities. Title III of the USA PATRIOT Act provides for a significant overhaul of the U.S. anti-money laundering regime. Among other provisions, it requires financial institutions operating in the United States to develop new anti-money laundering compliance programs, due diligence policies and controls to ensure the detection and reporting of money laundering. Such required compliance programs are intended to supplement existing compliance requirements, also applicable to financial institutions, under the Bank Secrecy Act and the Office of Foreign Assets Control Regulations.

**Other Regulations**

Interest and other charges collected or contracted for by Ottawa Savings Bank are subject to state usury laws and federal laws concerning interest rates. Ottawa Savings Bank s loan operations are also subject to federal laws applicable to credit transactions, such as the:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies;
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies; and
- Rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

The deposit operations of Ottawa Savings Bank also are subject to the:

- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Electronic Funds Transfer Act and Regulation E promulgated thereunder, which governs automatic deposits to and withdrawals from deposit accounts and customers rights and liabilities arising from the use of automated teller machines and other electronic banking services; and
- Check Clearing for the 21st Century Act (also known as Check 21 ), which, effective October 28, 2004, gives substitute checks, such as digital check images and copies made from that image, the same legal standing as the original paper check.

Table of Contents

## FEDERAL AND STATE TAXATION

### Federal Income Taxation

*General*. We report our income on a fiscal year basis using the accrual method of accounting. The federal income tax laws apply to us in the same manner as to other corporations with some exceptions, including particularly our reserve for bad debts discussed below. The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to us. Our federal income tax returns have been either audited or closed under the statute of limitations through tax year 2003. Ottawa Savings Bank s maximum federal income tax rate was 35% for both the 2006 and 2005 tax year.

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

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

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

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

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

Under the Tax Allocation Agreement, Ottawa Savings Bank and any of its subsidiaries calculate their federal and state income tax liabilities as if they were filing a separate tax return. If there is tax liability

28

Table of Contents

calculated on this separate entity basis, Ottawa Savings Bank pays that tax liability to Ottawa Savings Bancorp, Inc. Payments are made no earlier than five days prior to the time that Ottawa Savings Bancorp, Inc. is required to make either estimated or final tax payments for the consolidated or combined return. If Ottawa Savings Bank and its subsidiaries have a taxable loss for a year on a separate entity basis, and if that loss could have been carried back to obtain a refund, Ottawa Savings Bancorp, Inc. pays an amount equal to such refund to Ottawa Savings Bank, whether or not any such refund is actually received on a consolidated or combined basis. If that taxable loss would not have resulted in a refund on a separate entity basis because there was no carryback available, but that loss is used on the consolidated or combined return to reduce tax liability on a consolidated or combined basis, Ottawa Savings Bancorp, Inc. pays Ottawa Savings Bank an amount equal to the tax savings from using that loss.

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

**State Taxation**

Ottawa Savings Bancorp, Inc. is subject to the Illinois Income Tax and the Illinois Personal Property Tax Replacement Income Tax, at the rates of 4.8% and 2.5%, respectively for fiscal year 2007. These amounts remain unchanged from 2006 and 2005. These taxes are imposed on our federal taxable income, with certain adjustments.

**ITEM 2. DESCRIPTION OF PROPERTY**

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

The following table sets forth certain information relating to this facility at December 31, 2006.

| Location | Year Opened/ Acquired | Net Book Value at December 31, 2006 | Square Footage | Owned/ Leased | Date of Lease Expiration |
|---|---|---|---|---|---|
| 925 LaSalle Street Ottawa, IL 61350 | 1958 | $ 7,373,000 | 21,000 | Owned | N/A |

**ITEM 3. LEGAL PROCEEDINGS**

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

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to a vote of stockholders during the fourth quarter of the year ended December 31, 2006.

Table of Contents

**ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS**

The Company s common stock is traded on the Over-the-Counter Bulletin Board under the symbol OTTW . At December 31, 2006, the Company had 411 record holders of its common stock. The table below shows the reported high and low bid price of the common stock, as reported on the OTC Bulletin Board and dividends declared during the periods indicated in 2006 and 2005. Quotations reflect inter-dealer prices without mark-up, mark-down or commissions, and may not represent actual transactions. The Company completed its initial public offering on July 11, 2005.

| | 2006 | | | 2005 | | |
|---|---|---|---|---|---|---|
| | High | Low | Dividends Declared | High | Low | Dividends Declared |
| First quarter | $ 12.25 | $ 10.50 | $ 0.05 | N/A | N/A | N/A |
| Second quarter | $ 12.25 | $ 11.40 | $ 0.05 | N/A | N/A | N/A |
| Third quarter | $ 12.25 | $ 11.55 | $ 0.05 | $ 11.25 | $ 10.00 | $ |
| Fourth quarter | $ 12.80 | $ 11.40 | $ 0.05 | $ 11.00 | $ 9.75 | $ |

**Dividend Policy**

The Company paid cash dividends of $0.20 per share during 2006, and did not pay cash dividends on its common stock during 2005. The Board of Directors will declare dividends upon consideration of a number of factors, including capital requirements, the Company s and the Bank s financial condition and results of operations, tax considerations, statutory and regulatory limitations and general economic conditions. No assurances can be given that any dividends will be paid or that, if paid, will not be reduced or eliminated in future periods. Special cash dividends, stock dividends or returns of capital may, to the extent permitted by regulations, be paid in addition to, or in lieu of, regular cash dividends. The Company has filed consolidated tax returns with the Bank. Accordingly, it is anticipated that any future cash distributions made by the Company to its stockholders would be treated as cash dividends and not as a nontaxable return of capital for federal and state tax purposes.

Dividends from the Company will depend, in large part, upon receipt of dividends from the Bank. Federal and state law imposes certain limitations on dividends by savings banks. See *Regulation and Supervision* .

Table of Contents

## PART II

**ITEM 6. MANAGEMENT S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION**

**General**

This discussion and analysis reflects the Company s consolidated financial statements and other relevant statistical data, and is intended to enhance your understanding of our financial condition and results of operations. The information in this section has been derived from and should be read in conjunction with the consolidated financial statements and notes to the consolidated financial statements, which appear beginning on page F-1.

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

During the period from March 2000 until April 2004, as part of our investment activities, we purchased loan participations from Commercial Loan Corporation ( CLC ) of Oak Brook, Illinois. In April 2004, we were informed by our regulators, the FDIC and the Illinois Department of Financial and Professional Regulation Division of Banking ( IDFPR ) that CLC had misappropriated funds from loans it was servicing for others. At that time, Ottawa Savings Bank had 38 outstanding loan participations with CLC in the aggregate amount of approximately $15.0 million. In May 2004, CLC filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code. In December 2004, CLC s remaining assets were transferred to the CLC Creditors Trust.

In December 2004, we received a payment of $5.6 million in cash and loans from the CLC Creditors Trust. This payment included $784,000 in residential condominium loans, $2.5 million in commercial real estate loans, $518,000 in commercial lines of credit, $153,000 in residential real estate loans and $1.6 million in cash. As of December 31, 2006, all of the foregoing loans are performing according to their terms. Although we have retained certain unsecured claims against the CLC Creditors Trust, we have charged-off the remaining $9.5 million of our investment in the CLC loan participations. In October 2005 and March 2006, the Company received a net settlement of $190,000 and $1.3 million, respectively from the CLC Creditors Trust on previously charged-off loan participations with CLC. These settlements were recorded as a recovery to the allowance for loan losses in 2005 and 2006, accordingly.

**Critical Accounting Policies**

We consider accounting policies involving significant judgments and assumptions by management that have, or could have, a material impact on the carrying value of certain assets or income to be critical accounting policies. We consider the allowance for loan losses, market value of investment securities available for sale and the liability for post-retirement benefits to be our critical accounting policies.

*Allowance for Loan Losses*. The allowance for loan losses is an amount necessary to absorb known or inherent losses that are both probable and reasonably estimable and is established through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The

**Table of Contents**

allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect each borrower s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

*Market value of investment securities available for sale*. Market values for investment securities are provided monthly by a third party service provider. Management is also responsible for evaluating all investments with unrealized losses on a regular basis to determine whether investments with unrealized losses should be written down to realizable amounts. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) our intent and ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

*Liability for post-retirement health benefits*. The liability for post-retirement health benefits was estimated based upon an actuarial report obtained by bank management from an experienced, third party actuary. Assumptions used by the actuary in the calculation include discount rates, current and future health care costs, life expectancies, and employee years of service.

**Selected Financial Data**

The following tables set forth selected financial and other data of the Company for the periods and at the dates indicated. The information should be read in conjunction with the Consolidated Financial Statements and Notes beginning on page F-1.

| | At December 31, | | |
|---|---|---|---|
| | **2006** | **2005** | **2004** |
| | **(In Thousands, except per share data)** | | |
| Financial Condition Data: | | | |
| Total Assets | $ 204,865 | $ 185,863 | $ 169,285 |
| Loans, net(1) | 142,537 | 124,939 | 114,826 |
| Securities held to maturity | 1,183 | 1,405 | 1,818 |
| Securities available for sale | 36,786 | 37,920 | 30,640 |
| Deposits | 182,857 | 164,881 | 156,654 |
| Stockholders Equity | 19,421 | 19,234 | 11,006 |
| Book Value per common share | $ 8.73 | $ 8.64 | N/A |

**Table of Contents**

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| | (In Thousands, except per share data) | | |
| Operation Data: | | | |
| Total interest and dividend income | $ 10,328 | $ 8,886 | $ 8,351 |
| Total interest expense | 6,034 | 4,766 | 4,069 |
| Net interest income | 4,294 | 4,120 | 4,282 |
| Provision for loan losses | (1,263) | (190) | 7,391 |
| Other income | 276 | 214 | 128 |
| Other expense | 4,652 | 3,251 | 2,702 |
| Income tax expense (benefit) | 237 | 405 | (2,186) |
| Net income (loss) | $ 944 | $ 868 | $ (3,497) |
| Basic earnings per share(2) | $ 0.44 | $ 0.17 | N/A |
| Diluted earnings per share(2) | $ 0.43 | $ 0.17 | N/A |

(1) Net of loans in process, deferred loan (costs) fees, and allowance for loan losses.
(2) Net income for the six months ended June 30, 2005 is not included in the calculation of basic and diluted earnings per share for the year ended December 31, 2005.

| | At or for the Years Ended December 31, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| Performance Ratios: | | | |
| Return on average assets | 0.50% | 0.48% | (2.11)% |
| Return on average stockholders equity | 4.72 | 5.78 | (24.76) |
| Average stockholders equity to average assets | 10.56 | 8.38 | 8.52 |
| Stockholders equity to total assets at end of period | 9.48 | 10.35 | 6.50 |
| Net interest rate spread(1) | 2.26 | 2.44 | 2.49 |
| Net interest margin(2) | 2.45 | 2.52 | 2.69 |
| Average interest-earning assets to average interest-bearing liabilities | 105.35 | 102.58 | 107.77 |
| Other expense to average assets | 2.45 | 1.82 | 1.63 |
| Efficiency ratio(3) | 101.81 | 75.02 | 61.26 |
| Regulatory Capital Ratios: | | | |
| Tangible capital | 8.59 | 9.23 | 5.44 |
| Tier 1 core capital | 8.59 | 9.23 | 5.44 |
| Total risk-based capital | 16.30 | 18.00 | 9.04 |
| Asset Quality Ratios: | | | |
| Net charge-offs (recoveries) to average gross loans outstanding | (0.96) | (0.12) | 6.04 |
| Allowance for loan losses to gross loans outstanding | 0.29 | 0.30 | 0.37 |
| Non-performing loans to gross loans | 0.76 | 1.31 | 0.52 |
| Non-performing assets to total assets(4) | 0.54 | 0.92 | 0.49 |
| Other Data: | | | |
| Number of full-service offices | 1 | 1 | 1 |

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

Table of Contents

**Comparison of Financial Condition at December 31, 2006 and December 31, 2005**

Our total assets increased by $19.0 million, or 10.22%, to $204.9 million at December 31, 2006, from $185.9 million at December 31, 2005. The increase in total assets was primarily the result of an increase in loans of $17.6 million, or 14.09%. The increase in loans is primarily the result of the purchase of loan participations. Cash and due from banks increased $5.4 million, or 106.65%, due in part to the redemption of $1.7 million of excess Federal Home Loan Bank stock and the maturity of $1.1 million, or 2.99% of available for sale securities. In addition the Company received $831,000 in income tax refunds as a result of the CLC losses in 2001, 2002 and 2003, which reduced our income tax receivable by 67.56%. The funding for the increase in loans came from funds generated as a result of the maturities and repayments of investment securities, increased deposits and the deployment of funds received from the redemption of Federal Home Loan Bank stock.

Total deposits increased $18.0 million, or 10.90%, to $182.9 million at December 31, 2006, from $164.9 million at December 31, 2005. The increase in deposits is consistent with our strategy of growing our core funding, as certificates of deposit increased by $20.9 million, partially offset by a decrease in checking deposits of $983,000, a decrease in money market accounts of $1.8 million, and a decrease in passbook accounts of $168,000. Certificates of deposit and savings deposits are considered core funding. The increase in certificates of deposit was primarily the result of our offering competitive rates on renewals and new deposits, which also allowed us to obtain two labor union deposits totaling $11.0 million. As liquid accounts, the decreases in checking, savings and money market accounts is partially due to the movement of the funds into higher paying certificate of deposit accounts, while the remainder can be attributed to normal balance fluctuations. We did not have any borrowings at December 31, 2006 or 2005.

Equity increased $188,000 to $19.4 million at December 31, 2006, from $19.2 million at December 31, 2005. This increase in equity reflects income for the twelve months ended December 31, 2006 of $944,000, an adjustment of $55,000 to reflect the adoption SAB No. 108, allocation of ESOP shares valued at $60,000, compensation expense on stock awards and options of $13,000, and a decrease in other comprehensive loss of $31,000, which was due to the change in value of the available for sale securities portfolio triggered by an increase in interest rates. The increases are offset by cash dividends paid in the amount of $200,000, recognition of redeemable common stock of allocated ESOP shares of $128,000 to account for possible execution of put options, and the cost to purchase shares for the Management Recognition Plan ( MRP ) in the amount of $587,000.

**Comparison of Results of Operations for the Years Ended December 31, 2006 and December 31, 2005**

*General*. Net income for the year ended December 31, 2006 was $944,000 compared to $868,000 for the year ended December 31, 2005. The increase is primarily due to a decrease in income tax expense, offset by an increase in expenses that exceeds the increases in income.

*Interest Income*. Interest income increased $1.4 million, or 16.23%, to $10.3 million for the year ended December 31, 2006, from $8.9 million for the year ended December 31, 2005. The average yield on interest-earning assets increased to 5.88% in 2006 from 5.43% in 2005, and average interest-earning assets increased $12.1 million, or 7.37%, to $175.6 million for the year ended December 31, 2006 from $163.5 million for the year ended December 31, 2005.

Interest and fee income from loans increased $1.2 million, or 18.24%, to $8.2 million for the year ended December 31, 2006, from $7.0 million for the year ended December 31, 2005. The increase was due to an increase in the average yield to 6.33% in 2006 from 5.96% in 2005 and an increase of $13.1 million or 11.24% in the average balance of loans during 2006 to $130.0 million from $116.9 million in 2005. The increase in the average yield on loans was primarily due to the originations and purchases of non-residential mortgage loans and consumer loans which generally have higher interest rates and fees than single family mortgage loans. Interest income from securities increased $220,000, or 14.34%, to $1.8 million for the year ended December 31, 2006, from $1.5 million for the year ended December 31, 2005. The increase resulted from a $34,000 increase in the

**Table of Contents**

average balance of securities and an increase in the average yield to 4.66% for the year ended December 31, 2006 from 4.08% for the year ended December 31, 2005. FHLB dividends decreased $136,000, or 54.45%, to $114,000 for the year ended December 31, 2006 from $250,000 for the year ended December 31, 2005. The decrease was due to a $1.3 million decrease in the average balance of FHLB stock held, and a decrease in average yield to 3.44% for the year ended December 31, 2006, from 5.47% for the year ended December 31, 2005.

*Interest Expense*. Total interest expense increased $1.3 million or 26.61%, to $6.0 million for 2006 from $4.8 million for 2005. The increase in interest expense resulted from an increase in the average cost of interest bearing liabilities to 3.62% from 2.99% in 2005, reflecting a higher concentration of our customers deposits invested in certificates of deposit earning higher yields than in liquid accounts where rates have declined, and a $7.3 million increase in the average balance of interest bearing liabilities to $166.7 million for the year ended December 31, 2006, from $159.4 million for the year ended December 31, 2005. The average balance of money market accounts increased $1.3 million, or 14.70%, to $10.3 million in 2006, from $9.2 million in 2005, offset by a decrease in the average yield to 2.15% for the year ended December 31, 2006 compared to 2.21% for the year ended December 31, 2005. The average balance of passbook accounts decreased $883,000, or 7.44%, to $11.0 million for the year ended December 31, 2006, from $11.9 million for the year ended December 31, 2005, while the average yield on passbook accounts decreased to ..54% in 2006 from 1.00% in 2005. The average balance of certificates of deposit increased $6.9 million, or 5.34%, to $136.4 million for the year ended December 31, 2006 from $129.4 million for the year ended December 31, 2005, and the average yield increased to 4.18% in 2006 from 3.36% in 2005. Interest expense related to borrowings was none during 2006 and 2005.

*Net Interest Income*. Net interest income increased $174,000, or 4.22%, to $4.3 million for 2006 from $4.1 million for 2005, primarily as a result of an increase in our ratio of average interest earning assets to average interest-bearing liabilities to 105.35% for the year ended December 31, 2006, from 102.58% for the year ended December 31, 2005, offset by a decrease in net interest margin to 2.45% for 2006 from 2.52% for 2005.

*Provision for Loan Losses*. We establish provisions for loan losses, which are charged to operations, at a level necessary to absorb known and inherent losses that are both probable and reasonably estimable at the date of the financial statements. In evaluating the level of the allowance for loan losses, management considers historical loss experience, the types of loans and the amount of loans in the loan portfolio, adverse situations that may affect the borrower s ability to repay, the estimated value of any underlying collateral, peer group information, and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available or as future events change. Based on our evaluation of these factors, management recorded a negative provision of $1.3 million for the year ended December 31, 2006, as compared to a negative provision of $190,000 for the year ended December 31, 2005. We used the same methodology and generally similar assumptions in assessing the allowance for both years. The allowance for loan losses was $420,000, or 0.29% of gross loans outstanding at December 31, 2006, as compared to $391,000, or 0.30%, of gross loans outstanding at December 31, 2005. The level of the allowance is based on estimates, and the ultimate losses may vary from the estimates.

Determining the amount of the allowance for loan losses involves a high degree of judgment. Management reviews the level of the allowance on a quarterly basis, at a minimum, and establishes the provision for loan losses based on the composition of the loan portfolio, delinquency levels, loss experience, economic conditions, and other factors related to the collectibility of the loan portfolio. Nonperforming loans were $1.1 million and $1.7 million at December 31, 2006 and 2005, respectively. We have allocated the allowance among categories of loan types as well as classification status at each period-end date. Assumptions and allocation percentages based on loan types and classification status have been consistently applied. Classified loans are assigned a higher percentage of allowance allocation. However, due to the low percentage of such loans, the balance in the allowance over the period has remained relatively stable.

Although we believe that we used the best information available to establish the allowance for loan losses, future additions to the allowance may be necessary based on estimates that are susceptible to change as a result

Table of Contents

of changes in economic conditions and other factors. In addition, the OTS, as an integral part of its examination process, periodically reviews our allowance for loan losses.

*Other Income*. Other income increased $62,000, or 28.97%, to $276,000 for the year ended December 31, 2006, as compared to $214,000 for the year ended December 31, 2005. Income from the sale of loans increased $26,000, or 226.75%, to $37,000 for the year ended December 31, 2006, from $11,000 for the year ended December 31, 2005. Customer service fees increased $56,000, or 46.61%, to $177,000 for the year ended December 31, 2006, from $121,000 for the year ended December 31, 2005 primarily due to an increase in the amount the Company charges for overdrafts. Other miscellaneous income increased $57,000, or 361.95%, to $72,000 for the year ended December 31, 2006, from $15,000 for the year ended December 31, 2005 primarily due to interest received on prior years tax refunds. The increases in other income were offset by a decrease of $74,000 in reimbursement of organization costs from the CLC Trust received only in the second quarter of 2005.

*Other Expense*. Other expenses for the year ended December 31, 2006 increased $1.4 million, or 43.10%, to $4.7 million from $3.3 million for the year ended December 31, 2005. Salaries and employee benefits for the year ended December 31, 2006 increased $1.4 million, or 83.00%, to $3.0 million from $1.6 million for the year ended December 31, 2005 primarily due to the decision of the Bank s board and management to make a previously reported additional contribution of $1.3 million to the Bank s defined benefit retirement plan in order to reduce current and future obligations of the plan. The remaining increase in salaries and employee benefits is attributable to increases in employee salaries, increases in the cost of the ESOP plan, and the addition of compensation expense for the MRP stock awards and Recognition and Retention Plan ( RRP ) stock options. Occupancy expense for the year ended December 31, 2006 increased $106,000, or 29.87%, to $462,000 from $356,000 for the year ended December 31, 2005 as a result of increased depreciation expense, repair and maintenance expenses and real estate taxes. Data processing expenses increased $41,000, or 19.25%, for the year ended December 31, 2006 to $252,000, from $211,000 for the year ended December 31, 2005 due to increases in the number of accounts processed for the bank, transaction volume, and increases in postage, supplies and services passed through to the bank. Expenses for legal and professional services decreased $134,000, or 33.67%, to $263,000 for the year ended December 31, 2006, from $397,000 for the year ended December 31, 2005, primarily as a result of decreased expenses attributable to the completion of the stock conversion in 2005. Other expenses increased $65,000, or 15.67%, for the year ended December 31, 2006, to $481,000, from $416,000 for the year ended December 31, 2005, due primarily to expenses relating to being a public company for a full year in 2006 as compared to approximately six months in 2005. Deposit insurance premiums decreased $26,000, or 55.75%, to $21,000 for the year ended December 31, 2006, from $46,000 for the year ended December 31, 2005.

*Income Tax Expense*. We realized an income tax expense of $237,000 for the year ended December 31, 2006 compared to $405,000 for the year ended December 31, 2005. The income tax expense is a direct result of the pre tax income for the applicable periods. During the period ending June 30, 2006 this amount was adjusted due to managements re-evaluation of the deferred tax accounts, resulting in increased deferred tax assets, which subsequently reduced income tax expense for the year ended December 31, 2006. The effective tax rates were 20.03% and 31.83% for the years ended December 31, 2006 and 2005, respectively.

Table of Contents

**Average Balance Sheet**

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

| | Year Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2006 | | | 2005 | | | 2004 | | |
| | AVERAGE BALANCE | INTEREST | AVERAGE YIELD/ COST | AVERAGE BALANCE | INTEREST | AVERAGE YIELD/ COST | AVERAGE BALANCE | INTEREST | AVERAGE YIELD/ COST |
| | (Dollars in Thousands) | | | | | | | | |
| **ASSETS** | | | | | | | | | |
| Interest-earning assets | | | | | | | | | |
| Securities, net(1) | $ 37,628 | $ 1,753 | 4.66% | $ 37,594 | $ 1,533 | 4.08% | $ 27,936 | $ 1,266 | 4.53% |
| Loans receivable, net(2) | 130,024 | 8,234 | 6.33% | 116,885 | 6,964 | 5.96% | 121,406 | 6,547 | 5.39% |
| Federal Home Loan Bank stock | 3,318 | 114 | 3.44% | 4,571 | 250 | 5.47% | 7,577 | 510 | 6.73% |
| Other investments | 4,594 | 227 | 4.94% | 4,458 | 139 | 3.12% | 2,051 | 28 | 1.37% |
| Total interest-earning assets | 175,564 | 10,328 | 5.88% | 163,508 | 8,886 | 5.43% | 158,970 | 8,351 | 5.25% |
| Non-interest-earning assets | 14,035 | | | 15,580 | | | 6,748 | | |
| **TOTAL ASSETS** | $ 189,599 | | | $ 179,088 | | | $ 165,718 | | |
| **LIABILITIES AND EQUITY** | | | | | | | | | |
| Interest-bearing liabilities | | | | | | | | | |
| Money Market accounts | $ 10,346 | $ 222 | 2.15% | $ 9,020 | $ 199 | 2.21% | $ 6,055 | $ 79 | 1.30% |
| Passbook accounts | 10,988 | 59 | 0.54% | 11,871 | 119 | 1.00% | 11,687 | 116 | 0.99% |
| Certificates of Deposit accounts | 136,352 | 5,698 | 4.18% | 129,441 | 4,354 | 3.36% | 121,817 | 3,791 | 3.11% |
| Checking | 8,967 | 55 | 0.61% | 9,065 | 94 | 1.04% | 7,817 | 81 | 1.04% |
| Advances from Federal Home Loan Bank | | | 0.00% | | | 0.00% | 135 | 2 | 1.48% |
| Total interest-bearing liabilities | 166,653 | 6,034 | 3.62% | 159,397 | 4,766 | 2.99% | 147,511 | 4,069 | 2.76% |
| Non-interest-bearing liabilities | 2,926 | | | 4,681 | | | 4,087 | | |
| **TOTAL LIABILITIES** | 169,579 | | | 164,078 | | | 151,598 | | |
| **EQUITY** | 20,020 | | | 15,010 | | | 14,120 | | |
| **TOTAL LIABILITIES AND EQUITY** | $ 189,599 | | | $ 179,088 | | | $ 165,718 | | |
| **NET INTEREST INCOME** | | $ 4,294 | | | $ 4,120 | | | $ 4,282 | |
| **NET INTEREST RATE SPREAD(3)** | | | 2.26% | | | 2.44% | | | 2.49% |
| **NET INTEREST MARGIN(4)** | | | 2.45% | | | 2.52% | | | 2.69% |
| **RATIO OF AVERAGE INTEREST-EARNING ASSETS TO AVERAGE INTEREST-BEARING LIABILITIES** | | | 105.35% | | | 102.58% | | | 107.77% |

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(1) Includes unamortized discounts and premiums.
(2) Amount is net of deferred loan origination (costs) fees, undisbursed loan funds, unamortized discounts and allowance for loan losses and includes non-performing loans. Loan fees included in interest income were $145,000, $107,000 and $213,000, for 2006, 2005 and 2004, respectively.
(3) Net interest rate spread represents the difference between the yield on average interest-earning assets and the average cost of interest-bearing liabilities.
(4) Net interest margin represents net interest income divided by average interest-earning assets.

Table of Contents

**Rate/Volume Analysis**

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

| | 2006 COMPARED TO 2005 INCREASE (DECREASE) DUE TO | | | 2005 COMPARED TO 2004 INCREASE (DECREASE) DUE TO | | |
|---|---|---|---|---|---|---|
| | VOLUME | RATE | NET | VOLUME | RATE | NET |
| | (Dollars in Thousands) | | | | | |
| Interest earned on | | | | | | |
| Securities, net | $ 1 | $ 219 | $ 220 | 438 | (172) | 266 |
| Loans receivable, net | 783 | 487 | 1,270 | (244) | 673 | 429 |
| Federal Home Loan Bank stock | (68) | (68) | (136) | (202) | (58) | (260) |
| Other investments | 4 | 84 | 88 | 33 | 78 | 111 |
| Total interest-earning assets | $ 720 | $ 722 | $ 1,442 | $ 24 | $ 522 | $ 546 |
| Interest expense on | | | | | | |
| Money Market accounts | $ 29 | $ (6) | $ 23 | $ 39 | $ 81 | $ 120 |
| Passbook accounts | (9) | (51) | (60) | 2 | 1 | 3 |
| Certificates of Deposit accounts | 232 | 1,112 | 1,344 | 237 | 326 | 563 |
| Checking | (1) | (38) | (39) | 13 | 0 | 13 |
| Advances from Federal Home Loan Bank | | | | (2) | | (2) |
| Total interest-bearing liabilities | 251 | 1,017 | 1,268 | 289 | 408 | 697 |
| Change in net interest income | $ 469 | $ (295) | $ 174 | $ (264) | $ (113) | $ (151) |

**Management of Market Risk**

*General*. The majority of our assets and liabilities are monetary in nature. Consequently, our most significant form of market risk is interest rate risk. Our assets, consisting primarily of residential mortgage loans, have longer maturities than our liabilities, consisting primarily of deposits. As a result, a principal part of our business strategy is to manage interest rate risk and reduce the exposure of our net interest income to changes in market interest rates. Accordingly, our board of directors has established an Asset/Liability Management Committee which is responsible for evaluating the interest rate risk inherent in our assets and liabilities, for determining the level of risk that is appropriate given our business strategy, operating environment, capital, liquidity and performance objectives, and for managing this risk consistent with the guidelines approved by the board of directors. Senior management monitors the level of interest rate risk on a regular basis and the Asset/Liability Management Committee, which consists of senior management operating under a policy adopted by the board of directors, meets as needed to review our asset/liability policies and interest rate risk position.

We have sought to manage our interest rate risk in order to limit the exposure of our earnings and capital to changes in interest rates. In an attempt to accomplish this, we offer a variety of floating rate loans based on the prime rate and loans that adjust on one- to five-year intervals, based on various indices including the prime rate and U.S. treasury securities. In addition, we have attempted to lengthen the maturities of our deposit accounts by offering proportionately higher interest rates for longer term, 3-5 year certificate accounts and by increasing our core deposits, in which the overall balances are generally less volatile to interest rate fluctuations than certificate accounts.

Table of Contents

*Net Portfolio Value*. The net present value of an institution s cash flow from assets, liabilities and off balance sheet items (the institution s net portfolio value or NPV ) would change in the event of a range of assumed changes in market interest rates. The OTS provides institutions an interest rate sensitivity report of net portfolio value. The OTS s simulation model uses a discounted cash flow analysis and an option-based pricing approach to measuring the interest rate sensitivity of net portfolio value. Historically, the model estimated the economic value of each type of asset, liability and off-balance sheet contract under the assumption that the United States Treasury yield curve increases by 100 to 300 basis points, or decreases by 100 to 200 basis points instantaneously in 100 basis point increments. A basis point equals one-hundredth of one percent, and 100 basis points equals one percent. An increase in interest rates from 3% to 4% would mean, for example, a 100 basis point increase in the Change in Interest Rates column below.

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

| | December 31, 2006 | | | | |
|---|---|---|---|---|---|
| | Net Portfolio Value | | | Net Portfolio Value As A Percentage Of Present Value Assets | |
| Change In Interest Rates (Basis Points) | Estimated NPV | Amount Of Change | Percent Of Change | NPV Ratio | Change In Basis Points |
| | (Dollars In Thousands) | | | | |
| +300 | $ 7,157 | $ (11,292) | -61.00% | 3.76% | (528) |
| +200 | 11,101 | (7,348) | -40.00% | 5.69% | (335) |
| +100 | 14,959 | (3,490) | -19.00% | 7.49% | (155) |
| 0 | 18,449 | | | 9.04% | |
| -100 | 21,234 | 2,785 | 15.00% | 10.22% | 118 |
| -200 | $ 23,141 | $ 4,692 | 25.00% | 10.99% | 195 |

| | December 31, 2005 | | | | |
|---|---|---|---|---|---|
| | Net Portfolio Value | | | Net Portfolio Value As A Percentage Of Present Value Assets | |
| Change In Interest Rates (Basis Points) | Estimated NPV | Amount Of Change | Percent Of Change | NPV Ratio | Change In Basis Points |
| | (Dollars In Thousands) | | | | |
| +300 | $ 11,597 | $ (7,240) | -38.00% | 6.71% | (348) |
| +200 | 14,169 | (4,668) | -25.00% | 8.01% | (218) |
| +100 | 16,646 | (2,191) | -12.00% | 9.20% | (99) |
| 0 | 18,837 | | | 10.19% | |
| -100 | 20,431 | 1,594 | 8.00% | 10.86% | 67 |
| -200 | $ 20,989 | $ 2,152 | 11.00% | 11.02% | 83 |

The table above indicates that at December 31, 2006, in the event of a 100 basis point decrease in interest rates, we would experience an increase of approximately 15% in net portfolio value. In the event of 200 basis point increase in interest rates, we would experience a decrease of approximately 40% in net portfolio value.

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

Table of Contents

**Liquidity and Capital Resources**

We maintain liquid assets at levels we consider adequate to meet our liquidity needs. Our liquidity ratio averaged 14.1% for the year ended December 31, 2006 compared to 14.2% for the year ended December 31, 2005. We adjust our liquidity levels to fund deposit outflows, pay real estate taxes on mortgage loans, repay our borrowings and to fund loan commitments. We also adjust liquidity as appropriate to meet asset and liability management objectives.

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

Our cash flows are derived from operating activities, investing activities and financing activities as reported in our Consolidated Statements of Cash Flows included with the Consolidated Financial Statements.

Our primary investing activities are the origination and purchase of one- to four-family, commercial real estate and multi-family and other loans, including loans originated for sale, and the purchase of investment securities. For the years ended December 31, 2006, and 2005, our loan originations totaled $35.8 million and $37.9 million, respectively. For the years ended December 31, 2006 and 2005, we purchased $17.6 million and $13.2 million in loans, respectively. For the years ended December 31, 2006, and 2005, we received $1.7 million and $1.8 million, respectively, from the sale of loans, resulting in gains of $37,000 and $11,000, respectively. Cash received from the calls, maturities and pay-downs on securities totaled $6.8 million and $7.1 million for the years ended December 31, 2006, and 2005, respectively. We purchased $5.5 million and $14.8 million, respectively, in securities during the years ended December 31, 2006, and 2005. We decreased security purchases in 2006 compared to 2005 in order to increase our investment in purchased loans, for a higher return on investment. For a more detailed breakdown of our loan activity, see the section entitled *Our Business-Loan Origination, Purchase and Sales*.

Deposit flows are generally affected by the level of interest rates, the interest rates and products offered by local competitors, and other factors. During the years ended December 31, 2006, and 2005, deposits increased $18.0 million and $8.2 million, respectively.

Liquidity management is both a daily and long-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the Federal Home Loan Bank of Chicago to provide advances. At December 31, 2006 and 2005 we had no advances from the Federal Home Loan Bank of Chicago, but we had an available borrowing limit of $46.9 million and $53.0 million, respectively.

At December 31, 2006 we had outstanding commitments to originate loans of $3.1 million, unfunded commitments under lines of credit of $9.1 million, unfunded commitments on construction loans of $3.9 million, and unfunded standby letters of credit of $1.8 million. At December 31, 2006, certificates of deposit scheduled to mature in less than one year totaled $135.4 million. Based on prior experience, management believes that a significant portion of such deposits will remain with us, although there can be no assurance that this will be the case. In the event a significant portion of our deposits are not retained by us, we will have to utilize other funding sources, such as Federal Home Loan Bank of Chicago advances, in order to maintain our level of assets. Alternatively, we could reduce our level of liquid assets, such as our cash and cash equivalents. In addition, the cost of such deposits may be significantly higher if market interest rates are higher at the time of renewal.

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

For the year ended December 31, 2006, the Company did not engage in any off-balance sheet transactions reasonably likely to have a material adverse effect in its financial condition, results of operations or cash-flows.

Table of Contents

**Recent Accounting Pronouncements**

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140*. The statement amends SFAS no. 140 by (1) requiring the separate accounting for servicing assets and servicing liabilities, which arise from the sale of financial assets; (2) requiring all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable; and (3) permitting an entity to choose between an amortization method or a fair value method for subsequent measurement for each class of separately recognized servicing assets and servicing liabilities. This statement is effective for fiscal years beginning after September 15, 2006, with earlier adoption permitted. The Company does not expect that the adoption of this Statement will have a material impact on its financial position, results of operation and cash flows.

In June 2006, the FASB issued FASB Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes*. This interpretation applies to all tax positions accounted for in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 clarifies the application of SFAS No. 109 by defining the criteria that an individual tax position must meet in order for the position to be recognized within the financial statements and provides guidance on measurement, de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition for tax positions. This interpretation is effective for fiscal years beginning after December 15, 2006, with earlier adoption permitted. The Company is currently evaluating the impact that the adoption of this interpretation will have on its financial position, results of operation and cash flows. The Company does not expect that the adoption of this interpretation will have a material impact on its financial position, results of operation and cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* . This Statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. It clarifies that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. This Statement does not require any new fair value measurements, but rather, it provides enhanced guidance to other pronouncements that require or permit assets or liabilities to be measured at fair value. This Statement is effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted. The Company is currently evaluating the impact that the adoption of this Statement will have on its financial position, results of operation and cash flows.

In September 2006, the FASB issued Statement No. 158, ( SFAS No. 158 ), Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R). SFAS No. 158 requires a company that sponsors a postretirement benefit plan to fully recognize, as an asset or liability, the over-funded or under-funded status of its benefit plan in its balance sheet. The funded status is measured as the difference between the fair value of the plan s assets and its benefit obligation (projected benefit obligation for pension plans and accumulated postretirement benefit obligation for other postretirement benefit plans). Currently, the funded status of such plans is reported in the notes to the financial statements. This provision is effective for public companies for fiscal years ending after December 15, 2006. In addition, SFAS No. 158 also requires a company to measure its plan assets and benefit obligations as of its year end balance sheet date. Currently, a company is permitted to choose a measurement date up to three months prior to its year end to measure the plan assets and obligations. This provision is effective for all companies for fiscal years ending after December 15, 2008. The Company does not expect that the adoption of this Statement will have a material impact on its financial position, results of operation and cash flows.

**Impact of Inflation and Changing Prices**

The financial statements and related notes of Ottawa Savings Bank have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ). GAAP generally requires the measurement of financial position and operating results in terms of historical dollars without consideration for changes in the relative purchasing power of money over time due to inflation. The impact of inflation is

Table of Contents

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

**ITEM 7. FINANCIAL STATEMENTS**

The information required by this Item 7 is contained on pages F-1 through F-31 of this form 10-KSB.

**ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 8A. CONTROLS AND PROCEDURES**

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

**ITEM 8B. OTHER INFORMATION**

None.

Table of Contents

## PART III

### ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS, CONTROL PERSONS AND CORPORATE GOVERNANCE; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT

(a) *Directors*. The information required in response to this item regarding the Company s directors, the audit committee, the audit committee financial expert and the code of ethics and business conduct will be contained in the Company s definitive Proxy Statement (the Proxy Statement ) for its Annual Meeting of Stockholders to be held on May 3, 2007 under the captions *Proposal 1 Election of Directors*, *Corporate Governance Committees of the Board of Directors of Ottawa Savings Bancorp, Inc.*, *Corporate Governance Code of Ethics and Business Conduct*, and *Section 16(a) Beneficial Ownership Reporting Compliance* and the information included therein is incorporated herein by reference.

(b) *Executive Officers of the Company*. The information required in response to this item regarding the Company s executive officers will be contained in the Company s Proxy Statement under the captions *Proposal 1 Election of Directors Executive Officers Who Are Not Directors* and *Section 16(a) Beneficial Ownership Reporting Compliance* and the information included therein is incorporated herein by reference.

### ITEM 10. EXECUTIVE COMPENSATION

The information required in response to this item will be contained in the Proxy Statement under the captions *Corporate Governance Directors Compensation*, and *Executive Compensation* and the information included therein is incorporated herein by reference.

### ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

(a) *Securities Authorized for Issuance under Equity Compensation Plans*.

| | Number of Securities to be issued upon Exercise of Outstanding Options, Warrants and Rights (a) | Weighted Average Exercise Price of Outstanding Options, Warrants and Rights (b) | Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding securities reflected in column a) (c) |
|---|---|---|---|
| Equity Compensation Plans Approved by Stockholders | 92,666 | 12.35 | 16,354 |
| Equity Compensation Plans not Approved by Stockholders | | | |
| Total | 92,666 | 12.35 | 16,354 |

(b) *Stock Ownership*. The information required in response to this item will be contained in the Proxy Statement under the caption Beneficial Stock Ownership and the information included therein is incorporated herein by reference.

### ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required in response to this item will be contained in the Proxy Statement under the caption Transactions with Related Persons and the information included therein is incorporated herein by reference.

**ITEM 13. EXHIBITS**

The exhibits filed as a part of this Form 10-KSB are listed in the Exhibit Index, which is incorporated herein by reference.

**Table of Contents**

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required in response to this item will be contained in the Proxy Statement under the captions *Audit Fees*, *Audit-Related Fees*, *Tax Fees* and *All Other Fees* and the information included therein is incorporated herein by reference.

Table of Contents

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

**Contents**


| | |
|---|---|
| Report of Independent Registered Public Accounting Firm on the Consolidated Financial Statements | F-2 |
| Consolidated Financial Statements | |
| Consolidated balance sheets | F-3 |
| Consolidated statements of income | F-4 |
| Consolidated statements of equity | F-5 |
| Consolidated statements of cash flows | F-6 |
| Notes to consolidated financial statements | F-7  F-31 |

Table of Contents

**Report of Independent Registered Public Accounting Firm on the Consolidated Financial Statements**

To the Board of Directors

Ottawa Savings Bancorp, Inc.

Ottawa, Illinois

We have audited the accompanying consolidated balance sheets of Ottawa Savings Bancorp, Inc. and its subsidiary (the Company) as of December 31, 2006 and 2005, and the related consolidated statements of income, equity, 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ottawa Savings Bancorp. Inc. and subsidiary as of December 31, 2006 and 2005, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

As described in Note 15 to the consolidated financial statements, retained earnings as of January 1, 2006, have been adjusted to reflect the adoption of SEC Staff Accounting Bulletin No. 108.

Champaign, Illinois

March 27, 2007

McGladrey & Pullen LLP is a member firm of RSM International

an affiliation of separate and independent legal entities.

F-2

Table of Contents

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

**Consolidated Balance Sheets**

**December 31, 2006 and 2005**

| | 2006 | 2005 |
|---|---|---|
| **Assets** | | |
| Cash and due from banks including interest bearing deposits of $7,859,993 and $3,525,422 at December 31, 2006 and 2005, respectively | **$ 10,414,312** | $ 5,039,518 |
| Securities held to maturity (fair value of $1,171,297 and $1,392,860 at December 31, 2006 and 2005, respectively) | **1,182,853** | 1,404,850 |
| Securities available for sale | **36,786,248** | 37,920,403 |
| Federal Home Loan Bank stock, at cost | **2,347,016** | 4,037,808 |
| Loans, net of allowance for loan losses of $419,685 and $390,994 at December 31, 2006 and 2005, respectively | **142,536,815** | 124,938,714 |
| Premises and equipment, net | **7,866,270** | 8,041,537 |
| Accrued interest receivable | **947,613** | 801,633 |
| Mortgage servicing rights | **102,155** | 114,813 |
| Income tax refund receivable | **399,077** | 1,230,032 |
| Deferred tax asset | **1,526,653** | 1,740,867 |
| Other assets | **756,147** | 592,763 |
| **Total assets** | **$ 204,865,159** | $ 185,862,938 |
| **Liabilities and Stockholders Equity** | | |
| Liabilities | | |
| Deposits: | | |
| Non-interest bearing | **$ 2,460,289** | $ 2,339,108 |
| Interest bearing | **180,396,467** | 162,541,840 |
| **Total deposits** | **182,856,756** | 164,880,948 |
| Accrued interest payable | **138,630** | 77,000 |
| Other liabilities | **2,320,144** | 1,671,405 |
| **Total liabilities** | **185,315,530** | 166,629,353 |
| Commitments and contingencies (Note 13) | | |
| Redeemable common stock held by ESOP plan | **128,307** | |
| **Stockholders Equity** | | |
| Common Stock, $.01 par value 12,000,000 shares authorized; 2,224,911 shares issued and outstanding | **22,249** | 22,249 |
| Additional Paid-in-Capital | **8,536,872** | 8,522,984 |
| Retained earnings | **12,647,340** | 11,848,059 |
| Unallocated ESOP shares | **(661,388)** | (712,264) |
| Unearned MRP shares | **(579,449)** | |
| Accumulated other comprehensive (loss) | **(415,995)** | (447,443) |
| Maximum cash obligation related to ESOP shares | **(128,307)** | |
| **Total Stockholders Equity** | **19,421,322** | 19,233,585 |
| **Total liabilities and stockholders equity** | **$ 204,865,159** | $ 185,862,938 |

See Accompanying Notes to Consolidated Financial Statements.

Table of Contents

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

**Consolidated Statements of Income**

**Years Ended December 31, 2006 and 2005**

| | 2006 | 2005 |
|---|---|---|
| Interest and dividend income: | | |
| Interest and fees on loans | **$ 8,234,477** | $ 6,964,458 |
| Securities: | | |
| Mortgage-backed and related securities | **1,053,784** | 883,800 |
| U.S. agency securities | **698,675** | 648,895 |
| Federal Home Loan Bank Stock dividends | **113,879** | 249,989 |
| Interest-bearing deposits | **227,208** | 138,901 |
| **Total interest and dividend income** | **10,328,023** | 8,886,043 |
| Interest expense: | | |
| Deposits | **6,034,129** | 4,766,094 |
| **Total interest expense** | **6,034,129** | 4,766,094 |
| **Net interest income** | **4,293,894** | 4,119,949 |
| Provision for loan losses | **(1,263,478)** | (189,771) |
| **Net interest income after provision for loan losses** | **5,557,372** | 4,309,720 |
| Other income: | | |
| Gain (loss) on sales of securities available for sale | **2,507** | (201) |
| Gain on sale of loans | **36,838** | 11,274 |
| Originations of mortgage servicing rights, net of amortization | **(12,658)** | 2,276 |
| (Loss) on sale of OREO | | (10,000) |
| Customer service fees | **176,979** | 120,711 |
| Reimbursement of organization costs for CLC Trust | | 74,297 |
| Other | **72,346** | 15,661 |
| **Total other income** | **276,012** | 214,018 |
| Other expenses: | | |
| Salaries and employee benefits | **3,005,172** | 1,642,199 |
| Directors fees | **85,167** | 83,616 |
| Occupancy | **462,083** | 355,802 |
| Deposit insurance premium | **20,524** | 46,386 |
| Legal and professional services | **263,158** | 396,760 |
| Data processing | **252,308** | 211,574 |
| Advertising | **82,499** | 98,634 |
| Other | **481,511** | 416,268 |
| **Total other expenses** | **4,652,422** | 3,251,239 |
| **Income before income taxes** | **1,180,962** | 1,272,499 |
| Income tax expense | **236,505** | 404,957 |

| | | | | |
|---|---|---|---|---|
| **Net income** | **$** | **944,457** | $ | 867,542 |
| **Basic earnings per share** | **$** | **0.44** | $ | 0.17 |
| **Diluted earnings per share** | **$** | **0.43** | $ | 0.17 |

See Accompanying Notes to Consolidated Financial Statements.

Table of Contents

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

**Consolidated Statements of Equity**

**Years Ended December 31, 2006 and 2005**

| | Common Stock | Additional Paid-in Capital | Retained Earnings | Unallocated ESOP Shares | Unearned MRP Shares | Accumulated Other Comprehensive Income (Loss) | Maximum Cash Obligation Related to ESOP Shares | Total |
|---|---|---|---|---|---|---|---|---|
| Balance, December 31, 2004 | $ | $ | $ 10,980,517 | $ | $ | $ 24,986 | $ | $ 11,005,503 |
| Comprehensive income: | | | | | | | | |
| Net income | | | 867,542 | | | | | 867,542 |
| Other comprehensive (loss), net of tax: | | | | | | | | |
| Unrealized losses on securities available for sale arising during period, net of taxes of $(243,440) | | | | | | (472,562) | | (472,562) |
| Reclassification adjustment for losses included in net income, net of tax benefit of $68 | | | | | | 133 | | 133 |
| **Comprehensive income** | | | | | | | | 395,113 |
| Issuance of common stock, net of costs | 22,249 | 8,520,440 | | | | | | 8,542,689 |
| Purchase of 76,314 ESOP shares | | | | (763,140) | | | | (763,140) |
| Allocation of 5,088 of ESOP shares | | 2,544 | | 50,876 | | | | 53,420 |
| Balance, December 31, 2005 as previously reported | 22,249 | 8,522,984 | 11,848,059 | (712,264) | | (447,443) | | 19,233,585 |
| Adjustment to reflect the adoption of SEC Staff Accounting Bulletin No. 108, (Note 15) | | | 55,066 | | | | | 55,066 |
| Balance, December 31, 2005 as restated | 22,249 | 8,522,984 | 11,903,125 | (712,264) | | (447,443) | | 19,288,651 |
| Comprehensive income: | | | | | | | | |
| Net income | | | 944,457 | | | | | 944,457 |
| Other comprehensive income, net of tax: | | | | | | | | |
| Unrealized gains on securities available for sale arising during period, net of taxes of $17,052 | | | | | | 33,103 | | 33,103 |
| Reclassification adjustment for gains included in net income, net of tax expense of ($852) | | | | | | (1,655) | | (1,655) |
| **Comprehensive income** | | | | | | | | 975,905 |
| Allocation of 5,088 of ESOP shares | | 8,903 | | 50,876 | | | | 59,779 |
| Purchase of 43,608 MRP shares | | | | | (587,002) | | | (587,002) |
| Compensation expense on MRP awards granted | | | | | 7,553 | | | 7,553 |
| Compensation expense on RRP options granted | | 4,985 | | | | | | 4,985 |
| Cash dividends paid, $0.20 per share | | | (200,242) | | | | | (200,242) |
| Change related to ESOP shares cash obligation | | | | | | | (128,307) | (128,307) |
| Balance, December 31, 2006 | $ 22,249 | $ 8,536,872 | $ 12,647,340 | $ (661,388) | $ (579,449) | $ (415,995) | $ (128,307) | $ 19,421,322 |

See Accompanying Notes to Consolidated Financial Statements.

Table of Contents

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

**Consolidated Statements of Cash Flows**

**Years Ended December 31, 2006 and 2005**

| | 2006 | 2005 |
|---|---|---|
| Cash Flows from Operating Activities | | |
| Net income | $ **944,457** | $ 867,542 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | **261,912** | 177,858 |
| Provision for loan losses | **(1,263,478)** | (189,771) |
| Provision for deferred income taxes | **198,013** | 955,355 |
| Net amortization of premiums and discounts on securities | **22,241** | 156,339 |
| Federal Home Loan Bank stock dividends | | (173,108) |
| Loss (gain) on sale of available for sale securities | **(2,507)** | 201 |
| Origination of mortgage loans held for sale | **(1,734,778)** | (1,808,799) |
| Proceeds from sale of mortgage loans held for sale | **1,771,616** | 1,820,073 |
| Gain on sale of loans, net | **(36,838)** | (11,274) |
| Origination of mortgage servicing rights, net of amortization | **12,658** | (2,276) |
| Loss on sale of OREO | | 10,000 |
| ESOP compensation expense | **59,779** | 53,420 |
| MRP compensation expense | **7,553** | |
| Compensation expense on stock options | **4,985** | |
| Change in assets and liabilities: | | |
| (Increase) in accrued interest receivable | **(145,980)** | (96,932) |
| (Increase) decrease in other assets and tax refund receivable | **667,571** | (236,428) |
| Increase in accrued interest payable and other liabilities | **123,367** | 122,915 |
| **Net cash provided by operating activities** | **890,571** | 1,645,115 |
| Cash Flows from Investing Activities | | |
| Securities available for sale: | | |
| Purchases | **(5,459,340)** | (14,837,438) |
| Sales, calls, maturities and paydowns | **6,624,146** | 6,767,049 |
| Securities held to maturity: | | |
| Maturities and paydowns | **219,261** | 330,854 |
| Net (increase) in loans | **(16,365,488)** | (9,813,012) |
| Proceeds from sale of OREO | **30,865** | 89,983 |
| Purchase of premises and equipment | **(31,579)** | (1,965,833) |
| Proceeds from redemption of Federal Home Loan Bank stock | **1,690,792** | 1,796,300 |
| **Net cash (used in) investing activities** | **(13,291,343)** | (17,632,097) |
| Cash Flows from Financing Activities | | |
| Net increase in deposits | **17,975,808** | 8,227,213 |
| Proceeds from stock offering, net of expenses | | 8,542,689 |
| Cash dividends paid | **(200,242)** | |
| Purchase of ESOP shares | | (763,140) |
| **Net cash provided by financing activities** | **17,775,566** | 16,006,762 |
| **Net increase in cash and due from banks** | **5,374,794** | 19,780 |
| Cash and due from banks: | | |

| | | |
|---|---|---|
| Beginning | **5,039,518** | 5,019,738 |
| Ending | **$ 10,414,312** | $ 5,039,518 |
| Supplemental Disclosures of Cash Flow Information | | |
| Cash payments for: | | |
| Interest paid to depositors | **$ 5,972,499** | $ 4,702,498 |
| Income taxes, net of refunds received | **(809,226)** | (293,950) |
| Supplemental Schedule of Noncash Investing and Financing Activities | | |
| Real estate acquired through or in lieu of foreclosure | **126,507** | 60,000 |
| Sale of foreclosed real estate through loan origination | **95,642** | 170,000 |
| Liability due to the recording of ESOP put options | **(128,307)** | |
| Capitalization of interest through adoption of SAB 108 | **55,066** | |
| Contract to purchase shares for MRP Plan | **587,002** | |

See Accompanying Notes to Consolidated Financial Statements.

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

**Notes to Consolidated Financial Statements**

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

*Principles of consolidation*

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

*Change in reporting entity*

On January 20, 2005, the Board of Directors of the Bank unanimously adopted a plan of conversion providing for the conversion of the Bank from an Illinois chartered mutual savings bank to a federally chartered stock savings bank and the purchase of all of the common stock of the Bank by the Company. The depositors of the Bank approved the plan at a meeting held on May 6, 2005.

In adopting the plan, the Board of Directors of the Bank determined that the conversion was advisable and in the best interests of its depositors and the Bank. The conversion was completed on July 11, 2005 when the Company issued 1,223,701 shares of common stock to Ottawa Savings Bancorp MHC, and 1,001,210 shares of common stock to the public resulting in $10,012,100 of gross proceeds.

*Nature of business*

The primary business of the Company is the ownership of the Bank. Through the Bank, the Company is engaged in providing a variety of financial services to individual and corporate customers in the Ottawa, Illinois area, which is primarily an agricultural area. The Bank s primary source of revenue is single-family residential loans to middle-income individuals.

*Use of estimates*

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

*Significant group concentration of credit risk*

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

*Cash Equivalents*

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

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

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

**Notes to Consolidated Financial Statements (Continued)**

*Investment securities*

Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and reported at amortized cost. Securities not classified as held to maturity securities are classified as available for sale and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income (loss). Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

*Federal Home Loan Bank stock*

The Bank s required investment in the capital stock of the Federal Home Loan Bank is carried at cost, as fair values are not readily determinable.

On April 18, 2006 the Federal Home Loan Bank of Chicago ( FHLBC ) announced plans to redeem excess (or voluntary ) capital stock held by its members. The FHLBC received regulatory approval to redeem approximately $795 million of stock held by its members in excess of the minimum required as a condition for membership. During the second quarter of 2006, the Company redeemed approximately $1.2 million of excess stock (the Company s pro rata share). On November 8, 2006, the Federal Housing Finance Board authorized the FHLB s redemption on an additional $375 million of members excess (or voluntary ) capital stock. The company s pro rata share of approximately $500,000 was redeemed during the fourth quarter.

*Loans*

The Bank grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout Ottawa, Illinois and the surrounding area. The ability of the Bank s debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

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

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Other personal loans are typically charged off no later than 180 days past their due date. Past due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

All interest accrued but not collected for loans that are placed on non-accrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

*Allowance for loan losses*

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

The allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

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

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

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

*Servicing*

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage

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

**Notes to Consolidated Financial Statements (Continued)**

servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. Capitalized servicing rights are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

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

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

*Transfers of Financial Assets*

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

*Foreclosed real estate*

Real estate properties acquired through, or in lieu of, loan foreclosure are initially recorded at fair value at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other expenses. The Company had no investment in foreclosed real estate at December 31, 2006 and 2005.

*Income taxes*

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

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

*Premises and equipment*

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

| | Years |
|---|---|
| Buildings | 5-50 |
| Furniture and equipment | 5-39 |

*Pension plan*

The Bank has a pension plan covering substantially all employees. It is the policy of the Bank to fund the maximum amount that can be deducted for federal income tax purposes but in amounts not less than the minimum amounts required by law.

*Employee stock ownership plan*

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

*Stock compensation*

Effective November 21, 2006, the Company adopted SFAS No. 123(R), Share-Based Payment, which requires the company to measure all employee stock-based compensation awards using a fair value method and record such expenses in its consolidated financial statements. The Company had no stock-based awards granted prior to adoption of SFAS No. 123(R).

In accordance with the provisions of SFAS 123(R), the Company recognizes compensation cost for all stock-based awards granted November 21, 2006, based on the estimated grant date fair value. The fair value of stock options are estimated using a Black-Scholes option pricing model and amortized to expense over the option s vesting periods, as more fully disclosed in Note 10.

*Off-balance-sheet financial instruments*

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

*Comprehensive income (loss)*

Comprehensive income (loss) consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale, which are also recognized as separate components of stockholder s equity.

*Long-term assets*

Premises and equipment and other long-term assets are reviewed for impairment when events indicate that their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

*Loss contingencies*

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

*Fair value of financial instruments*

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed Note 14. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

*Earnings per share*

Basic earnings per share is based on net income divided by the weighted average number of shares outstanding during the period, including allocated and committed-to-be-released ESOP shares and vested stock awards. Diluted earnings per share show the dilutive effect, if any, of additional common shares issuable under stock options. The Company had no common stock equivalents as of December 31, 2005, consequently, basic and diluted earnings per share are the same.

| | Years ended December 31, 2006 | 2005 |
|---|---|---|
| Net income available to common stockholders | $ 944,457 | $ 363,796 |
| Basic potential common shares: | | |
| Weighted average shares outstanding | 2,224,911 | 2,224,911 |
| Weighted average unallocated Employee Stock Ownership Plan shares | (68,870) | (76,286) |
| Weighted average unvested MRP shares | (4,898) | |
| Basic weighted average shares outstanding | 2,151,143 | 2,148,625 |
| Dilutive potential common shares | | |
| Weighted average unrecognized compensation on MRP shares | 40,093 | |
| Weighted average RRP options outstanding** | | |
| Dilutive weighted average shares outstanding | 2,191,236 | 2,148,625 |
| Basic earnings per share* | $ 0.44 | $ 0.17 |
| Diluted earnings per share* | $ 0.43 | $ 0.17 |

* The initial public offering was consummated on July 11, 2005. Net income for the six months ended June 30, 2005 is not included in the calculation of basic and diluted income per share for the year ended December 31, 2005.

** The effect of stock options was not included in the calculation of diluted earnings per share because to do so would have been anti-dilutive.

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

**Notes to Consolidated Financial Statements (Continued)**

*Segment reporting*

The Company views the Bank as one operating segment, therefore, separate reporting of financial segment information is not considered necessary. The Company approaches the Bank as one business enterprise which operates in a single economic environment since the products and services, types of customers and regulatory environment all have similar characteristics.

*Recent accounting pronouncements*

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140.* The statement amends SFAS no. 140 by (1) requiring the separate accounting for servicing assets and servicing liabilities, which arise from the sale of financial assets; (2) requiring all separately recognized serving assets and servicing liabilities to be initially measured at fair value, if practicable; and (3) permitting an entity to choose between an amortization method or a fair value method for subsequent measurement for each class of separately recognized servicing assets and servicing liabilities. This statement is effective for fiscal years beginning after September 15, 2006, with earlier adoption permitted. The Company does not expect that the adoption of this Statement will have a material impact on its financial position, results of operation and cash flows.

In June 2006, the FASB issued FASB Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes*. This interpretation applies to all tax positions accounted for in accordance with SFAS No. 109, *Accounting for Income Taxes.* FIN 48 clarifies the application of SFAS No. 109 by defining the criteria that an individual tax position must meet in order for the position to be recognized within the financial statements and provides guidance on measurement, de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition for tax positions. This interpretation is effective for fiscal years beginning after December 15, 2006, with earlier adoption permitted. The Company is currently evaluating the impact that the adoption of this interpretation will have on its financial position, results of operation and cash flows. The Company does not expect that the adoption of this interpretation will have a material impact on its financial position, results of operation and cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* . This Statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. It clarifies that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. This Statement does not require any new fair value measurements, but rather, it provides enhanced guidance to other pronouncements that require or permit assets or liabilities to be measured at fair value. This Statement is effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted. The Company is currently evaluating the impact that the adoption of this Statement will have on its financial position, results of operation and cash flows.

In September 2006, the FASB issued Statement No. 158, ( SFAS No. 158 ), Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R). SFAS No. 158 requires a company that sponsors a postretirement benefit plan to fully recognize, as an asset or liability, the over-funded or under-funded status of its benefit plan in its balance sheet. The funded status is measured as the difference between the fair value of the plan s assets and its benefit obligation (projected benefit obligation for pension plans and accumulated postretirement benefit obligation for other postretirement benefit plans). Currently, the funded status of such plans is reported in the notes to the financial statements. This provision is effective for public companies for fiscal years ending after December 15, 2006. In addition, SFAS No. 158 also requires a company to measure its plan assets and benefit obligations as of its year

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

end balance sheet date. Currently, a company is permitted to choose a measurement date up to three months prior to its year end to measure the plan assets and obligations. This provision is effective for all companies for fiscal years ending after December 15, 2008. The Company does not expect that the adoption of this Statement will have a material impact on its financial position, results of operation and cash flows.

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

The Bank is required to maintain average balances on hand with the Federal Reserve Bank. At December 31, 2006 and 2005, these reserve balances amounted to $25,000 respectively.

**Note 3. Investment Securities**

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

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **December 31, 2006:** | | | | |
| **Held to Maturity** | | | | |
| Mortgage-backed securities | $ 1,182,853 | $ 5,196 | $ 16,752 | $ 1,171,297 |
| **Available for Sale** | | | | |
| U.S. agency securities | $ 15,836,227 | $ 10,793 | $ 132,025 | $ 15,714,995 |
| Mortgage-backed securities | 21,580,316 | 15,633 | 524,696 | 21,071,253 |
| | $ 37,416,543 | $ 26,426 | $ 656,721 | $ 36,786,248 |
| **December 31, 2005:** | | | | |
| **Held to Maturity** | | | | |
| Mortgage-backed securities | $ 1,404,850 | $ 6,006 | $ 17,996 | $ 1,392,860 |
| **Available for Sale** | | | | |
| U.S. agency securities | $ 16,833,221 | $ 27,766 | $ 220,276 | $ 16,640,711 |
| Mortgage-backed securities | 21,765,125 | 13,663 | 499,096 | 21,279,692 |
| | $ 38,598,346 | $ 41,429 | $ 719,372 | $ 37,920,403 |

At December 31, 2006 and 2005, U.S. agency securities with a carrying value of approximately $5,585,000 and $4,800,000, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law.

The amortized cost and fair value at December 31, 2006, by contractual maturity, are shown below. Maturities may differ from contractual maturities in mortgage-backed securities because the mortgages underlying the securities may be called or repaid without any penalties. Therefore, stated maturities of mortgage-backed securities are not disclosed.

| | Securities Held to Maturity | | Securities Available for Sale | |
|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Due within one year | $ | $ | $ 4,500,000 | $ 4,479,540 |
| Due after one year through five years | | | 11,336,227 | 11,235,455 |
| Due after five through ten years | | | | |
| Due after ten years | | | | |
| Mortgage-backed securities | 1,182,853 | 1,171,297 | 21,580,316 | 21,071,253 |
| | $ 1,182,853 | $ 1,171,297 | $ 37,416,543 | $ 36,786,248 |

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

There were $2,507 in gross realized gains in 2006 and none in 2005. Gross realized losses amounted to none in 2006 and $201 in 2005. The tax benefit (provision) applicable to these net realized gains and losses amounted to $(852) and $68, respectively.

Information pertaining to securities with gross unrealized losses at December 31, 2006 and 2005 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

| | Less than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| **December 31, 2006** | | | | | | |
| **Securities Available for Sale** | | | | | | |
| Debt securities: | | | | | | |
| U.S. agency securities | $ 1,995,440 | $ 4,560 | $ 11,710,906 | $ 127,465 | $ 13,706,346 | $ 132,025 |
| Mortgage-backed securities | | | 18,914,936 | 524,696 | 18,914,936 | 524,696 |
| | $ 1,995,440 | $ 4,560 | $ 30,625,842 | $ 652,161 | $ 32,621,282 | $ 656,721 |
| **Securities Held to Maturity** | | | | | | |
| Mortgage-backed securities | $ | $ | $ 770,929 | $ 16,752 | $ 770,929 | $ 16,752 |
| **December 31, 2005** | | | | | | |
| **Securities Available for Sale** | | | | | | |
| Debt securities: | | | | | | |
| U.S. agency securities | $ 8,097,124 | $ 90,972 | $ 6,518,407 | $ 129,304 | $ 14,615,531 | $ 220,276 |
| Mortgage-backed securities | 10,963,128 | 169,962 | 9,980,440 | 329,134 | 20,943,568 | 499,096 |
| | $ 19,060,252 | $ 260,934 | $ 16,498,847 | $ 458,438 | $ 35,559,099 | $ 719,372 |
| **Securities Held to Maturity** | | | | | | |
| Mortgage-backed securities | $ 41,604 | $ 249 | $ 848,496 | $ 17,747 | $ 890,100 | $ 17,996 |

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

At December 31, 2006, 51 securities have unrealized losses with aggregate depreciation of 1.98% from the Bank s amortized cost basis. These unrealized losses relate principally to interest rates relative to the market. In analyzing an issuer s financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts reports. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available for sale, no declines are deemed to be other than temporary.

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

**Note 4. Loans**

The components of loans are as follows:

| | December 31, | |
|---|---|---|
| | **2006** | **2005** |
| Mortgage loans: | | |
| Secured by one-to-four family residences | $ 87,468,579 | $ 75,845,981 |
| Multi-family | 8,062,931 | 11,835,958 |
| Construction | 7,767,308 | 11,827,236 |
| Home equity lines of credit | 7,639,784 | 9,027,559 |
| | 110,938,602 | 108,536,734 |
| Less: | | |
| Undisbursed portion of construction and other mortgage loans | (3,895,157) | (5,007,805) |
| **Total mortgage loans** | 107,043,445 | 103,528,929 |
| Other loans: | | |
| Non-residential real estate | 22,071,552 | 11,944,465 |
| Non-residential lines of credit | 535,616 | 746,496 |
| Commercial | 888,337 | |
| Commercial lines of credit | 421,130 | |
| Consumer loans | 12,011,733 | 9,051,623 |
| | 142,971,813 | 125,271,513 |
| Less: Allowance for loan losses | (419,685) | (390,994) |
| Plus: Deferred loan costs (fees) | (15,313) | 58,195 |
| **Loans, net** | $ 142,536,815 | $ 124,938,714 |

Activity in the allowance for loan losses is summarized as follows:

| | Years Ended December 31, | |
|---|---|---|
| | **2006** | **2005** |
| Balance at beginning of year | $ 390,994 | $ 438,506 |
| Provision credited to income | (1,263,478) | (189,771) |
| Loans charged off | (41,862) | (53,532) |
| Recoveries of loans previously charged off | 1,334,031 | 195,791 |
| Balance at end of year | $ 419,685 | $ 390,994 |

The allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. Based on their review and as a result of the recoveries of prior losses received, the allowance account was reduced by $1,263,478 during 2006 to better reflect the credit risk in the loan portfolio.

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

The following is a summary of information pertaining to impaired and non-accrual loans:

| | December 31, 2006 | 2005 |
|---|---|---|
| Impaired loans without a valuation allowance | $ | $ |
| Impaired loans with a valuation allowance | 7,134 | 49,845 |
| Total impaired loans | $ 7,134 | $ 49,845 |
| Valuation allowance related to impaired loans | $ 1,736 | $ 7,477 |
| Total non-accrual loans | $ 1,069,954 | $ 1,607,465 |
| Total loans past due ninety days or more and still accruing | $ 44,859 | $ 96,594 |

| | Years Ended December 31, 2006 | 2005 |
|---|---|---|
| Average investment in impaired loans | $ 10,873 | $ 33,702 |
| Interest income recognized on impaired loans | $ | $ |
| Interest income recognized on a cash basis on impaired loans | $ | $ |

No additional funds are committed to be advanced in connection with impaired loans.

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

| | Years Ended December 31, 2006 | 2005 |
|---|---|---|
| Balance, beginning of year | $ 278,630 | $ 194,547 |
| Deletions due to change in status | (137,038) | |
| Additions | 18,000 | 459,075 |
| Repayments | (51,841) | (374,992) |
| Balance, end of year | $ 107,751 | $ 278,630 |

**Note 5. Servicing**

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of mortgage and other loans serviced for others were $15,501,476 and $17,234,726 at December 31, 2006 and 2005, respectively.

The fair values of these servicing rights were $102,155 and $114,813 at December 31, 2006 and 2005, respectively. The fair value of servicing rights was determined using discount rates, prepayment speeds, depending upon the stratification of the specific right, and a weighted average default rate.

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

**Note 6. Accrued Interest Receivable**

Accrued interest receivable at December 31, 2006 and 2005 are summarized as follows:

| | 2006 | 2005 |
|---|---|---|
| U.S. agency securities | $ 159,725 | $ 155,312 |
| Mortgage-backed securities | 89,910 | 92,590 |
| Loans | 697,978 | 553,731 |
| | $ 947,613 | $ 801,633 |

**Note 7. Premises and Equipment**

Premises and equipment at December 31, 2006 and 2005 are summarized as follows:

| | 2006 | 2005 |
|---|---|---|
| Cost: | | |
| Land | $ 1,966,898 | $ 1,966,898 |
| Buildings | 6,558,937 | 6,479,925 |
| Furniture and equipment | 1,447,080 | 1,439,870 |
| | 9,972,915 | 9,886,693 |
| Less: Accumulated depreciation | 2,106,645 | 1,845,156 |
| | $ 7,866,270 | $ 8,041,537 |

**Note 8. Deposits**

Deposits at December 31, 2006 and 2005 are summarized as follows:

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | Amount | Percent | Amount | Percent |
| Non-interest bearing checking | $ 2,460,289 | 1.35% | $ 2,339,108 | 1.42% |
| Interest bearing checking | 8,678,466 | 4.75% | 9,782,553 | 5.93% |
| Money market | 8,443,182 | 4.62% | 10,206,495 | 6.19% |
| Passbook savings | 10,593,266 | 5.79% | 10,761,313 | 6.53% |
| Certificates of deposit | 152,681,553 | 83.49% | 131,791,479 | 79.93% |
| Interest bearing | 180,396,467 | 98.65% | 162,541,840 | 98.58% |

| | | | | |
|---|---|---|---|---|
| Total | $ 182,856,756 | 100.00% | $ 164,880,948 | 100.00% |

Interest expense on deposits for the years ended December 31, 2006 and 2005 is summarized as follows:

| | 2006 | 2005 |
|---|---|---|
| Money market | $ 221,807 | $ 199,553 |
| Passbook savings | 59,238 | 118,662 |
| Certificates of deposit | 5,697,996 | 4,353,797 |
| Checking | 55,088 | 94,082 |
| | $ 6,034,129 | $ 4,766,094 |

Deposits from directors, principal officers, their immediate families at December 31, 2006 and 2005 were $308,973 and $673,585, respectively.

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

**Notes to Consolidated Financial Statements (Continued)**

The aggregate amount of public deposits was approximately $7,490,188 and $5,685,387 at December 31, 2006 and 2005, respectively.

The aggregate amount of jumbo certificates of deposit within a minimum denomination of $100,000 was approximately $39,858,000 and $36,776,000 at December 31, 2006 and 2005, respectively. Individual deposits in excess of $100,000 are not insured by the FDIC.

At December 31, 2006, scheduled maturities of certificates of deposit are as follows:

| | |
|---|---|
| 2007 | $ 135,435,122 |
| 2008 | 10,154,417 |
| 2009 | 5,074,202 |
| 2010 | 1,229,899 |
| 2011 | 787,913 |
| | $ 152,681,553 |

The Bank held brokered deposits of $15,527,000 and $2,352,000 at December 31, 2006 and 2005, respectively. The broker receives a fee from the Bank for the brokered deposits. Total fee expense of $20,270 and $2,952 were recognized for the years ended December 31, 2006 and 2005, respectively.

**Note 9. Employment Benefit and Retirement Plans**

*Employee stock ownership plan*

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

Shares purchased by the ESOP with the loan proceeds are held in a suspense account and are allocated to ESOP participants on a pro rata basis as principal and interest payments are made by the ESOP to the Company. The loan is secured by shares purchased with the loan proceeds and will be repaid by the ESOP with funds from the Company s discretionary contributions to the ESOP and earnings on the ESOP assets. Annual payments of approximately $77,478, including interest at 6.25%, are to be made by the ESOP.

As shares are committed to be released from collateral, the Company will report compensation expense equal to the current market price of the shares and the shares will become outstanding for earnings-per-share (EPS) computations. During 2006, 5,088 shares, with an average fair value of $11.75 per share were committed to be released, resulting in ESOP compensation expense of $59,779 for the year.

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

A terminated participant or the beneficiary of a deceased participant who received a distribution of employer stock from the ESOP has the right to require the Company to purchase such shares at their fair market value any time within 60 days of the distribution date. If this right is not exercised, an additional 60 day exercise period is available in the year following the year in which the distribution is made and begins after a new valuation of the stock has been determined and communicated to the participant or beneficiary. At December 31, 2006, 10,176 shares at a fair value of $12.61 have been classified as mezzanine capital.

| | December 31, | |
|---|---|---|
| | 2006 | 2005 |
| Shares allocated | 10,176 | 5,088 |
| Unallocated shares | 66,138 | 71,226 |
| Total ESOP shares | 76,314 | 76,314 |
| Fair value of unallocated shares | $ 834,000 | $ 747,873 |

*Defined benefit retirement plan*

The Bank has a qualified defined-benefit retirement plan covering substantially all of its employees with the Financial Institutions Retirement Fund. The Financial Institutions Retirement Fund is a tax-qualified pension trust covering multiple participating employers, employee-members and retirees and beneficiaries. Expenses of $1,695,825 and $384,000 were recorded for the years ended December 31, 2006 and 2005, respectively, of which $1,297,000 related to the anticipated freezing of the plan.

Governmental regulations impose certain requirements relative to multi-employer plans. In the event of plan termination or employer withdrawal, an employer may be liable for a portion of the plan s unfunded vested benefits. The Bank has not received information from the plan s administrators to determine its share of unfunded vested benefits. On February 23, 2007, the Board of Directors of Ottawa Savings Bank approved the freezing of the Bank s defined benefit pension plan (the Plan ), effective April 1, 2007. The plan provides benefits to eligible employees based on a participant s years of benefit service and a participant s highest five consecutive years of compensation. Effective with the freeze, each active participant s pension benefit will be determined based on a participant s compensation and period of employment as of March 31, 2007. Compensation and employment after that date will not be taken into account.

*401(k) plan*

The Bank maintains a voluntary 401(K) plan for substantially all employees. Employees may contribute up to 15 percent of their compensation subject to certain limits based on federal tax laws. The Bank makes matching contributions equal to 50 percent of the first 5 percent of an employee s compensation contributed to the Plan. Matching contributions vest to the employee equally over a five-year period. Matching expense was $26,568 for 2006 and $18,803 for 2005. In conjunction with the freeze of the Defined Benefit Plan, the Bank plans on increasing its matching contributions in the current 401(k) plan from 50 percent of the first 5 percent to 50 percent of the first 6 percent of an employee s compensation contributed to the plan. The Bank also plans to contribute an amount equal to 3 percent of an eligible employee s compensation to the 401(k) plan each pay period. Additionally, the Bank plans on increasing the maximum amount of voluntary deferrals allowed under the 401(k) plan from 15 percent to 75 percent of an employee s salary, subject to all applicable federal tax laws and plan limits.

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

*Deferred compensation*

The Bank has deferred compensation agreements with certain directors. Contributions to the plan for the years ended December 31, 2006 and 2005 were $92,483 and $69,700, respectively. The deferred compensation liability included on the balance sheet in other liabilities was $846,135 and $839,386 as of December 31, 2006 and 2005, respectively.

*Post-retirement health benefit plan*

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

Post-retirement health benefits valuation:

| | December 31, | |
|---|---|---|
| | **2006** | **2005** |
| Number of participants: | | |
| Retirees | 4 | 5 |
| Active employees fully eligible | 1 | |
| Active employees not yet eligible | 4 | 6 |
| Total | 9 | 11 |

Obligations and funded status:

| | December 31, | |
|---|---|---|
| | **2006** | **2005** |
| | (Amounts in thousands) | |
| **Change in benefit obligation** | | |
| Benefit obligation at beginning of year | $ 399 | $ 472 |
| Service cost | 6 | 6 |
| Interest cost | 23 | 28 |
| Actuarial (gain) | (185) | (90) |
| Benefits paid | (9) | (17) |
| Benefit obligation at end of year | 234 | 399 |
| **Change in plan assets** | | |
| Employer contributions | 9 | 17 |
| Benefits paid | (9) | (17) |
| Fair value of plan assets at year end | | |
| Funded status | (234) | (399) |
| Unrecognized actuarial (gain) | (186) | (13) |
| Net amount recognized | $ (420) | $ (412) |

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

Amounts recognized in the statement of financial position consist of:

| | December 31, | |
|---|---|---|
| | **2006** | **2005** |
| Accumulated post-retirement benefit obligation: | | |
| Retirees | $ (131,451) | $ (234,247) |
| Active employees fully eligible | (34,693) | |
| Active employees not yet eligible | (68,015) | (164,655) |
| Total | (234,159) | (398,902) |
| Plan assets at fair value | | |
| Funded status | (234,159) | (398,902) |
| Unrecognized (asset) liability, net (gain) or loss | (185,815) | (13,198) |
| (Accrued)/prepaid cost | $ (419,974) | $ (412,100) |

Components of Net Periodic Benefit Cost:

| | December 31, | |
|---|---|---|
| | **2006** | **2005** |
| Service cost | $ 6,280 | $ 6,565 |
| Interest cost | 22,628 | 27,754 |
| Amortization net gain | | 2,152 |
| Net cost | $ 28,908 | $ 36,471 |

Weighted average assumptions used to determine net periodic benefit cost:

| | December 31, | |
|---|---|---|
| | **2006** | **2005** |
| Discount rate | 6.00% | 5.75% |
| Expected long-term return on plan assets | | |
| Rate of compensation increase | | |

Assumed health care cost trend rates:

| | December 31, | |
|---|---|---|
| | **2006** | **2005** |
| Health care cost trend rate assumed for next year | 8.00% | 8.00% |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) | 4.00% | 4.00% |
| Year that the rate reaches the ultimate trend rate | 2011 | 2010 |

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

| | 1-Percentage Point Increase | 1-Percentage Point Decrease |
|---|---|---|
| | (Amounts in thousands) | |
| Effect on total of service and interest cost components | $ 3 | $ (3) |
| Effect on post-retirement benefit obligation | $ 23 | $ (23) |

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

**Notes to Consolidated Financial Statements (Continued)**

*Cash Flows*

Contributions: The Bank expects to contribute $7,000 to its other post-retirement benefit plan in 2007.

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

| Year | Other Benefits (Amounts in thousands) |
|---|---|
| 2007 | $ 7 |
| 2008 | 8 |
| 2009 | 8 |
| 2010 | 9 |
| 2011 | 9 |
| 2012-2016 | 56 |

**Note 10. Stock Compensation**

*Management recognition plan*

A Management Recognition and Retention Plan ( MRP ) provides for issue of shares to directors and officers. Pursuant to the Ottawa Savings Bancorp, Inc. 2006 Equity Incentive Plan, the Company purchased 43,608 shares and granted 37,065 shares of restricted stock on November 21, 2006. The shares were purchased by the Company at an average cost of $13.46 per share. These shares vest over a five year period. The unamortized cost of shares not yet vested and not yet granted of $579,449 is reported as a reduction of stockholders equity. Compensation expense for restricted stock awards totaled approximately $8,000 for the year ended December 31, 2006.

A summary of the status of the MRP stock awards at December 31, 2006 is as follows:

| Restricted Stock Awards | Shares | Weighted Average Grant Date Fair Value |
|---|---|---|
| Nonvested at beginning of year | | $ |
| Granted | 37,065 | 13.46 |
| Exercised | | |
| Forfeited | | |
| Nonvested at end of year | 37,065 | $ 13.46 |

*Stock option plan*

A Recognition and Retention Plan ( RRP ) provides for issues of options to directors, officers, and employees. Pursuant to the Ottawa Savings Bancorp, Inc. 2006 Equity Incentive Plan, the Company granted options of 92,666 shares of the Company s common stock, with an exercise

price of $12.35 per share on November 21, 2006. The options become exercisable in equal installments over a five year period from the grant date. The options expire ten years from the grant date.

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

The fair value of the stock options granted has been estimated using a Black-Scholes option pricing model. This option pricing model requires management to make subjective assumptions, such as expected stock price volatility, dividend rates, and expected time to exercise. The fair value of the options granted on November 21, 2006 was estimated at the grant date using the Black-Scholes model and the following assumptions:

| **Black-Scholes assumptions** | |
|---|---|
| Dividend rate | 0.40% |
| Risk-free interest rates | 4.58% |
| Expected time to exercise | 7 years |
| Volatility | 10.87% |

A summary of the status of the RRP stock options at December 31, 2006 is as follows:

| **Stock Options** | **Shares** | **Weighted Average Exercise Price** | **Weighted Average Remaining Contractual Term** | **Aggregate Intrinsic Value** |
|---|---|---|---|---|
| Outstanding at beginning of year | | $ | | |
| Granted | 92,666 | 12.35 | | |
| Exercised | | | | |
| Forfeited | | | | |
| Outstanding at end of year | 92,666 | $ 12.35 | 9.92 years | $ 24,093 |
| Exercisable at year end | | $ | | $ |
| Weighted average fair value per option granted during the year | $ 3.26 | | | |

The total compensation cost at December 31, 2006, related to non-vested options not yet recognized was approximately $297,000 with an average expense recognition period of 4.9 years. The Company recognized compensation expense of approximately $5,000 and a deferred tax asset of approximately $400 for the year ended December 31, 2006. All options granted remain un-vested at December 31, 2006 and are expected to be exercisable in accordance with their original terms.

**Note 11. Income Taxes**

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

Income tax expense is summarized as follows:

| | **Years Ended December 31, 2006** | **2005** |
|---|---|---|
| Federal: | | |
| Current | $ 17,665 | $ (584,244) |

| | | |
|---|---|---|
| Deferred | 218,840 | 970,938 |
| | 236,505 | 386,694 |
| State: | | |
| Current | 20,827 | 33,846 |
| Deferred | (20,827) | (15,583) |
| | | 18,263 |
| | $ 236,505 | $ 404,957 |

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

The Company s income tax expense differed from the maximum statutory federal rate of 35% for the years ended December 31, 2006 and 2005, as follows:

| | Years Ended December 31, | |
|---|---|---|
| | **2006** | **2005** |
| Expected income taxes | $ 413,337 | $ 445,375 |
| Income tax effect of: | | |
| Tax exempt interest | (2,402) | (3,897) |
| State taxes, net of federal tax benefit | | 11,871 |
| Income taxed at lower rates | (11,810) | (12,725) |
| Other | (162,620) | (35,667) |
| | $ 236,505 | $ 404,957 |

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

| | December 31, | |
|---|---|---|
| | **2006** | **2005** |
| Deferred tax assets: | | |
| Allowance for loan losses | $ 162,964 | $ 151,823 |
| Net operating loss carryforwards | 574,026 | 1,032,109 |
| Net unrealized loss on securities available for sale | 214,300 | 230,500 |
| Employee benefit plans | 539,535 | 500,607 |
| Other | 50,918 | |
| **Deferred tax asset** | 1,541,743 | 1,915,039 |
| Deferred tax liabilities: | | |
| Deferred loan costs | | (22,597) |
| FHLB stock dividends | (15,090) | (15,090) |
| Other | | (136,485) |
| **Deferred tax liability** | (15,090) | (174,172) |
| **Net deferred tax asset** | $ 1,526,653 | $ 1,740,867 |

Retained earnings at December 31, 2006 include approximately $1,169,000 for which no federal income tax liability has been recognized. This amount represents an allocation of income to bad debt deductions for tax purposes only. Reductions of amounts so allocated for purposes other than bad debt losses or adjustments arising from carryback of net operating losses would create income for tax purposes only, which would be subject to the then current corporate income tax rate. The unrecorded deferred income tax liability on the above amount was approximately $453,000 at December 31, 2006.

Federal net operating losses of $1,100,000 as of December 31, 2006 can be carried forward until the year 2024. Illinois net operating loss carryforwards of approximately $4,100,000 as of December 31, 2006, which expire in 2015 and 2016, are available to offset future state taxable income.

**Note 12. Regulatory Matters**

The Bank is subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet the minimum regulatory capital requirements can initiate certain mandatory, and

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

**Notes to Consolidated Financial Statements (Continued)**

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total risk-based capital and Tier 1 capital to risk-weighted assets (as defined in the regulations), Tier 1 capital to adjusted total assets (as defined), and tangible capital to adjusted total assets (as defined). Management believes as of December 31, 2006 and 2005 that the Bank meets all capital adequacy requirements to which it is subject.

To be categorized as adequately capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as disclosed in the table below. There are no conditions or events that management believes have occurred that would change the Bank s capitalization classification.

| | Actual | | For Capital Adequacy Purposes: | | To Be Well Capitalized Under Prompt Corrective Action Provisions: | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **December 31, 2006:** | | | | | | |
| Total Risk-Based Capital (to Risk Weighted Assets) | $ 17,994,829 | 16.30% | $ 8,831,920 | 8.00% | $ 11,039,900 | 10.00% |
| Tier I Capital (to Risk Weighted Assets) | $ 17,575,144 | 15.92% | $ 4,415,960 | 4.00% | $ 6,623,940 | 6.00% |
| Tier I Capital (to Adjusted Total Assets) | $ 17,575,144 | 8.59% | $ 8,180,600 | 4.00% | $ 10,225,750 | 5.00% |
| Tangible Capital (to Adjusted Total Assets) | $ 17,575,144 | 8.59% | $ 3,067,725 | 1.50% | N/A | N/A |
| **December 31, 2005:** | | | | | | |
| Total Risk-Based Capital (to Risk Weighted Assets) | $ 17,376,301 | 18.00% | $ 7,724,480 | 8.00% | $ 9,655,600 | 10.00% |
| Tier I Capital (to Risk Weighted Assets) | $ 16,985,307 | 17.59% | $ 3,862,240 | 4.00% | $ 5,793,360 | 6.00% |
| Tier I Capital (to Adjusted Total Assets) | $ 16,985,307 | 9.23% | $ 7,359,280 | 4.00% | $ 9,199,100 | 5.00% |
| Tangible Capital (to Adjusted Total Assets) | $ 16,985,307 | 9.23% | $ 2,759,730 | 1.50% | N/A | N/A |

**Note 13. Commitments and Contingencies**

In the ordinary course of business, the Bank has various commitments and contingent liabilities that are not reflected in the accompanying financial statements. In the opinion of management, the ultimate disposition of these matters is not expected to have a material adverse affect on the financial position of the Bank.

The Company s mutual holding company waived its share of dividends declared by the Company amounting to $244,740 and none for the years ended December 31, 2006 and 2005, respectively.

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit. This instrument involves elements of credit and interest-rate risk in excess of the amount recognized in the statement of financial condition.

At December 31, 2006 and 2005, the following financial instruments were outstanding whose contract amounts represent credit risk:

| | Variable rate | Fixed rate | Total | Range of rates or fixed rate |
|---|---|---|---|---|
| As of December 31, 2006: | | | | |
| Commitments to originate loans | $ 2,708,996 | $ 420,523 | $ 3,129,519 | 6.75%-8.00% |
| Unfunded commitments on construction | 2,845,525 | 1,049,632 | 3,895,157 | 6.25%-7.25% |
| Unfunded commitments under lines of credit | 9,120,052 | | 9,120,052 | |
| | 14,674,573 | 1,470,155 | 16,144,728 | |
| Standby letters of credit | 1,809,260 | 29,600 | 1,838,860 | 7.00%-7.25% |
| | $ 16,483,833 | $ 1,499,755 | $ 17,983,588 | |
| As of December 31, 2005: | | | | |
| Commitments to originate loans | $ 3,146,565 | $ 898,113 | $ 4,044,678 | 5.50%-7.25% |
| Unfunded commitments on construction loans | 3,429,934 | 1,577,871 | 5,007,805 | 5.00%-8.00% |
| Unfunded commitments under lines of credit | 7,554,618 | | 7,554,618 | |
| | 14,131,117 | 2,475,984 | 16,607,101 | |
| Standby letters of credit | 2,826,733 | 296,101 | 3,122,834 | 6.75%-8.00% |
| | $ 16,957,850 | $ 2,772,085 | $ 19,729,935 | |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank is based on management s credit evaluation of the customer.

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

The Company does not engage in the use of interest rate swaps or futures, forwards or option contracts.

**Note 14. Fair Values of Financial Instruments**

Statement of Financial Accounting Standards No. 107, *Disclosures about Fair Value of Financial Instruments,* requires disclosure of fair value information about financial instruments, whether or not recognized in the statement of financial condition. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be

substantiated by comparison to independent markets and, in many cases,

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

could not be realized in immediate settlement of the instruments. Statement No. 107 excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Bank.

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

*Cash and Due from Banks:* The carrying amounts reported in the balance sheets for cash and due from banks approximate fair values.

*Securities*: Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. The carrying value of Federal Home Loan Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank.

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

*Deposits:* The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

*Accrued Interest Receivable and Payable*: The carrying amounts of accrued interest receivable and payable approximates fair values.

*Mortgage Servicing Rights:* The carrying amounts of these rights approximate their fair values.

*Loan Commitments*: Commitments to extend credit were evaluated and fair value was estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counter-parties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The Bank does not charge fees to enter into these agreements. As of December 31, 2006 and 2005, these items are immaterial in nature.

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

The estimated fair values of the Bank s financial instruments are as follows:

| | December 31, 2006 | | December 31, 2005 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial Assets: | | | | |
| Cash and due from banks | $ 10,414,312 | $ 10,414,312 | $ 5,039,518 | $ 5,039,518 |
| Securities | 40,316,117 | 40,304,561 | 43,363,061 | 43,351,071 |
| Accrued interest receivable | 947,613 | 947,613 | 801,633 | 801,633 |
| Loans | 142,536,815 | 141,103,000 | 124,938,714 | 124,086,000 |
| Mortgage servicing rights | 102,155 | 102,155 | 114,813 | 114,813 |
| Financial Liabilities: | | | | |
| Deposits | 182,856,756 | 182,300,000 | 164,880,948 | 163,465,000 |
| Accrued interest payable | 138,630 | 138,630 | 77,000 | 77,000 |

In addition, other assets and liabilities of the Bank that are not defined as financial instruments are not included in the above disclosures, such as property and equipment. Also, non-financial instruments typically not recognized in financial statements nevertheless may have value but are not included in the above disclosures. These include, among other items, the estimated earnings power of core deposit accounts, the trained work force, customer goodwill and similar items.

**Note 15. Adoption of SEC Staff Accounting Bulletin No. 108**

The Company has adopted SEC Staff Accounting Bulletin No. 108 (SAB 108), Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB 108 states that the registrants must quantify the impact of correcting all misstatements, including both the carryover (iron curtain method) and reversing (rollover method) effects of prior year misstatements on the current year financial statements, and by evaluating the misstatements quantified under each method in light of both quantitative and qualitative factors.

In adopting the requirements of SAB 108, the Company adjusted its fixed assets which were understated by $55,066 as of January 1, 2006. Such understatement resulted from unrecorded capitalized interest on the construction of the main facility that was placed in service in March of 2004, which was previously evaluated as being immaterial under the rollover method. The Company has reported the cumulative effect of the initial application of SAB 108 by adjusting retained earnings as of January 1, 2006 with a credit of $55,066, to increase its fixed assets. The adjustment of the quarterly financial results for 2006 will be accomplished by adjusting the applicable financial statement line items when such information is next presented. Reports previously filed with the SEC will not be amended.

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

**Note 16. Condensed Parent Only Financial Statements**

| | December 31, 2006 | December 31, 2005 |
|---|---|---|
| | (in thousands) | |
| ***Statements of financial condition*** | | |
| Assets: | | |
| Cash and cash equivalents | $ 437,947 | $ 606,381 |
| Equity in net assets of Ottawa Savings Bank | 18,307,838 | 17,918,513 |
| Other assets | 675,537 | 708,691 |
| | $ 19,421,322 | $ 19,233,585 |
| Liabilities and stockholders equity: | | |
| Other liabilities | $ | $ |
| Stockholders equity | 19,421,322 | 19,233,585 |
| | $ 19,421,322 | $ 19,233,585 |

| | Years Ended December 31, 2006 | Years Ended December 31, 2005 |
|---|---|---|
| | (in thousands) | |
| ***Statements of income*** | | |
| Equity in net income of subsidiary | $ 945,804 | $ 845,159 |
| Interest income | 70,404 | 28,683 |
| **Operating income** | 1,016,208 | 873,842 |
| Other expenses | 70,117 | 6,300 |
| **Income before income tax benefit** | 946,091 | 867,542 |
| Income tax expense | 1,634 | |
| **Net income** | $ 944,457 | $ 867,542 |

Table of Contents

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

**Notes to Consolidated Financial Statements (Continued)**

| | December 31, 2006 | December 31, 2005 |
|---|---|---|
| | (in thousands) | |
| ***Statements of cash flows*** | | |
| Operating activities: | | |
| Net income | $ 944,457 | $ 867,542 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Distributions in excess of (less than) net income of subsidiary | (945,804) | (845,159) |
| Other | | 3,573 |
| **Net cash provided by operating activities** | (1,347) | 25,956 |
| Investing activities: | | |
| Investment in subsidiary | | (7,250,000) |
| Payments received on ESOP note receivable | 33,155 | 50,876 |
| **Net cash provided by (used in) investing activities** | 33,155 | (7,199,124) |
| Financing activities: | | |
| Proceeds from stock offering, net of expenses | | 7,779,549 |
| Cash dividends paid | (200,242) | |
| Purchase of treasury stock | | |
| **Net cash provided by (used in) financing activities** | (200,242) | 7,779,549 |
| **Net increase (decrease) in cash and cash equivalents** | (168,434) | 606,381 |
| Cash and cash equivalents: | | |
| Beginning of period | 606,381 | |
| End of period | $ 437,947 | $ 606,381 |
| Supplemental Schedule of Noncash Investing and Financing Activities | | |
| Recording of ESOP put options at Bank level | $ (128,307) | $ |
| Purchase of MRP shares | 587,002 | |

Table of Contents

## SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

OTTAWA SAVINGS BANCORP, INC.

Date: March 27, 2007

By: /s/ GARY OCEPEK
**Gary Ocepek**
**President, Chief Executive Officer and Director**

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

| Name | Title | Date |
|---|---|---|
| /s/ GARY OCEPEK<br>**Gary Ocepek** | President, Chief Executive Officer and Director (principal executive officer) | March 27, 2007 |
| /s/ JON KRANOV<br>**Jon Kranov** | Senior Vice President and Chief Financial Officer (principal accounting and financial officer) | March 27, 2007 |
| /s/ JAMES A. FERRERO<br>**James A. Ferrero** | Director | March 27, 2007 |
| /s/ KEITH JOHNSON<br>**Keith Johnson** | Director | March 27, 2007 |
| /s/ ARTHUR C. MUELLER<br>**Arthur C. Mueller** | Director | March 27, 2007 |
| /s/ DANIEL J. REYNOLDS<br>**Daniel J. Reynolds** | Director | March 27, 2007 |

Table of Contents

**EXHIBIT INDEX**

| Exhibit No. | Description of Exhibit |
|---|---|
| 3.1 | Certificate of Incorporation of Ottawa Savings Bancorp, Inc. (incorporated by reference to Exhibit 3.1 to company s Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005, as amended) |
| 3.2 | Bylaws of Ottawa Savings Bancorp, Inc. (incorporated by reference to Exhibit 3.2 to company s Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005, as amended) |
| 10.1 | Ottawa Savings Bank Employee Stock Ownership Plan and Trust Agreement, (incorporated by reference to Exhibit 10.1 to Company s Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005, as amended) |
| 10.2 | ESOP Loan Documents, (incorporated by reference to Exhibit 10.2 to Company s Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005, as amended) |
| 10.3 | Form of Ottawa Savings Bancorp, Inc. and Ottawa Saving Bank Employment Agreement with Mr. Ocepek, (incorporated by reference to Exhibit 10.3 to Company s Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005, as amended) |
| 10.4 | Form of Ottawa Savings Bancorp, Inc. and Ottawa Saving Bank Employment Agreement with Mr. Kranov, (incorporated by reference to Exhibit 10.4 to Company s Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005, as amended) |
| 10.5 | Form of Ottawa Savings Bancorp, Inc. and Ottawa Saving Bank Employment Agreement with Mr. Devermann, (incorporated by reference to Exhibit 10.5 to Company s Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005, as amended) |
| 10.6 | Ottawa Savings Bancorp, Inc. Director Emeritus Plan, (incorporated by reference to Exhibit 10.6 to Company s Registration Statement on Form SB-2, No. 333-123455, file on March 18, 2005, as amended) |
| 10.7 | Ottawa Savings Bank Employees Savings and Profit Sharing Plan and Trust, (incorporated by reference to Exhibit 10.7 to Company s Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005, as amended). |
| 10.8 | Ottawa Savings Bank Change in Control Severance Compensation Plan, (incorporated by reference to Exhibit 10.8 to Company s Registration Statement on Form SB-2, No. 333-123455, filed on March 18, 2005, as amended) |
| 10.9 | Ottawa Savings Bank, Inc. Voluntary Deferred Compensation Plan (incorporated by reference to Exhibit 10.9 to Company s Registration Statement on Form SB-2, No. 333-123455, filed on May 16, 2005) |
| 10.10 | Amendment to Ottawa Savings Bank, Inc. Voluntary Deferred Compensation Plan for Directors, (incorporated by reference to Exhibit 10.10 to Company s Registration Statement on Form SB-2, No. 333-123455, filed on May 16, 2005, as amended) |
| 11.1 | Computation of per share earnings (included in Note 1 to the Company s Consolidated Financial Statements) |
| 14.1 | Ottawa Savings Bancorp, Inc. Code of Ethics and Business Conduct |
| 21.1 | List of Subsidiaries (incorporated by reference to Exhibit 21.1 to Company s 2006 Annual Report on Form 10-KSB, No. 000-51367, filed on March 29, 2006) |
| 23.1 | Consent of McGladrey and Pullen, LLP |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer |
| 32.1 | Section 1350 Certifications |