Capital Pacific Bancorp

Office of the Special Inspector General
Troubled Asset Relief Program
1500 Pennsylvania Ave., N. W., Suite 1064
Washington, D.C. 20220

March 3, 2009

Dear Mr. Barofsky

We have received your letter dated February 6, 2009 requesting information about our intended use of TARP funds, our actual use of TARP funds to date, and other related inquiries. Our response is below, and follows the outline suggested in your letter.

(1)(a). We expect to use our TARP funds to provide us with the capital to make new business loans that we might otherwise not make in this difficult economic cycle. We also expect that the TARP funds will provide other less predictable, but equally important benefits. Examples include a calming influence on our business clients and their overall sense of financial security, and new opportunities for the bank to grow, either by client acquisition or business combination. Our expected use of the TARP funds remains consistent with that outlined in our original application.

(b) Our TARP funds are not segregated from other institutional funds.

(c) From December 23, 2008 which is the date we received the TARP funds through February 28, 2009, we have originated new loans totaling $5.7 million and renewed existing loans totaling $6.1 million. This volume is higher than the same period last year and demonstrates that we continue to be an active lender consistent with past practice despite material economic deterioration observed in our market. We also bid on the whole bank purchase of a failing community bank in our market upon invitation by the FDIC. Under this purchase, we would have assumed 100% of the loans and deposits of that bank. We did not win that bid.

(d) We expect to continue to use the TARP funds as outlined in (1)(a).

(2) The employment contracts of our senior executive officers were amended on December 23, 2008 to address the compensation requirements associated with the TARP funds. Specifically, the amendments state that incentive compensation may be required to be repaid to the Bank if the payments were based on materially inaccurate financial statements or performance metric criteria. The amendments also state that if an executive's employment is terminated involuntarily or by reason of bankruptcy, insolvency, or receivership of the Bancorp or its wholly owned subsidiary, Capital Pacific Bank, severance compensation will be reduced to the extent it is a "golden parachute payment" as defined under Internal Revenue Code Section 280G(e).

Getting it done.

805 SW Broadway, Suite 780, Portland, Oregon 97205 Phone: 503-796-0100 | Fax: 503-796-0100 www.capitalpacificbank.com

Our compensation committee is also expected to review the incentive compensation arrangements with senior executive officers annually to ensure that such arrangements do not encourage the officers to take unnecessary or excessive risks, both long-term and short-term, that threaten the value of Bancorp or the Bank.

No changes have been made to address the new laws included in the American Recovery and Reinvestment Act of 2009 because we are uncertain as to how they may pertain to us, and whether certain provisions are retrospective, or prospective, or subject to further rulemaking on the part of the Treasury Department.

Enclosed is our press release to the media about our participation in the TARP program. Also enclosed is a copy of management's internal original summary of the TARP program which was used for discussion purposes by our Board of Directors prior to our decision to apply for the program. Lastly, enclosed is a summary of the loans originated and renewed during the period of December 23, 2008 through February 28, 2009 as compared to the same period in 2008.

As evidenced by our signatures below, we certify the accuracy of all statements, representations, and supporting information provided in this letter, subject to the requirements and penalties set forth in Title 18, United States Code, Section 1001.

Mark Stevenson
CEO

Felice Belfiore
EVP / CFO

Press Release

Source: Capital Pacific Bancorp

Capital Pacific Bank Receives Preliminary Approval From U.S. Treasury's Capital Purchase Program

Thursday November 6, 4:23 pm ET

PORTLAND, OR--(MARKET WIRE)--Nov 6, 2008 -- Capital Pacific Bancorp (OTC BB:CPBO.OB - News), parent company of Capital Pacific Bank, today announced it has received preliminary approval of its $4 million application to participate in the U.S. Department of the Treasury's Capital Purchase Program (TCPP). The program is designed to attract broad participation by healthy banking institutions to help stabilize the financial system and increase lending for the benefit of the U.S. economy. Capital Pacific Bank is believed to be the first bank of its size in this region to be approved.

"Being accepted to receive TCPP funding recognizes Capital Pacific Bank's financial stability," said Mark Stevenson, CEO of Capital Pacific Bank. "TCPP funds are being made available only to those banks that are in a strong financial position. The new funds strengthen our already strong capital position and increase our capacity for growth."

As of September 30, 2008, Capital Pacific Bank's total capital ratio stood at 13.3%, well in excess of the 10% standard to be considered well capitalized. As such, the TCPP proceeds will be immediately available for local lending purposes. "We'll use it to allow us to expand lending programs while continuing to maintain healthy capital ratios," Stevenson said. "This is exactly what the federal government intended when the program was established."

Stevenson indicated participation in the program is a smart business move. "As a local community bank, we are very supportive of opportunities to deploy new capital on behalf of Oregonians and our local businesses," he said. "It's a cost-effective use of taxpayer resources because it is an investment in our community rather than an outright expenditure."

Stevenson said participation in the program will allow Capital Pacific Bank additional flexibility when setting appropriate loan growth levels in the current market cycle. He also indicated the bank could use the funding to explore pursuing business combinations with other small community banks, including those that are struggling in the current economic climate. "TCPP funds would allow us to be better positioned to merge or acquire other banks without material detriment to our own capital ratios," he said.

As a TCPP participant, Capital Pacific Bancorp will issue $4 million in preferred stock, paying cumulative dividends on a quarterly basis at a rate of 5% p.a. until the fifth anniversary when the rate steps up to 9% if not refinanced by the Company. The stock carries no voting rights and may be refinanced at any time during the first three years using the proceeds from a common stock offering or another preferred stock issuance. The terms and conditions of the transaction and the preferred stock will conform to those provided by the U.S. Treasury. A summary of the Capital Purchase Program can be found on the Treasury's web site at http://www.ustreas.gov/initiatives/eesa.

About Capital Pacific Bancorp

Capital Pacific Bancorp (OTC BB:CPBO.OB - News) is the parent company of Capital Pacific Bank, which serves businesses, professionals and nonprofit organizations with comprehensive business banking expertise and an elite level of service. Headquartered in the Fox Tower in downtown Portland, the bank's full array of products and services are delivered through a strategic combination of highly experienced client service officers and the innovative application of technology. For more information on Capital Pacific Bancorp, past press releases or letters to shareholders, please visit www.capitalpacificbank.com.

Forward-looking statements

Statements in this release about future events or performance are forward-looking statements, which involve known and unknown risks, uncertainties and other factors that may cause the actual results of the company to be materially different from any future results expressed or implied by such forward-looking statements. Factors that could affect future results include changes in the financial condition of our borrowers, changes in economic conditions generally, deteriorating asset values caused by changing market conditions, loan losses that exceed our allowance for loan losses and fluctuations in interest rates and the impact those factors may have upon clients of the company. Other factors include competition for loans and deposits within the company's trade area, and the impact that may have upon growth or income. Although forward-looking statements help to provide complete information about the company, readers should keep in mind that forward-looking statements may be less reliable than historical information. The company undertakes no obligation to update or revise forward-looking statements in this release to reflect events or changes in circumstances that occur after the date of this release.

Contact:

Contact:
Christie Nye
Email Contact
or
Timm Locke
Email Contact
Pipeline Public Relations + Marketing
(503) 546-7811

CPB MEMORANDUM

TO: BOARD

FROM: MARK STEVENSON

FELICE BELFIORE

SUBJECT: THE CASE FOR TARP'S CPP PROGRAM

DATE: 11/26/08

STRUCTURE OF CPP

- $4,000,000 in preferred stock
- 5% coupon for five years, 9% after that.
- Callable in three years.
- Immediately converted warrants of $.01 per share equal to 5% of the total issue price for a total cost of $200,000.

BENEFITS OF CPP

- Will support new loans that we would otherwise be unable to make. [redacted] b(4)
- Is more favorable than other forms of capital available to Bancorp to fund growth. The 5% coupon is cheaper than similar issues to household bank names in any economic cycle (standard is 8-10%). There are no underwriting costs. It has a 3 yr call. The warrants are typical. The total cost of capital is estimated at 5.19%. This excludes the value of the call option which would most likely reduce the cost of capital below 5%.
- Will act as a buffer for what is evolving into one of the worst economic cycles we have experienced. None of us know how bad the economy is going to get. Community banks cannot find available capital right now and that is probably not changing anytime soon.
- [redacted] b(4)

RESTRICTIONS ON EXECUTIVE COMPENSATION

Banks participating in CPP must comply with the following limits on executive compensation: (a) limits on compensation that exclude incentives for Senior Executive Officer (SEOs) of financial institutions to take unnecessary and excessive risks that threaten the value of the financial institution; (b) required recovery of any bonus or incentive compensation paid to a SEO based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate; (c) prohibition on the financial institution from making any golden parachute payment to any SEO; and (d) agreement to limit a claim to a federal income tax deduction for certain executive remuneration (generally $500,000 per executive). The provisions apply while the Treasury holds an equity or debt position in the financial institution.

While the first limitation is fairly broad, it appears that it is the compensation committee's responsibility to assure that incentives are consistent with good judgment. In any case, it's difficult to make a direct connection between these restrictions and compensation programs here at CPB.

RESTRICTIONS ON DIVIDENDS AND REPURCHASES

If we participate in CPP, we will be restricted from issuing any cash or stock dividends, or repurchasing any common shares for three years. (While we could petition the Treasury Department for permission to do so, there is little assurance that such permission would be granted.). [redacted] b(4)

DILUTION

The CPP funds are initially dilutive until the capital can be put to work. Keefe, Bruyette & Woods estimates that banks will need to leverage the CPP funds 3.1 to 1 to offset the dividend cost. Our estimate is about the same. [redacted] b(4)

[redacted]

$ [redacted] b(4)

(1) 2010 & 2011 assumes $20 million in loans and deposits per year and no table funding revenue. Deposit and staffing assumptions are unchanged in both scenarios (which may or may not be realistic depending on our future outlook)

OTHER GOVERNMENT IMPOSED RESTRICTIONS / MANDATES

The Treasury department has not issued any specific instructions on how the CPP funds are to be used except to say the following:

"the Company agrees to expand the flow of credit to U.S. consumers and businesses on competitive terms to promote the sustained growth and vitality of the U.S. economy" "the Company agrees to work diligently, under existing programs, to modify the terms of residential mortgages as appropriate to strengthen the health of the U.S. housing market"

However, either the Treasury Department or Congress could later impose restrictions on the use of CPP funds, or demand an accounting for how the funds are used. We believe our intended use of funds lines up with the stated purpose of the program and thus, will be beyond any significant scrutiny.

PUBLIC PERCEPTION

One of our primary concerns of the program when first announced was the possibility of a stigma attached to those banks participating in the CPP program. Misinformation about the program remains a concern, especially amongst the general public that is experiencing "bail-out" fatigue. However, perception of the program within the investment community is positive and there is a reasonable amount of discussion about the downside to banks that either don't qualify for CPP or choose not to participate. Our stockholders are mixed, although generally, stock performance of banks announcing preliminary approval is better than those that have not. Keefe, Bruyette & Woods reports that 82% of banks that have received preliminary approval from the Treasury have outperformed the KBW bank index since the date of their announcement.

	12/23/2008 -2/28/2009		12/23/2007 -2/28/2008	
	No.	Amount	No.	Amount
Loans Originated	21	5,740,219	20	3,374,507
Loans Renewed	45	6,117,115	19	1,587,977

	2/28/2009	2/28/2008
Total Loans Outstanding	135,138,949	128,577,948