easternmichiganbank.com

2015
Annual Report

Eastern
Michigan
Financial
Corporation

Mission Statement

To continue as a progressive and growing community bank, serving our communities by offering a wide range of competitive services for our customers, resulting in a profitable organization, enabling us to build capital, pay appropriate dividends to our stockholders and competitive salaries to our employees.

Core Values

At Eastern Michigan Bank, we take great pride in being a community bank. At the center of our value system is our core commitment to provide value driven products and courteous service delivered by a caring and professional staff. After all, we're not just in the "banking business," we're in the business of financing people's lives and dreams - a responsibility we don't take lightly.

Our Promise

We promise our customers they can rely on us to listen to their needs and try to provide solutions. We also promise to always practice discretion and tact when it comes to personal or professional financial issues and to treat our customers with respect, dignity and integrity, all while doing our best to help them reach their financial goals.

General Information

Eastern Michigan Financial Corporation is the holding company for Eastern Michigan Bank, a full service community bank with offices in Croswell, Deckerville, Fort Gratiot, Lakeport, Lexington, Marysville, Minden City, Port Huron and Sandusky.

Investor Relations Contact

Karen M. Lord, Senior Vice President, Chief Financial Officer
Eastern Michigan Financial Corporation
65 N. Howard Avenue, Croswell, Michigan 48422
810.398.5135

Independent Auditors

Rehmann Robson
5800 Gratiot, Suite 201
Saginaw, Michigan 48638
989.799.9580

Corporate Headquarters

Eastern Michigan Financial Corporation
65 N. Howard Avenue
Croswell, Michigan 48422

Transfer Agent and Registrar

Computershare Shareholder Services
P.O. Box 30170
College Station, Texas 77842-3170
800.368.5948

Stock Symbol

Over-The-Counter Bulletin Board: EFIN

Annual Meeting

The Eastern Michigan Financial Corporation annual meeting of company shareholders is scheduled for Tuesday, April 19 at 5:30 p.m. and will be held at Lakeview Hills Golf Resort, 6560 E. Peck Road, Lexington, Michigan 48450.

2015 ANNUAL REPORT

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Administration Building Remodel Inside Back Cover

Administrative Offices
65 N. Howard Avenue
Croswell, Michigan 48422
810.679.2500

Fort Gratiot Branch
3061 Krafft Road
Fort Gratiot, Michigan 48059
810.966.2281

Loan Center
66 N. Howard Avenue
Croswell, Michigan 48422
810.679.2500

Port Huron Branch
600 Water Street
Port Huron, Michigan 48060
810.987.9777

Croswell Branch
37 N. Howard Avenue
Croswell, Michigan 48422
810.679.3620

Lakeport Branch
7090 Lakeshore Road
Lakeport, Michigan 48059
810.385.3211

Marysville Branch
2970 Gratiot Boulevard
Marysville, Michigan 48040
810.364.4854

Sandusky Branch
324 S. Sandusky Road
Sandusky, Michigan 48471
810.648.3230

Deckerville Branch
3636 Main Street
Deckerville, Michigan 48427
810.376.2015

Lexington Branch
5446 Main Street
Lexington, Michigan 48450
810.359.5353

Minden City Branch
1728 Main Street
Minden City, Michigan 48456
989.864.3393

Corporate Website
easternmichiganbank.com

A note about our cover:
Our cover image shows a hand holding a smart phone displaying the login screen from our mobile banking application. As referenced in our Letter to Shareholders on pages 6 and 7, we released mobile banking apps for iPhones, iPads and Android based smart phones early in 2015. Our mobile apps have much of the same functionality as traditional online banking, including some unique features such as personal mobile deposit.

BOARD OF DIRECTORS

Earl E. DesJardins, Chairman
Civil Engineer
BMJ Engineers & Surveyors, Inc., Port Huron

Timothy M. Ward, Vice Chairman
Chief Executive Officer
Eastern Michigan Bank, Croswell

Bradley D. Apsey, Director
President
Apsey Funeral Home Inc., Deckerville

Karen S. Flanagan, Director
Farmer
Sandusky

George J. McNaughton, Director
Farmer
Croswell

William G. Oldford, Jr., Director
President
Eastern Michigan Bank, Croswell

Kathlene M. Partaka, Director
Retired EVP, Operations
Eastern Michigan Bank, Croswell

Ann Randall Kendrick, Director
Owner
Pollock Randall Funeral Home, Port Huron
Marysville Funeral Home, Marysville

Patricia W. Ryan, Director
Retired Partner
Frohm, Kelley, Butler & Ryan, P.C., Port Huron

John C. Williams, Director
Retired Superintendent
Electrical & Water Departments, Croswell

Director Announcements

As discussed in more detail in our Letter to Shareholders on pages 6 and 7, William G. Oldford, Jr., joined Eastern Michigan Financial Corporation and Eastern Michigan Bank as President in late October. In November, he was appointed to the boards of directors of both the holding company and the bank.

William G. Oldford, Jr. and Timothy M. Ward

Eastern Michigan Financial Corporation Officers

Earl E. DesJardins, Chairman of the Board
Timothy M. Ward, Vice Chairman of the Board and Chief Executive Officer
William G. Oldford, Jr., President
Karen M. Lord, Senior Vice President, Chief Financial Officer
Ann E. Matthews, Senior Vice President, Secretary

Eastern Michigan Bank Senior Management Officers

Timothy M. Ward, Chief Executive Officer
William G. Oldford, Jr., President
Karen M. Lord, Senior Vice President, Chief Financial Officer
Ann E. Matthews, Senior Vice President, Operations

Eastern Michigan Bank Vice Presidents

William E. Cone, Vice President, Commercial Loan Manager
Jay A. Wofford, Vice President, Commercial Loan Officer
Christopher M. Flann, Vice President, Commercial Loan Officer
Kathleen M. Wurmlinger, Vice President, Mortgage Manager
L. Michael O'Vell, Vice President, Consumer Loan Manager and Security Officer

Eastern Michigan Bank Assistant Vice Presidents

Joseph L. Brown, Assistant Vice President, Appraiser
Kyle W. Jacobs, Assistant Vice President, Sandusky Branch Manager
Christi Agostino-Erd, Assistant Vice President, Mortgage Loan Officer
Clariece C. Creguer, Assistant Vice President, Deckerville and Minden City Branch Manager
Tammy J. Williford, Assistant Vice President, Marketing and Compliance Officer
Catherine L. Fitz, Assistant Vice President, Marysville Branch Manager
Stacie L. Bales, Assistant Vice President, Operations
Stefanie M. Abbott, Assistant Vice President, Lexington Branch Manager
Gerald D. Hepfer, Assistant Vice President, Commercial Loan Officer

Eastern Michigan Bank Officers

Karen S. Biskey, Computer Manager and Information Security Officer
Cindy M. Mugridge, Lakeport Branch Manager
Nancy A. Kulman, Port Huron Branch Manager
Mary K. Heiden, Loan Processing Manager
Trishette L. Davis, Croswell Branch Manager
Audra L. Levitte, Human Resources Director
Rachel L. Galbraith, Commercial Loan Officer
Kathleen M. Saelens, Fort Gratiot Branch Manager
Julie A. DeGrande, Bank Secrecy Act Officer

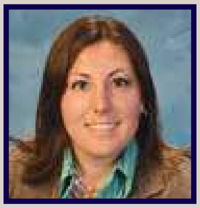
Promotions

Catherine L. Fitz
Assistant Vice President, Branch Manager

Branch Manager Catherine Fitz was promoted to assistant vice president in September 2015. Ms. Fitz joined Eastern in 2006 when we opened our Marysville location. She holds an associate's degree in business administration from Baker College as well as a diploma in banking from the American Institute of Banking. Ms. Fitz is very involved with her local community, serving as vice chair of the Port Huron division of the March of Dimes and treasurer of the Marysville Rotary Club. She is also an active member with the Marysville Friends of the Arts and Women's Life Arc Angels, Chapter #820.

Stacie L. Bales
Assistant Vice President, Operations

Operations Officer Stacie Bales was promoted to assistant vice president in September 2015. Since joining the bank in 2001, she has served as human resources assistant, administrative assistant, administrative specialist and most recently, Bank Secrecy Act officer. Ms. Bales also serves on the board of the Croswell-Lexington Little League.



Stefanie M. Abbott
Assistant Vice President, Branch Manager

Branch Manager Stefanie Abbott was promoted to assistant vice president in September 2015. Ms. Abbott joined Eastern in 2003, working as a teller, head teller and assistant manager before being promoted to branch manager of our Lexington location in 2011. She holds an associate's degree in communications from St. Clair County Community College. Ms. Abbott is also active in the community, serving as chairman of the McLaren Community Health Team (Lexington) and treasurer of the Croswell/Lexington Chamber of Commerce. She is also a member of the Deckerville League of Women and chairs their annual fundraising bazaar.

Gerald D. Hepfer
Assistant Vice President, Commercial Loan Officer

Commercial Loan Officer Gerald Hepfer was promoted to assistant vice president in September 2015. Mr. Hepfer joined the bank in August of 2010 as a credit analyst and was promoted to commercial loan officer in 2011. He holds a diploma in commercial lending from the American Bankers Association, an associate's degree in banking and finance from Kirtland Community College and a bachelor's degree in business administration with a concentration in finance from Saginaw Valley State University.

Julie A. DeGrande
Bank Secrecy Act Officer

Julie DeGrande was appointed Bank Secrecy Act (BSA) officer in September 2015. Ms. DeGrande's new responsibilities of administering the bank's BSA program were added to her existing operational duties. Since joining Eastern in 2003, she has served as teller, teller trainer/Vertex specialist, head teller/Vertex specialist and administrative specialist. Ms. DeGrande has an associate's degree in business from St. Clair County Community College.

BRANCH & ADMINISTRATIVE STAFF

Croswell Branch
Chelsea Bowerman, Assistant Branch Manager
Megan Bowers, Head Teller
Jamie Goline, Teller
Katie Hurley, Teller
Christine Jones, Teller
Brett Nemeckay, Teller
Colleen Newberry, Teller

Deckerville Branch
Ashley Grabitz, Assistant Branch Manager
Scott Cameron, Teller, CSR
Debra Quick, Vault Teller
Nancy Vogel, Teller

Fort Gratiot Branch
Catherine Mugridge, Assistant Branch Manager
Amber LePla, Head Teller
Tamira Alden, Teller
Diane Johnson, Teller
Falon Stocks, Teller

Lakeport Branch
Judith Smith, Assistant Branch Manager
Donna Gentner, Head Teller
Judith Bowers, Teller
Kari Wagner, Teller

Lexington Branch
Krista Short, Assistant Branch Manager
Paula Mullen, Head Teller
Deborah Dickinson, Teller
Suzanne Hedges, Teller
Andrea Krug, Teller
Amanda Matthews, Teller

Marysville Branch
Karen Hubble, Head Teller
Terri Herman, Teller
Alyssa Patterson, Teller

Minden City Branch
Hannah Griffith, Teller

Port Huron Branch
Ashley McCormick, Assistant Branch Manager
Elizabeth McPhillips, Head Teller
Chelsea Alexis, Teller
Stephanie Blake, Teller

Sandusky Branch
Rita Berberich, Assistant Branch Manager
Alicia Reinke, Head Teller
Shena Abend, Teller
Mindy Fetting, Teller
Roxann Green, Teller

Loan Center (Croswell)
Kathleen Breckner, Mortgage/Commercial Loan Clerk
Jennifer Burns, Commercial Loan Clerk/Analyst
Amanda Mosher, Mortgage Specialist, Underwriter
Nicki Parker, Mortgage/Collections Clerk
Crystal Sweet, Consumer Loan Clerk/Courier
Kara Turcott, Credit Analyst
Tiffany Warczinski, Commercial Loan Clerk
Jasmine Williams, Consumer Loan Documentation Specialist

Administrative Staff
Nikki Butler, Bookkeeping Supervisor
Chelsea DuPree, Human Resources Assistant
Melissa Gelinski, Accountant
Darlene Innes, Courier
Barb Krawczyk, Administrative Specialist
Heather Langolf, Accounting Clerk
Ashley Lindke, Bookkeeper
Dru Moran, Bookkeeper
Mechel Smith, Administrative Specialist

Eastern Michigan Bank offers non-bank investment services through Financial Advisor Nicholas Dickinson representing Eastern Michigan Investment Services.

Eastern Michigan Investment Services

Securities & Advisory Services offered through Investment Professionals, Inc. Member FINRA & SIPC

Located at:
Eastern Michigan Bank
65 N. Howard Avenue
Croswell, Michigan 48422
810.398.5129
easternmichiganinvestments.com

NO BANK GUARANTEE | NOT FDIC INSURED | MAY LOSE VALUE All Securities and Advisory Services offered through Investment Professionals, Inc. (IPI), a Registered Broker/Dealer & Registered Investment Advisor and member FINRA & SIPC. The investment services offered by IPI under the name Eastern Michigan Investment Services are in no way affiliated with or offered by Eastern Michigan Bank, nor is Eastern Michigan Bank a registered broker/dealer. Customers working with Eastern Michigan Investment Services will be dealing solely through IPI with respect to their investment, brokerage and securities transactions. IPI does not offer or provide legal or tax advice. Please consult your attorney and/or tax advisor for such services. The products offered by Investment Professionals, Inc. are not insured by the FDIC, the NCUA or any other agency of the government, are not deposits or other obligations for the bank or guaranteed by the bank and involve investment risks, including possible loss of principal amount invested.

Eastern Michigan Bank is proud to recognize employees who celebrated milestone anniversaries with us in 2015.

25 Year Award

Darlene Innes
Courier

15 Year Award

Judith Bowers
Teller

10 Year Award

Ashley Lindke
Bookkeeper

Timothy Ward
Chief Executive Officer

Catherine Mugridge
Assistant Branch Manager

Christi Agostino-Erd
AVP, Mortgage Loan Officer

Deborah Dickinson
Teller

Julie DeGrande
Bank Secrecy Act Officer

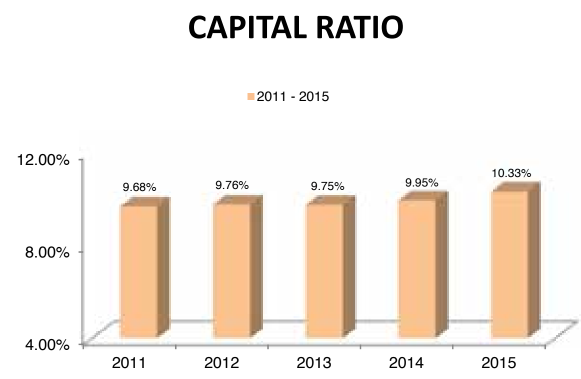
5 Year Award

Gerald Hepfer
AVP, Commercial Loan Officer

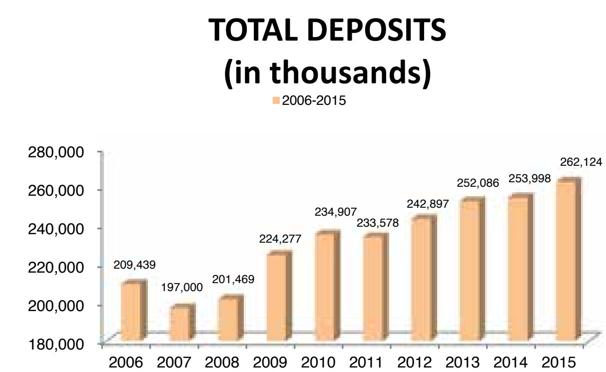
LETTER TO SHAREHOLDERS

Eastern Michigan Financial Corporation announced significant events in late 2015.

In November, we entered into a purchase agreement to acquire Ruth Bank Corporation and its wholly owned subsidiary, Ruth State Bank. Established in 1907, Ruth State Bank operates from a single location in Ruth, Michigan, in lower Huron County. Ruth Bank Corporation has been owned principally by the Zinger family since its inception and current President Joe Zinger has followed his father and grandfather in leading this institution. As part of the acquisition and integration of Ruth State Bank, we will be closing and consolidating our Minden City branch into the Ruth branch. With Minden's limited hours, lack of an ATM and four mile proximity to Ruth, the consolidation of these branches into one location makes economic sense. Existing Minden customers will enjoy expanded hours in Ruth and 24 hour access to an ATM machine to be installed this summer.

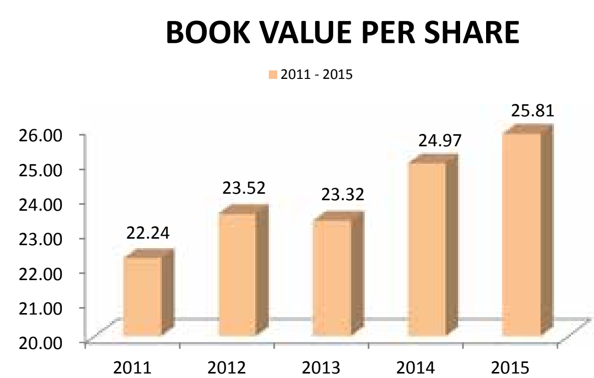


The acquisition of Ruth Bank Corporation was at slightly higher than one times September 30, 2015 book value. As such, the acquisition will generate only a nominal intangible on our balance sheet. As with any acquisition, conversion changes are inevitable and we expect one time charges of about $870,000 to earnings in 2016. For 2017, we expect the acquisition to be accretive to earnings by $0.35 per share.



The acquisition of Ruth Bank Corporation will be an all cash transaction, thus no shareholder dilution will occur due to the sale or issuance of new stock. A careful study of our post acquisition balance sheet will reveal that the equity in our holding company will not have changed materially, but that the ratios by which we are measured will decrease due to the increase in size of the overall balance sheet. Despite the reductions in our capital ratios – our balance sheet will remain very solid.

As we move forward with the integration of this operation and welcome our new customer base, we will look for opportunities to expand our customer relationships utilizing the benefits associated with the acquisition. Given our lending staff's expertise and our ability to provide larger loans than Ruth State Bank could, we see significant potential to generate more assets.



In late October, we also announced the hiring of William G. Oldford, Jr., who came to us from Talmer Bank and Trust, Port Huron where he served as Regional President, Northeast (Thumb) Region in addition to managing the wealth management division of Talmer in Michigan, Ohio, Indiana and Illinois. Will started his banking career over sixteen years ago at the former Citizens First Savings Bank where he was a member of senior management team and managed the Trust Department and Investment Services division. Born and raised just five miles from our headquarters in Lexington, Michigan, he holds a bachelor's degree from the University of Michigan, a juris doctor from California Western Law School and a master of laws taxation from Wayne State University Law School. Will's initial focus with us will be the branch banking and operations of the bank as he has taken on the responsibilities of Ann Matthews, Senior Vice President, Operations who retired in early 2016. The board's eventual plan is for Will to succeed Tim when he retires in a few years. For now, Will holds the title of president and Tim remains as CEO with the added responsibility of running the loan side of the bank.

October also brought the final implementation of the Truth in Lending Act/Real Estate Settlement Procedures Act Integrated Disclosure Rule, commonly referred to as TRID. TRID ushered in sweeping change to federally mandated mortgage loan disclosure requirements and the expense and time required to bring our loan processes into compliance was significant. Despite this added challenge, our residential mortgage business actually improved in 2015 and we increased income generated from selling loans to the secondary market by around $40,000 over 2014. We do expect to face headwinds in the future with refinancing as mortgage interest rates are likely to increase, but we have developed plans to maintain a mortgage volume that will generate meaningful fee and servicing income.

The sale of two larger parcels of bank owned real estate drove strong fourth quarter results, helping propel us to a very positive year-end net income of $1,972 million. One long held parcel in Fort Gratiot Township was sold at a nearly six figure gain compared to carrying value as it had been written down in prior years due to a then declining market. Located across from Meijer, this land will soon be home to a new Tractor Supply Company store. We also liquidated a second parcel of farm land that we had not held long and even though we sold it at current market value, carrying value rules helped us realize a modest gain.

Lower crop, milk and most recently, beef prices have somewhat dampened agricultural industry performance of late, resulting in a modest pull back in land prices and reduced demand for loans. Since agricultural loans comprise a significant portion of our portfolio, we must be diligent in our efforts to both keep our products competitive and prudently manage risk. Long term (15-20 years) fixed rate loans are popular with borrowers and in previous years, we've lost opportunities to farm credit service provider, GreenStone, because they were able to offer those terms and we were not. Losing those long term opportunities has also jeopardized our chance at the products we did offer – such as shorter term equipment loans -- as GreenStone was able to establish a foothold with our borrowers. Becoming a seller/servicer for the Federal Agricultural Mortgage Corporation (Farmer Mac) has made it possible for us to offer long term fixed rate loans as well, and in 2015 we originated $2.5 million in loans for them, resulting in additional fee income for us. From a risk management standpoint, we continue to seek Farm Service Agency (part of USDA) loan guarantees where needed and participate in their Certified Lender Program. Our Certified Lender status means reduced paperwork and an expedited approval process, helping us better serve our customers overall.

In last year's annual report, we announced the release of our mobile banking service, including mobile apps for smart phones. Our branch staff deserves much credit for the nice job they have done "kick starting" this product! By year-end, we were at over 1,000 active mobile users, compared to just over 2,500 users of traditional online banking, a product we have had for more than 10 years. In early fourth quarter, we added a mobile deposit feature, allowing our personal mobile banking users to deposit checks using their smart phone's camera. The adoption rate for mobile deposit has been even more rapid. By year-end, almost one-third of our existing users had signed up for it.

At $0.55 per share, dividend payments to shareholders in 2015 were consistent with the previous three years, including a $0.07 per share bonus dividend in the fourth quarter. Our board understands the importance of dividends to our shareholders and hopes that as the efficiencies of integrating Ruth State Bank take hold, increased dividends will follow. Shareholder's equity ended the year at $29.6 million which equates to a book value of $25.81 per share.

As always, the directors, officers, and entire staff of Eastern Michigan Bank join us in thanking you for your continued support. We look forward to seeing you at the annual shareholders' meeting on April 19, 2016, at 5:30 p.m. at Lakeview Hills in Lexington.

Sincerely,

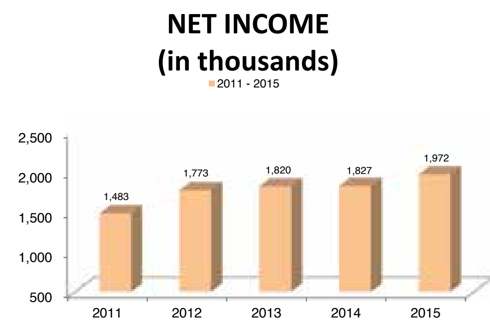
Earl E. DesJardins
Chairman of the Board

Timothy M. Ward
Vice Chairman of the Board,
Chief Executive Officer

2015 HIGHLIGHTS AND TEN YEAR FINANCIAL PROFILE

2015 Highlights - Year In Brief

FOR THE YEAR (in thousands)	2015	2014	% Change
Net Interest Income	$ 8,306	$ 8,275	0.4%
Non-Interest Income	1,694	1,530	10.7%
Non-Interest Expense	7,448	7,291	2.2%
Net Income	1,972	1,827	7.9%
YEAR END (in thousands)			
Total Assets	$ 293,028	$ 283,251	3.5%
Loans, Net of Unearned Interest	137,535	137,025	0.4%
Allowance for Loan Losses	1,204	1,688	-28.7%
Deposits	262,124	253,998	3.2%
Shareholders' Equity	29,572	28,394	4.1%
PER SHARE			
Net Income	$ 1.73	$ 1.61	7.5%
Book Value	25.81	24.97	3.4%
Cash Dividends	0.55	0.55	0.0%
Number of Shares Outstanding	1,145,731	1,137,294	0.7%



Ten Year Financial Profile

FOR THE YEAR (in thousands)	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Net Interest Income	$ 8,306	$ 8,275	$ 8,175	$ 8,500	$ 8,674	$ 8,768	$ 8,369	$ 8,671	$ 9,209	$ 8,933
Provision for Loan Losses	(144)	69	283	406	933	1,066	2,294	991	476	296
Non-Interest Income	1,694	1,530	1,669	1,571	1,278	1,531	1,659	240	1,105	1,243
Non-Interest Expense	7,448	7,291	7,223	7,395	7,132	7,170	7,068	7,050	7,058	6,620
Income Before Income Taxes	2,696	2,445	2,338	2,270	1,887	2,063	666	870	2,780	3,260
Less: Income Taxes	724	618	518	497	404	495	16	131	833	959
Net Income	1,972	1,827	1,820	1,773	1,483	1,568	650	739	1,947	2,301
AT YEAR END (in thousands)										
Total Investment Securities	$ 110,344	$ 118,054	$ 113,141	$ 85,452	$ 72,389	$ 64,855	$ 38,149	$ 17,891	$ 27,234	$ 18,303
Restricted Investments	980	1,022	916	916	905	952	982	922	922	922
Federal Funds Sold	0	0	0	0	0	0	1,631	4,523	4,401	20,227
Total Loans	137,535	137,025	136,487	139,580	144,116	155,858	170,633	174,926	168,443	175,764
Allowance for Loan Losses	1,204	1,688	1,765	2,758	2,796	3,155	3,716	2,233	1,901	1,905
Total Assets	293,028	283,251	279,362	270,472	259,757	259,966	250,424	226,950	223,366	233,098
Total Deposits	262,124	253,998	252,086	242,897	233,578	234,907	224,277	201,469	197,000	209,439
Borrowed Funds	0	0	0	0	0	0	2,000	2,000	2,000	0
Shareholders' Equity	29,572	28,394	26,489	26,616	25,103	23,983	23,056	22,373	23,484	22,555
PER SHARE										
Net Income	$ 1.73	$ 1.61	$ 1.60	$ 1.57	$ 1.31	$ 1.39	$ 0.58	$ 0.64	$ 1.69	$ 1.99
Book Value	25.81	24.97	23.32	23.52	22.24	21.25	20.43	19.82	20.36	19.54
Cash Dividends	0.55	0.55	0.55	0.55	0.48	0.48	0.48	0.96	0.96	0.92
Number of Shares Outstanding	1,145,731	1,137,294	1,135,669	1,131,649	1,128,737	1,128,737	1,128,737	1,128,737	1,153,667	1,154,256
Return on Average Assets	0.69%	0.65%	0.67%	0.68%	0.58%	0.61%	0.28%	0.33%	0.87%	1.00%
Return on Average Equity	6.64%	6.65%	6.83%	6.83%	5.94%	6.48%	2.83%	3.20%	8.29%	10.32%
Capital Ratio	10.33%	9.95%	9.75%	9.76%	9.68%	8.98%	9.33%	9.85% *	10.22% *	9.62%

* Prior to 2009 the capital ratio was not measured at the consolidated level. Capital ratios reported in those earlier years are based on Eastern Michigan Bank results.

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands except share data)

	December 31	
	2015	2014
ASSETS		
Cash and demand deposits due from banks	$ 5,225	$ 5,681
Interest bearing balances due from banks	22,429	6,463
Cash and cash equivalents	**27,654**	**12,144**
Certificates of deposit held in other banks	2,472	1,229
Investment securities		
Available-for-sale	102,628	118,054
Held-to-maturity	7,716	-
Restricted investments	980	1,022
Net loans	136,331	135,337
Accrued interest receivable	945	946
Premises and equipment, net	5,735	5,842
Foreclosed assets	1,191	1,556
Bank-owned life insurance	6,159	6,009
Other assets	1,217	1,112
Total assets	**$ 293,028**	**$ 283,251**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$ 70,456	$ 62,175
Interest-bearing	191,668	191,823
Total deposits	**262,124**	**253,998**
Accrued interest payable and other liabilities	1,332	859
Total liabilities	**263,456**	**254,857**
Commitments and contingencies (Notes 11, 13, and 14)		
Shareholders' equity		
Common stock, $5 par value; 3,000,000 shares authorized, 1,145,731 (1,137,294 in 2014) shares issued and outstanding	5,728	5,686
Additional paid-in-capital	1,864	1,812
Retained earnings	22,207	20,877
Accumulated other comprehensive (loss) income	(227)	19
Total shareholders' equity	**29,572**	**28,394**
Total liabilities and shareholders' equity	**$ 293,028**	**$ 283,251**

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

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands except per share data)

	Year Ended December 31	
	2015	2014
Interest and dividend income		
Loans (including fees)	$ 6,650	$ 6,763
Securities		
Taxable	1,596	1,587
Nontaxable	368	416
Other	97	95
Federal funds sold and deposits with banks	40	59
Total interest and dividend income	**8,751**	**8,920**
Interest expense	445	645
Net interest income	**8,306**	**8,275**
Provision for loan losses	(144)	69
Net interest income, after provision for loan losses	**8,450**	**8,206**
Noninterest income		
Service charges on deposit accounts	924	902
Other service charges and fees	221	202
Other	549	426
Total noninterest income	**1,694**	**1,530**
Noninterest expenses		
Compensation and benefits	4,045	3,868
Occupancy and equipment	1,026	1,082
Other	2,377	2,341
Total noninterest expenses	**7,448**	**7,291**
Income before federal income taxes	**2,696**	**2,445**
Federal income taxes	724	618
Net income	**$ 1,972**	**$ 1,827**
Net income per basic share of common stock	**$ 1.73**	**$ 1.61**
Net income per diluted share of common stock	**$ 1.71**	**$ 1.60**

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)

	Year Ended December 31	
	2015	**2014**
Available-for-sale securities		
Unrealized holding (losses) gains arising during the year	$ (394)	$ 1,038
Reclassification adjustment for net realized gains included in net income	22	-
Comprehensive (loss) income before income tax benefit (expense)	(372)	1,038
Income tax benefit (expense) related to other comprehensive (loss) income	126	(353)
Other comprehensive (loss) income	**(246)**	**685**
Net income	1,972	1,827
Comprehensive income	**$ 1,726**	**$ 2,512**

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Dollars in thousands except per share data)

	Common Stock		Additional Paid-In-Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
	Shares	Amount				
Balances, January 1, 2014	1,135,669	$ 5,678	$ 1,802	$ 19,675	$ (666)	$ 26,489
Comprehensive income	-	-	-	1,827	685	2,512
Common stock options recognized	-	-	2	-	-	2
Issuance of shares upon exercise of common stock options	1,625	8	8	-	-	16
Cash dividends paid ($0.55 per share)	-	-	-	(625)	-	(625)
Balances, December 31, 2014	1,137,294	5,686	1,812	20,877	19	28,394
Comprehensive income	-	-	-	1,972	(246)	1,726
Common stock options recognized	-	-	2	-	-	2
Issuance of shares upon exercise of common stock options	9,614	48	50	-	-	98
Repurchase of common stock	(1,177)	(6)	-	(13)	-	(19)
Cash dividends paid ($0.55 per share)	-	-	-	(629)	-	(629)
Balances, December 31, 2015	1,145,731	$ 5,728	$ 1,864	$ 22,207	$ (227)	$ 29,572

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands except per share data)

	Year Ended December 31	
	2015	2014
Cash flows from operating activities		
Net income	$ 1,972	$ 1,827
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	(144)	69
Depreciation	452	519
Provision for foreclosed assets	37	115
Net amortization of investment securities premiums	563	673
Share-based compensation	2	2
Net gain on sale of loans	(130)	(83)
(Gain) loss on sale of equipment	(29)	2
Gain on sale of foreclosed assets	(170)	(93)
Gain on sale of securities	(22)	-
Increase in cash value of bank-owned life insurance	(150)	(148)
Deferred income tax expense (benefit)	203	(93)
Origination of loans held for sale	(4,159)	(2,260)
Proceeds from loan sales	4,289	2,343
Changes in operating assets which provided cash		
Accrued interest receivable	1	70
Other assets	(31)	354
Accrued interest payable and other liabilities	473	72
Net cash provided by operating activities	**3,157**	**3,369**
Cash flows from investing activities		
Net change in certificates of deposit held in other banks	(1,243)	4,288
Activity in held-to-maturity securities		
Purchases	(7,718)	-
Activity in available-for-sale securities		
Purchases	(17,421)	(28,342)
Maturities, prepayments, calls and sales	31,936	23,794
Redemption (purchase) of restricted investments	42	(106)
Loan principal originations, net	(1,589)	(1,846)
Purchases of premises and equipment	(584)	(275)
Proceeds from sale of foreclosed assets	1,237	880
Proceeds from sale of equipment	117	3
Net cash provided by (used in) investing activities	**4,777**	**(1,604)**
Cash flows from financing activities		
Acceptances and withdrawals of deposits, net	8,126	1,912
Proceeds from sale of common stock	98	16
Repurchase and retirement of stock	(19)	-
Cash dividends paid	(629)	(625)
Net cash provided by financing activities	**7,576**	**1,303**
Net increase in cash and cash equivalents	**15,510**	**3,068**
Cash and cash equivalents, beginning of year	12,144	9,076
Cash and cash equivalents, end of year	**$ 27,654**	**$ 12,144**

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

1. BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation and Nature of Business

The accompanying consolidated financial statements include the accounts of **Eastern Michigan Financial Corporation**, a registered bank holding company (the "Corporation"), and its wholly owned subsidiary, Eastern Michigan Bank (the "Bank"), and the Bank's wholly owned subsidiaries Eastern Michigan Properties, LLC; Eastern Michigan Financial Services, Inc.; and Eastern Michigan Real Estate, Inc. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Corporation is independently owned and operates a community bank engaged in the business of retail and commercial banking services through its nine branches located in Sanilac and St. Clair counties in Michigan. Active competition, principally from other commercial banks, savings banks and credit unions, exists in all of the Bank's primary markets. The Bank's results of operations can be significantly affected by changes in interest rates or changes in the automotive and agricultural industries which comprise a significant portion of the local economic environment.

Concentration Risks

The Bank's primary deposit products are interest- and noninterest-bearing checking accounts, savings accounts and time deposits and its primary lending products are real estate mortgages, commercial and consumer loans. The Bank does not have significant concentrations with respect to any one industry, customer, or depositor.

The Bank is a state chartered bank and a member of the Federal Deposit Insurance Corporation ("FDIC") Bank Insurance Fund. The Bank is subject to the regulations and supervision of the Federal Reserve Board and state regulators and undergoes periodic examinations by these regulatory authorities. The Corporation is also subject to regulations of the Federal Reserve Board governing bank holding companies.

Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and the reported amounts of income and expenses during the year. Actual results could differ from those estimates. Significant estimates include but are not limited to the determination of the allowance for loan losses, the fair value of certain investment securities, and the valuation of foreclosed assets.

Summary of Significant Accounting Policies

Accounting policies used in preparation of the accompanying consolidated financial statements are in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The principles which materially affect the determination of the consolidated financial position and results of operations of the Corporation and its subsidiary are summarized below.

Cash and Cash Equivalents

For the purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, interest-bearing balances due from banks, short-term money market investments, and federal funds sold. Generally, federal funds are sold for a one-day period. The Bank maintains deposit accounts in various financial institutions which generally exceed the FDIC insured limits or are not insured. Management does not believe the Corporation is exposed to any significant interest, credit or other financial risk as a result of these deposits.

Certificates of deposit held in other banks

Certificates of deposit held in other banks mature within 3 years and are carried at cost.

Fair Value Measurements

Fair value refers to the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants in the market in which the reporting entity transacts such sales or transfers based on the assumptions market participants would use when pricing an asset or liability. Assumptions are developed based upon prioritizing information within a fair value hierarchy that gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable data, such as the reporting entity's own data (Level 3).

A description of each category in the fair value hierarchy is as follows:

Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the estimates of assumptions that market participants would use in pricing the asset or liability.

For a further discussion of Fair Value Measurements, refer to Note 2 to the consolidated financial statements.

Investment Securities

Debt securities that management has the ability and positive intent to hold to maturity are classified as held-to-maturity and are recorded at amortized cost. Securities not classified as held-to-maturity are classified as available-for-sale and are recorded at fair value, with unrealized gains and losses, net of the effect of deferred income taxes, recorded in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains or losses on the sale of securities are recorded in investment income on the trade date and are determined using the specific identification method.

Investment securities are reviewed at each reporting period for possible other-than-temporary impairment ("OTTI"). In determining whether an other-than-temporary impairment exists for debt securities, management must assert that: (a) it does not have the intent to sell the security; and (b) it is more likely than not the Corporation will not have to sell the security before recovery of its cost basis. If these conditions are not met, the Corporation must recognize an other-than-temporary impairment charge through earnings for the difference between the debt security's amortized cost basis and its fair value, and such amount is included in noninterest income. For these debt securities, the Corporation separates the total impairment into the credit loss component and the amount of the loss related to other factors. In order to determine the amount of the credit loss for a debt security, the Corporation calculates the recovery value by performing a discounted cash flow analysis based on the current cash flows and future cash flows management expects to recover. The amount of the total other-than-temporary impairment related to the credit risk is recognized in earnings and is included in noninterest income. The amount of the total other-than-temporary impairment related to other risk factors is recognized as a component of other comprehensive income. For debt securities that have recognized an other-than-temporary impairment through earnings, if through subsequent evaluation there is a significant increase in the cash flow expected, the difference between the amortized cost basis and the cash flows expected to be collected is accreted as interest income.

Available-for-sale equity securities are reviewed for other-than-temporary impairment at each reporting date. This evaluation considers a number of factors including, but not limited to, the length of time and extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer, and management's ability and intent to hold the securities until fair value recovers. If it is determined that management does not have the ability and intent to hold the securities until recovery or that there are conditions that indicate that a security may not recover in value, then the difference between the fair value and the cost of the security is recognized in earnings and is included in noninterest income. No such losses were recognized in 2015 or 2014.

Restricted Investments

The Bank is a member of the Federal Home Loan Bank System and is required to invest in capital stock of the Federal Home Loan Bank of Indianapolis ("FHLB"). The amount of the required investment is based upon the available balance of the Bank's outstanding home mortgage loans or advances from the FHLB and is carried at cost plus the value assigned to stock dividends.

The Bank is also a member of the Federal Reserve System and is required to invest in capital stock of the Federal Reserve Bank ("FRB"). The amount of the required investment is based upon the contributed capital of Eastern Michigan Bank and is carried at cost.

Finally, the Bank is a Farmer Mac I seller and is required to invest in capital stock of Farmer Mac. The amount of required investment is based upon the consolidated assets at the time of the initial stock purchase and is carried at cost.

Loans

Loans that management has the positive 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 loan origination costs, are deferred and recognized as an adjustment of the related loan yield 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. Consumer loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal and interest is considered doubtful.

All interest accrued in the current year but not collected for loans that are placed on nonaccrual or are charged off, is reversed against interest income while interest accrued but not collected in prior years is reversed against the allowance for loan losses. The interest on these loans is accounted for on the cash-basis until qualifying for return to accrual. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. For impaired loans not classified as nonaccrual, interest income is recognized daily as it is earned according to the terms of the loan agreement.

Nonperforming loans of the loan portfolio are comprised of those loans accounted for on a nonaccrual basis, accruing loans contractually past due 90 days or more as to interest or principal payments and loans modified under troubled debt restructurings (nonperforming originated loans).

Allowance for Loan Losses

The allowance for loan losses ("allowance") is an estimate of loan losses inherent in the Bank's loan portfolio. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the appropriateness of the total allowance after loan losses. Loan losses are charged off against the allowance when the Bank determines the loan balance to be uncollectible. Cash received on previously charged off amounts is recorded as a recovery to the allowance.

The allowance consists of two primary components, specific reserves related to impaired loans and general reserves. The general component covers non-impaired loans and is based on historical losses adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Bank over the most recent two years. This actual loss experience is adjusted for economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. These factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment.

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

Continued...

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 by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loans obtained market price, or the fair value of the collateral, less costs to sell, if the loan is collateral dependent. A loan is collateral dependent if the repayment is expected to be provided solely by the underlying collateral.

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

The Bank evaluates the credit quality of loans in the consumer loan portfolio, based primarily on the aging status of the loan and payment activity. Accordingly, nonaccrual loans, loans past due as to principal or interest 90 days or more and loans modified under troubled debt restructurings of the originated portfolio and acquired loans past due in accordance with the loans' original contractual terms are considered in a nonperforming status for purposes of credit quality evaluation.

Under certain circumstances, the Bank will provide borrowers relief through loan restructurings. A loan restructuring constitutes a troubled debt restructuring ("TDR") if for economic or legal reasons related to the borrower's financial difficulties the Bank grants a concession to the borrower that it would not otherwise consider. Restructured loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and are measured for impairment as described above.

The Bank assigns a risk rating to all loans except pools of homogeneous loans and periodically performs detailed internal reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by the Bank's regulators. During the internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which the borrowers operate and the fair values of collateral securing the loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into six major categories, defined as follows:

Pass: A pass loan is a credit with no existing or known potential weaknesses deserving of management's close attention.

Watch: Loans classified as watch have most of the characteristics of a pass loan; however, emerging weaknesses have been detected and warrant additional attention.

Special Mention: Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, this potential weakness may result in deterioration of the repayment prospects for the loan or of the Bank's credit position at some future date. Special mention loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

Substandard: Loans classified as substandard are not adequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the repayment of the debt. Well defined weaknesses include a borrower's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time, or the failure to fulfill economic expectations. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or repayment in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss: Loans classified as loss are considered uncollectible and are charged off immediately.

The majority of the Bank's consumer and residential loan portfolios are comprised of secured loans that are evaluated at origination on a centralized basis against standardized underwriting criteria. The ongoing measurement of credit quality of the consumer, home equity, and residential real estate loan portfolios is largely done on an exception basis. If payments are made on schedule, as agreed, then no further monitoring is performed. However, if delinquency occurs, the delinquent loans are turned over to the Bank's collection department for resolution, which generally occurs fairly rapidly and often through repossession and foreclosure. Credit quality for the entire consumer, home equity, and residential real estate loan portfolio is measured by the periodic delinquency rate, nonaccrual amounts and actual losses incurred.

The Bank maintains a separate general valuation allowance for each portfolio segment. These portfolio segments include commercial and industrial, agricultural, real estate related industries, other commercial loans, residential real estate, home-equity-and-consumer and other, and home equity with risk characteristics described as follows:

Commercial and Industrial: Commercial and industrial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

Agricultural: The risk associated with agricultural loans depends on current market prices, weather conditions and other outside factors that are distinct to this segment. These loans, as with commercial and industrial loans, are generally underwritten to existing cash flows of operating businesses. Debt coverage, however, is influenced by different economic indicators than other commercial loans.

Real Estate Related Industries: These loans generally possess a higher inherent risk of loss than other loan portfolio segments. Adverse economic developments or an overbuilt market impact real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for the properties to produce sufficient cash flow to service debt obligations.

Other Commercial: Other commercial loans are collateralized by real estate and are underwritten based upon existing cash flows of operating businesses. Because debt coverage is provided by business cash flows, trends in real estate values have less impact on this segment than other real estate segments and would be influenced more by unemployment rates and other key economic indicators.

Residential Real Estate: The degree of risk in residential mortgage lending depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than other real estate portfolio segments. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Consumer and Other: The consumer and other loan portfolio is usually comprised of a large number of small loans, including automobile, personal loans, etc. Most loans are made directly for consumer purchases. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate the borrowers' capacity to repay their obligations may be deteriorating.

Home Equity: As with residential real estate, the degree of risk in home equity lending depends on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion but in addition depends on the value of any loan with a first lien interest. These loans generally possess a higher inherent risk of loss than residential real estate portfolio segments. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Although management believes the allowance to be appropriate, ultimate losses may vary from its estimates. The Board of Directors reviews the appropriateness of the allowance monthly, including consideration of the relevant risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bank's primary regulators review the appropriateness of the allowance. The regulatory agencies may require changes to the allowance based on their judgment about information available at the time of their examination.

Loans Held for Sale
Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value in the aggregate and are included in loans on the accompanying consolidated balance sheets, if any. Net unrealized losses, if any, are recognized through a valuation allowance of which the provision is accounted for in the consolidated statements of income.

Transfers of Financial Assets
Transfers of financial assets, including mortgage loans held for sale, 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 legally isolated from the Corporation, 2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and 3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. Other than servicing, as disclosed in Note 5, the Corporation has no substantive continuing involvement related to these loans. The Corporation sold to an unrelated third party residential mortgage loans with proceeds of $4,289 and $2,343 during 2015 and 2014, respectively, which resulted in a net gain of $130 and $83 for 2015 and 2014, respectively. Servicing fee income earned on such loans was $85 and $93 for 2015 and 2014, respectively, and is included in other noninterest income on the consolidated statements of income.

Servicing
Servicing assets are recognized as separate assets when rights are acquired through the purchase or 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 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.

Servicing assets or liabilities are amortized in proportion to and over the period of net servicing income or net servicing loss and are assessed for impairment or increased obligation based on the fair value of rights compared to amortized cost at each reporting date. 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 for others. The fees are based on a contractual percentage of the outstanding principal, or a fixed amount per loan and are recognized as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income, a component of other noninterest income.

Foreclosed Assets
Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value, less costs to sell, on the date of transfer, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of the carrying amount or fair value less costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in expenses from foreclosed assets, net, a component of other noninterest expenses on the consolidated statements of income.

Premises and Equipment
Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation which is computed principally by the straight-line method based upon the estimated useful lives of the related assets, which range from 3 to 40 years. Major improvements are capitalized and appropriately amortized based upon the useful lives of the related assets or the expected terms of the leases, if shorter, using the straight-line method. Maintenance, repairs and minor alterations are charged to current operations as expenditures occur. Management annually reviews these assets to determine whether carrying values have been impaired.

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(Dollars in thousands except share data)

Share-Based Compensation Plans
Compensation cost relating to share-based payment transactions are required to be recognized in the consolidated financial statements. That cost is measured based on the fair value of the equity or liability instruments issued on the grant dates and is recognized over the service period, which is usually the vesting period.

Bank Owned Life Insurance
The Bank holds life insurance policies purchased on the lives of key officers. In the event of death of one of these individuals, the Bank, as beneficiary of the policies, would receive a specified cash payment equal to the face value of the policy. Such policies are recorded at their cash surrender value, or the amount that can be currently realized as of the balance sheet date. The change in cash surrender value is an adjustment of premiums paid in determining the net expense or income recognized under the contracts for the year and is included in other noninterest income.

Off-Balance Sheet Credit Related Financial Instruments
In the ordinary course of business, the Bank has entered into commitments to extend credit, including commercial letters of credit and standby letters of credit. Such financial instruments are considered to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is considered insignificant, the commitments are generally recorded only when they are funded.

Income Taxes
Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred income tax asset or liability is determined based on the federal income tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in federal income tax rates and laws. Valuation allowances are established, where necessary, to reduce deferred tax assets to the amount expected more likely than not to be realized. Income tax expense is the tax payable or refundable for the year plus or minus the change during the year in deferred tax assets and liabilities.

Net Income Per Share
Basic earnings per share represent income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from the assumed issuance. Potential common shares that may be issued by the Corporation relate solely to outstanding stock options, and are determined using the treasury stock method.

Reclassifications
Certain amounts as reported in the 2014 consolidated financial statements have been reclassified to conform with the 2015 presentation.

Subsequent Events
In preparing these consolidated financial statements, the Corporation has evaluated, for potential recognition or disclosure, significant events or transactions that occurred during the period subsequent to December 31, 2015, the most recent balance sheet presented herein, through February 5, 2016, the date these consolidated financial statements were available to be issued. No such events or transactions were identified other than that disclosed in Note 18.

2. FAIR VALUE MEASUREMENTS

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Marketable securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Corporation may be required to record at fair value other assets on a nonrecurring basis, such as securities held-to-maturity, loans, loans held for sale, foreclosed assets, mortgage servicing rights, and certain other assets and liabilities. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write downs of individual assets.

Following is a description of the valuation methodologies and key inputs used to measure financial assets and liabilities recorded at fair value, as well as a description of the methods and significant assumptions used to estimate fair value disclosures for financial instruments not recorded at fair value in their entirety on a recurring basis. For financial assets and liabilities recorded at fair value, the description includes an indication of the level of the fair value hierarchy in which the assets or liabilities are classified.

Cash and Cash Equivalents
The carrying amounts of cash and short-term instruments, including interest bearing balances due from banks, short-term money market investments, and Federal funds sold approximate fair values.

Certificates of deposit held in other banks
The carrying amounts of certificates of deposit held in other banks approximate fair values.

Investment Securities
Held-to-maturity securities are recorded at fair value on a nonrecurring basis, only when an other-than-temporary impairment is recorded. Investment securities classified as available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, those that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 fair value measurement is based upon quoted prices for similar securities, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions. Level 2 securities include U.S. government and federal agency securities, mortgage-backed securities issued by government-sponsored entities, state and municipal bonds, corporate debt securities in active markets, and auction rate money market preferred securities. For Level 3 securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators. Securities classified as Level 3 include securities in less liquid markets.

Restricted Investments
The carrying value of Federal Home Loan Bank Stock, Federal Reserve Bank Stock and Farmer Mac Stock approximates fair value based on the redemption provisions of the issuing entities.

Loans
For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for fixed interest rate loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The resulting amounts are adjusted to estimate the effect of declines, if any, in the credit quality of borrowers since the loans were originated. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with accounting standards for subsequent measurement of receivables. The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the impaired loan as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the impaired loan as nonrecurring Level 3.

Accrued Interest Receivable
The carrying amounts reported in the consolidated balance sheets for interest receivable approximate their fair value.

Foreclosed Assets
Upon transfer from the loan portfolio, foreclosed assets are adjusted to and subsequently carried at the lower of carrying value or fair value less costs to sell. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation reports the foreclosed asset as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation reports the foreclosed asset as nonrecurring Level 3.

Mortgage Servicing Rights
Mortgage servicing rights are subject to impairment testing. A valuation model, which utilizes a discounted cash flow analysis using interest rates and prepayment speed assumptions currently quoted for comparable instruments and a discount rate determined by management, is used for impairment testing. If the valuation model reflects a value less than the carrying value, loan servicing rights are adjusted to fair value through a valuation allowance as determined by the model. As such, the Corporation classifies loan servicing rights subjected to nonrecurring fair value adjustments as Level 3. At December 31, 2015 and 2014, there was no impairment recorded for mortgage servicing rights and, therefore, no mortgage servicing rights assets were recorded at fair value on a nonrecurring basis.

Interest- and Noninterest-Bearing Deposits
The fair values of demand deposit accounts, such as interest- and noninterest-bearing checking, savings and money market accounts, are equal to the amounts payable on demand. Fair values for interest-bearing deposits (time deposits) with defined maturities are based on the discounted value of contractual cash flows, using interest rates currently being offered for deposits of similar maturities. The fair values for variable-interest rate certificates of deposit approximate their carrying value.

Accrued Interest Payable
The carrying amounts reported in the consolidated balance sheets for interest payable approximate their fair value.

Commitments to Extend Credit, Standby Letters of Credit, and Undisbursed Loans
The Corporation's unused loan commitments, standby letters of credit and undisbursed loans have no carrying amount and have been estimated to have no realizable fair value.

Historically, a majority of the unused loan commitments have not been drawn upon and, generally, the Corporation does not receive fees in connection with these commitments.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Corporation believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Assets Recorded at Fair Value on a Recurring Basis
The following tables set forth by level, within the fair value hierarchy, the recorded amount of assets and liabilities measured at fair value on a recurring basis as of December 31:

2015	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Investment securities available-for-sale:				
U.S. government and federal agencies	$ -	$ 33,109	$ -	$ 33,109
Corporate bonds	-	4,873	-	4,873
Agency issued mortgage-backed securities	-	45,041	-	45,041
States and municipals	-	18,725	-	18,725
Money market preferred securities	-	880	-	880
Total assets at fair value	$ -	$102,628	$ -	$102,628

2014	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Investment securities available-for-sale:				
U.S. government and federal agencies	$ -	$ 36,999	$ -	$ 36,999
Corporate bonds	-	4,058	-	4,058
Agency issued mortgage-backed securities	-	53,768	-	53,768
States and municipals	-	22,419	-	22,419
Money market preferred securities	-	810	-	810
Total assets at fair value	$ -	$118,054	$ -	$118,054

Continued...

(Dollars in thousands except share data)

Assets Recorded at Fair Value on a Nonrecurring Basis
The following tables set forth by level, within the fair value hierarchy, the recorded amount of assets measured at fair value on a nonrecurring basis as of December 31:

2015	Assets at Carrying Value			
	Level 1	Level 2	Level 3	Total
Impaired loans (1)	$ -	$ -	$ 2,265	$ 2,265

2014	Assets at Carrying Value			
	Level 1	Level 2	Level 3	Total
Impaired loans (1)	$ -	$ -	$ 1,949	$ 1,949
Foreclosed assets (2)	-	-	476	476

(1) Certain impaired loans were remeasured and reported at fair value through a specific valuation allowance. Impaired loans of $2,265 and $1,949 as of December 31, 2015 and 2014, respectively, were reduced by a specific valuation allowance totaling $503 and $702 as of December 31, 2015 and 2014, respectively.

(2) There were no foreclosed assets which were written down resulting in a charge to earnings in 2015. Foreclosed assets as of December 31, 2014, which are carried at the lower of carrying value or fair value less cost to sell, were written down from cost to $476 resulting in charges of $76 to other noninterest income for the year then ended.

Quantitative information about Level 3 fair value measurements is as follows as of December 31, 2015:

Instrument	Level 3 Instruments			
	Fair Value	Valuation Technique	Unobservable Input	Weighted Average and/or Range
Impaired Loans	$ 2,265	Discounted Appraisal Value	Discount Applied to Collateral Appraisal	3 - 75 %

Quantitative information about Level 3 fair value measurements is as follows as of December 31, 2014:

Instrument	Level 3 Instruments			
	Fair Value	Valuation Technique	Unobservable Input	Weighted Average and/or Range
Impaired Loans	$ 1,949	Discounted Appraisal Value	Discount Applied to Collateral Appraisal	14 - 75%
Foreclosed Assets	$ 476	Discounted Appraisal Value	Discount Applied to Collateral Appraisal	15%

Estimated Fair Values of Financial Instruments Not Recorded at Fair Value in their Entirety on a Recurring Basis

Disclosure of the estimated fair values of financial instruments, which differ from carrying values, often requires the use of estimates. In cases where quoted market values in an active market are not available, the Corporation uses present value techniques and other valuation methods to estimate the fair values of its financial instruments. These valuation methods require considerable judgment and the resulting estimates of fair value can be significantly affected by the assumptions made and methods used. The methodologies for estimating fair value of financial assets and liabilities on a recurring and nonrecurring basis are discussed above.

The carrying amount and estimated fair value of financial instruments not recorded at fair value in their entirety on a recurring basis on the Corporation's consolidated balance sheets are as follows at December 31:

	2015		2014	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:				
Cash and cash equivalents	$ 27,654	$ 27,654	$ 12,144	$ 12,144
Certificates of deposit held in other banks	2,472	2,472	1,229	1,229
Investment securities held-to-maturity	7,716	7,668	-	-
Restricted investments	980	980	1,022	1,022
Net loans	136,331	136,529	135,337	136,481
Mortgage servicing rights	261	261	257	257
Accrued interest receivable	945	945	946	946
Liabilities:				
Noninterest-bearing deposits	$ 70,456	$ 70,456	$ 62,175	$ 62,175
Interest-bearing deposits	191,668	191,828	191,823	192,083
Accrued interest payable	16	16	24	24

3. INVESTMENT SECURITIES

The amortized cost and fair value of non-trading investment securities, including gross unrealized gains and losses, are summarized as follows as of December 31:

2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity				
U.S. government and federal agencies	$ 998	$ -	$ 1	$ 997
Agency issued mortgage-backed securities	4,718	-	47	4,671
States and municipals	2,000	-	-	2,000
Total held-to-maturity	**7,716**	**-**	**48**	**7,668**
Available-for-sale				
Debt securities:				
U.S. government and federal agencies	$ 33,103	$ 94	$ 88	$ 33,109
Corporate bonds	4,895	2	24	4,873
Agency issued mortgage-backed securities	45,325	91	375	45,041
States and municipals	18,649	110	34	18,725
Total debt securities	101,972	297	521	101,748
Money market preferred securities	1,000	-	120	880
Total available-for-sale	**102,972**	**297**	**641**	**102,628**
Total	**$ 110,688**	**$ 297**	**$ 689**	**$ 110,296**

2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale				
Debt securities:				
U.S. government and federal agencies	$ 37,076	$ 100	$ 177	$ 36,999
Corporate bonds	4,081	6	29	4,058
Agency issued mortgage-backed securities	53,621	305	158	53,768
States and municipals	22,248	196	25	22,419
Total debt securities	117,026	607	389	117,244
Money market preferred securities	1,000	-	190	810
Total	**$ 118,026**	**$ 607**	**$ 579**	**$ 118,054**

Investment securities with carrying values of $4,008 and $4,013 at December 31, 2015 and 2014, respectively, were pledged to secure public deposits or for other purposes as permitted or required by law.

The amortized cost and fair value of held-to-maturity securities and available-for-sale securities grouped by contractual maturity at December 31, 2015, are summarized as follows:

	Maturing					
	Due In One Year or Less	Due After One Year Through Five Years	Due After Five Years Through Ten Years	Over Ten Years	Securities With Variable Monthly Payments or No Contractual Maturity	Total
Held-to-maturity						
U.S. government and federal agencies	$ -	$ 998	$ -	$ -	$ -	$ 998
Agency issued mortgage-backed securities	-	-	-	-	4,718	4,718
States and municipals	-	1,500	500	-	-	2,000
Total held-to maturity	**-**	**2,498**	**500**	**-**	**4,718**	**7,716**
Available-for-sale						
Debt securities:						
U.S. government and federal agencies	$ 2,000	$ 29,103	$ 2,000	$ -	$ -	$ 33,103
Corporate bonds	2,024	2,871	-	-	-	4,895
Agency issued mortgage-backed securities	-	-	-	-	45,325	45,325
States and municipals	5,103	11,856	1,630	60	-	18,649
Total debt securities	**9,127**	**43,830**	**3,630**	**60**	**45,325**	**101,972**
Money market preferred securities	-	-	-	-	1,000	1,000
Total available-for-sale	**$ 9,127**	**$ 43,830**	**$ 3,630**	**$ 60**	**$ 46,325**	**$ 102,972**
Total amortized cost	**$ 9,127**	**$ 46,328**	**$ 4,130**	**$ 60**	**$ 51,043**	**$ 110,688**
Fair value	**$ 10,026**	**$ 46,357**	**$ 4,139**	**$ 62**	**$ 49,712**	**$ 110,296**

Continued...

(Dollars in thousands except share data)

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

Money market preferred securities have no maturity and are not reported by a specific maturity group. Because of their variable monthly payments, mortgage-backed securities are also not reported by a specific maturity group.

During 2015, proceeds from sales of available for sale securities amounted to approximately $1,206. Gross realized gains amounted to $22 and there were no gross realized losses during 2015. This resulted in reclassification of $22 ($15 net of tax) from accumulated other comprehensive income to gain on sale of securities in the consolidated statements of income for the year ended December 31, 2015. There were no sales of available-for-sale securities during 2014 and there were no gross realized gains or losses during 2014.

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

2015	Less Than 12 Months		Over 12 Months			
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Total Gross Unrealized Losses
Securities held-to-maturity						
U.S. government and federal agencies	$ 997	$ 1	$ -	$ -	$ 997	$ 1
Agency issued mortgage-backed securities	4,671	47	-	-	4,671	47
Total securities held-to-maturity	**$ 5,668**	**$ 48**	**$ -**	**$ -**	**$ 5,668**	**$ 48**
Securities available-for-sale						
Debt securities:						
U.S. government and federal agencies	$ 21,900	$ 85	$ 747	$ 3	$ 22,647	$ 88
Corporate bonds	999	3	1,848	21	2,847	24
Agency issued mortgage-backed securities	31,351	241	5,673	134	37,024	375
States and municipals	5,350	24	1,693	10	7,043	34
Total debt securities	$ 59,600	$ 353	$ 9,961	$ 168	$ 69,561	$ 521
Money market preferred securities	-	-	880	120	880	120
Total securities available-for-sale	**$ 59,600**	**$ 353**	**$ 10,841**	**$ 288**	**$ 70,441**	**$ 641**

2014	Less Than 12 Months		Over 12 Months			
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Total Gross Unrealized Losses
Securities available-for-sale						
Debt securities:						
U.S. government and federal agencies	$ 5,995	$ 5	$ 16,576	$ 172	$ 22,571	$ 177
Corporate bonds	-	-	1,935	29	1,935	29
Agency issued mortgage-backed securities	6,306	15	11,478	143	17,784	158
States and municipals	4,045	17	491	8	4,536	25
Total debt securities	16,346	37	30,480	352	46,826	389
Money market preferred securities	-	-	810	190	810	190
Total securities available-for-sale	**$ 16,346**	**$ 37**	**$ 31,290**	**$ 542**	**$ 47,636**	**$ 579**

As of December 31, 2015, the Corporation's investment security portfolio consisted of 156 securities, 71 of which were in an unrealized loss position. The unrealized losses are primarily related to the Corporation's U.S. government and federal agencies, agency issued mortgage-backed securities, and money market preferred securities as discussed below.

The Corporation has invested $1,000 in an auction rate money market preferred investment security instrument, which is classified as available-for-sale and reflected at estimated fair value. Due to credit market uncertainty, the trading for this security has been limited. Because the decline in the market value is attributable to changes in interest rates and limited trading, and not credit quality and because management does not intend to sell the security in an unrealized loss position, and it is more likely than not the Corporation will not be required to sell the security before recovery of its cost basis, the Corporation does not consider this security instrument to be other-than-temporarily impaired at December 31, 2015.

As of December 31, 2015 and 2014, management conducted an analysis to determine whether all securities currently in an unrealized loss position, including auction rate money market preferred security, should be considered other-than-temporarily impaired. Such analyses considered, among other factors, the following criteria:

- Has the value of the investment declined more than what is deemed reasonable based on a risk and maturity adjusted discount rate?
- Is the investment credit rating below investment grade?
- Is it probable that the issuer will be unable to pay the amount when due?
- Is it more likely than not that the Corporation will not have to sell the security before recovery of its cost basis?
- Has the duration of the investment been extended for an unreasonable period of time?

Based on the Corporation's analysis using the above criteria, the fact that management has asserted that it does not have the intent to sell these securities in an unrealized loss position, and that it is more likely than not the Corporation will not be required to sell the securities before recovery of their cost basis, management does not believe that the values of any securities are other-than-temporarily impaired as of December 31, 2015 or 2014.

4. LOANS AND ALLOWANCE FOR LOAN LOSSES

The Bank grants commercial, consumer and residential mortgage loans to customers situated primarily in Sanilac and St. Clair counties in Michigan. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area. Substantially all of the consumer and residential loans are secured by various items of property, while commercial loans are secured primarily by business assets and personal guarantees; a portion of loans are unsecured.

Loans are summarized as follows at December 31:

	2015	2014
Commercial and industrial	$ 25,426	$ 23,507
Agricultural	42,702	40,634
Real estate related industries	25,457	23,873
Other commercial	17,428	19,806
Residential real estate	18,284	20,819
Consumer and other	4,091	3,618
Home equity	4,147	4,768
Total loans	137,535	137,025
Allowance for loan losses	(1,204)	(1,688)
Loans, net	**$ 136,331**	**$ 135,337**

The allowance for loan losses and loans are as follows for the year ended December 31, 2015:

	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Residential Real Estate	Consumer and Other	Home Equity	Total
Allowance for loan losses:								
Balance at beginning of year	$ 266	$ 170	$ 543	$ 413	$ 222	$ 19	$ 55	$ 1,688
Provision for loan losses	(124)	497	(280)	(205)	(25)	(7)	-	(144)
Loans charged off	(19)	(375)	-	-	(15)	(20)	(12)	(441)
Recoveries of loans previously charged off	-	1	1	66	-	13	20	101
Balance at end of year	$ 123	$ 293	$ 264	$ 274	$ 182	$ 5	$ 63	$ 1,204
Allowance for loan losses attributable to loans:								
Individually evaluated for impairment	$ 48	$ 4	$ 161	$ 179	$ 70	$ -	$ 41	$ 503
Collectively evaluated for impairment	75	289	103	95	112	5	22	701
Total allowance for loan losses	$ 123	$ 293	$ 264	$ 274	$ 182	$ 5	$ 63	$ 1,204

Continued…

(Dollars in thousands except share data)

	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Residential Real Estate	Consumer and Other	Home Equity	Total
Loans:								
Individually evaluated for impairment	$ 599	$ 1,527	$ 1,536	$ 487	$ 237	$ -	$ 120	$ 4,506
Collectively evaluated for impairment	24,827	41,175	23,921	16,941	18,047	4,091	4,027	133,029
Total loans	$ 25,426	$ 42,702	$ 25,457	$ 17,428	$ 18,284	$ 4,091	$ 4,147	$137,535

The allowance for loan losses and loans are as follows for the year ended December 31, 2014:

	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Residential Real Estate	Consumer and Other	Home Equity	Total
Allowance for loan losses:								
Balance at beginning of year	$ 241	$ 175	$ 475	$ 566	$ 182	$ 20	$ 106	$ 1,765
Provision for loan losses	25	(6)	110	(139)	89	13	(23)	69
Loans charged off	-	-	(52)	(65)	(49)	(26)	(30)	(222)
Recoveries of loans previously charged off	-	1	10	51	-	12	2	76
Balance at end of year	$ 266	$ 170	$ 543	$ 413	$ 222	$ 19	$ 55	$ 1,688
Allowance for loan losses attributable to loans:								
Individually evaluated for impairment	$ 105	$ 103	$ 213	$ 230	$ 16	$ -	$ 35	$ 702
Collectively evaluated for impairment	161	67	330	183	206	19	20	986
Total allowance for loan losses	$ 266	$ 170	$ 543	$ 413	$ 222	$ 19	$ 55	$ 1,688
Loans:								
Individually evaluated for impairment	$ 729	$ 2,451	$ 1,598	$ 1,031	$ 279	$ -	$ 145	$ 6,233
Collectively evaluated for impairment	22,778	38,183	22,275	18,775	20,540	3,618	4,623	130,792
Total loans	$ 23,507	$ 40,634	$ 23,873	$ 19,806	$ 20,819	$ 3,618	$ 4,768	$137,025

The following table shows the loans allocated by management's internal risk ratings at December 31, 2015:

	Commercial Credit Risk Profile by Risk Rating				
	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Total
Risk rating					
Pass	$ 24,549	$ 40,264	$ 23,695	$ 16,743	$ 105,251
Watch	220	911	531	399	2,061
Special mention	-	328	753	-	1,081
Substandard	657	1,199	478	286	2,620
Total	$ 25,426	$ 42,702	$ 25,457	$ 17,428	$111,013

The following table shows the homogeneous loans allocated by payment activity as of December 31, 2015:

	Consumer Credit Risk Profile by Risk Rating			
	Residential Real Estate	Consumer and Other	Home Equity	Total
Payment activity				
Performing	$ 18,047	$ 4,091	$ 4,116	$ 26,254
Non-performing	237	-	31	268
Total	$ 18,284	$ 4,091	$ 4,147	$ 26,522

The following table shows the loans allocated by management's internal risk ratings at December 31, 2014:

	Commercial Credit Risk Profile by Risk Rating				
	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Total
Risk rating					
Pass	$ 22,400	$ 37,717	$ 22,044	$ 18,178	$ 100,339
Watch	966	466	568	632	2,632
Special mention	-	354	1,169	268	1,791
Substandard	116	2,097	92	459	2,764
Doubtful	25	-	-	269	294
Total	$ 23,507	$ 40,634	$ 23,873	$ 19,806	$107,820

The following table shows the homogeneous loans allocated by payment activity as of December 31, 2014:

	Consumer Credit Risk Profile by Risk Rating			
	Residential Real Estate	Consumer and Other	Home Equity	Total
Payment activity				
Performing	$ 20,540	$ 3,618	$ 4,759	$ 28,917
Non-performing	279	-	9	288
Total	$ 20,819	$ 3,618	$ 4,768	$ 29,205

The following table shows an aging analysis of the loan portfolio by time past due as of December 31, 2015:

	Accruing Interest				
	Current	30-89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
Commercial and industrial	$ 25,017	$ 409	$ -	$ -	$ 25,426
Agricultural	41,442	101	-	1,159	42,702
Real estate related industries	24,862	-	-	595	25,457
Other commercial	17,104	230	-	94	17,428
Residential real estate	17,526	521	-	237	18,284
Consumer and other	4,089	2	-	-	4,091
Home equity	4,109	7	-	31	4,147
Total	$ 134,149	$ 1,270	$ -	$ 2,116	$ 137,535

The following table shows an aging analysis of the loan portfolio by time past due as of December 31, 2014:

	Accruing Interest				
	Current	30-89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
Commercial and industrial	$ 23,442	$ -	$ -	$ 65	$ 23,507
Agricultural	39,773	-	-	861	40,634
Real estate related industries	23,252	-	-	621	23,873
Other commercial	19,426	-	-	380	19,806
Residential real estate	20,139	401	-	279	20,819
Consumer and other	3,613	5	-	-	3,618
Home equity	4,746	13	-	9	4,768
Total	$ 134,391	$ 419	$ -	$ 2,215	$ 137,025

The following table presents information related to impaired loans as of December 31, 2015:

	Recorded Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial and industrial	$ 272	$ 272	$ -	$ 364	$ 12
Agricultural	1,527	1,792	-	1,779	37
Real estate related industries	1,151	1,272	-	1,130	36
Other commercial	298	330	-	382	15
Residential real estate	91	179	-	152	-
Home equity	31	62	-	20	2
Loans with an allowance recorded					
Commercial and industrial	327	327	48	300	17
Agricultural	-	10	4	210	-
Real estate related industries	385	1,409	161	437	16
Other commercial	189	215	179	377	7
Residential real estate	146	218	70	106	-
Home equity	89	89	41	112	6

Continued...

(Dollars in thousands except share data)

	Recorded Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Total impaired loans					
Commercial and industrial	$ 599	$ 599	$ 48	$ 664	$ 29
Agricultural	1,527	1,802	4	1,989	37
Real estate related industries	1,536	2,681	161	1,567	52
Other commercial	487	545	179	759	22
Residential real estate	237	397	70	258	-
Home equity	120	151	41	132	8
Total	$ 4,506	$ 6,175	$ 503	$ 5,369	$ 148

The following table presents information related to impaired loans as of December 31, 2014:

	Recorded Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial and industrial	$ 455	$ 459	$ -	$ 253	$ 23
Agricultural	2,032	2,131	-	2,044	61
Real estate related industries	1,109	1,901	-	1,156	17
Other commercial	466	644	-	714	15
Residential real estate	213	341	-	455	-
Home equity	9	20	-	57	-
Loans with an allowance recorded					
Commercial and industrial	274	274	105	143	12
Agricultural	419	419	103	428	17
Real estate related industries	489	795	213	538	22
Other commercial	565	621	230	667	27
Residential real estate	66	66	16	46	-
Home equity	136	142	35	188	4
Total impaired loans					
Commercial and industrial	$ 729	$ 733	$ 105	$ 396	$ 35
Agricultural	2,451	2,550	103	2,472	78
Real estate related industries	1,598	2,696	213	1,694	39
Other commercial	1,031	1,265	230	1,381	42
Residential real estate	279	407	16	501	-
Home equity	145	162	35	245	4
Total	$ 6,233	$ 7,813	$ 702	$ 6,689	$ 198

The Bank does not have material commitments to lend additional funds to borrowers with loans whose terms have been modified in troubled debt restructurings or whose loans are on nonaccrual.

There were no loans that were modified in troubled debt restructurings during 2015.

A summary of loans that were modified in troubled debt restructurings during 2014 is as follows:

	Troubled Debt Restructurings		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Agricultural	1	$ 75	$ 75
Other commercial	1	39	39
Residential real estate	2	158	158
Home equity	1	75	75
	5	$ 347	$ 347

The following table details the number of loans and the recorded investment in loans considered to be troubled debt restructurings ("TDRs") by type of modification during 2014:

	Total Modifications				
	Principal Deferrals		Interest Rate Reductions		
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	Total Modifications
Agricultural	-	$ -	1	$ 75	$ 75
Other commercial	1	39	-	-	39
Residential real estate	2	158	-	-	158
Home equity	1	75	-	-	75
Total	4	$ 272	1	$ 75	$ 347

There were no TDRs for which there was a payment default whereby the borrower was past due with respect to principal and/or interest for 90 days or more during the 12 months ended December 31, 2015 and 2014, that had been modified during the 12-month period prior to default.

5. SERVICING

The Bank services loans for others which generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and taxing authorities, and processing foreclosures. Loans serviced as of December 31, 2015 and 2014, were $33,565 and $35,264, respectively; such loans are not included on the accompanying consolidated balance sheets.

The fair values of mortgage servicing rights were $261 and $257 at December 31, 2015 and 2014, respectively, and is included in other assets in the accompanying consolidated balance sheets. The fair values of servicing rights was determined using discount rates ranging from 8.5% to 10.0%, prepayment speeds ranging from 5.4% to 19.51%, depending upon the stratification of the specific right, and a weighted average default rate of 0.4%.

The following summarizes the carrying value and the changes therein of mortgage servicing rights for the years ended December 31:

	2015	2014
Mortgage servicing rights		
Balance at beginning of year	$ 257	$ 310
Mortgage servicing rights capitalized	49	28
Mortgage servicing rights amortized	(45)	(81)
Balance at end of year	$ 261	$ 257

6. FORECLOSED ASSETS

Real estate owned activity was as follows:

	2015	2014
Beginning balance of year	$ 1,556	$ 1,296
Loans transferred to real estate owned	739	1,162
Direct write-downs	(37)	(115)
Sales of real estate owned	(1,067)	(787)
End of year	$ 1,191	$ 1,556

At December 31, 2015, the balance of real estate owned includes $71 of foreclosed residential real estate properties recorded as a result of obtaining physical possession of the property. At December 31, 2015, the recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceeds are in process is $27.

Activity in the valuation allowance was as follows:

	2015	2014
Beginning balance of year	$ 404	$ 328
Reductions from sales of real estate owned	(232)	(39)
Direct write-downs	37	115
End of year	$ 209	$ 404

Expenses related to foreclosed assets include:

	2015	2014
Net gain on sales	$ (170)	$ (93)
Provision for unrealized losses	37	115
Operating expenses, net of rental income	41	78
End of year	$ 92	$ 100

Continued...

(Dollars in thousands except share data)

7. PREMISES AND EQUIPMENT

Net premises and equipment consists of the following amounts at December 31:

	2015	2014
Bank premises and land	$ 8,474	$ 8,555
Furniture and equipment	4,147	4,633
Total	12,621	13,188
Less accumulated depreciation	6,886	7,346
Premises and equipment, net	$ 5,735	$ 5,842

Depreciation expense was $452 and $519 for 2015 and 2014, respectively.

8. DEPOSITS

The following is a summary of the distribution of deposits at December 31:

	2015	2014
Interest-bearing		
NOW accounts	$ 47,441	$ 43,795
Savings	53,330	49,609
Money market demand	50,648	50,742
Time, $250,000 and over	1,772	1,885
Other time	38,477	45,792
Total interest-bearing	191,668	191,823
Noninterest-bearing demand	70,456	62,175
Total deposits	$ 262,124	$ 253,998

Scheduled maturities of time deposits for each of the five years succeeding December 31, 2015, are summarized as follows:

Year	Amount
2016	$ 20,772
2017	9,365
2018	3,956
2019	2,232
2020	3,924
Total	$ 40,249

9. FEDERAL INCOME TAXES

The provision for federal income taxes consists of the following components for the years ended December 31:

	2015	2014
Currently payable	$ 521	$ 713
Deferred expense (benefit)	203	(95)
Income taxes	$ 724	$ 618

A reconciliation between federal income tax expense reported and the amount computed by applying the statutory federal income tax rate of 34% to income before federal income taxes is as follows for the years ended December 31:

	2015	2014
Income tax provision at statutory rate	$ 917	$ 831
Effect of tax-exempt interest income	(131)	(150)
Other, net	(62)	(63)
Income taxes	$ 724	$ 618

The components of the net deferred income tax asset included within other assets in the accompanying consolidated balance sheets, resulted from the following temporary differences between the carrying amounts of assets and liabilities for federal income tax and financial reporting purposes as of December 31:

	2015	2014
Deferred tax assets		
Allowance for loan losses	$ 133	$ 281
Unrealized loss on available-for-sale securities	117	-
Nonaccrual loan interest	39	35
Deferred loan fees/costs	50	45
Capital loss carryover	-	40
Other real estate	22	96
Other	189	188
Total deferred tax assets	550	685
Deferred tax liabilities		
Depreciation	148	170
Mortgage servicing rights	89	87
Unrealized gain on available-for-sale securities	-	8
Other	61	50
Total deferred tax liabilities	298	315
Valuation allowance	-	(40)
Net deferred tax asset	$ 252	$ 330

A deferred tax asset valuation allowance was recorded as of December 31, 2014, to reduce deferred income tax assets to the amount reasonably expected by the Corporation to ultimately be realized.

The Corporation concluded that there are no significant uncertain tax positions requiring recognition in the Corporation's consolidated financial statements based on the evaluation performed for the years 2012 through 2015, the years which remain subject to examination by major tax jurisdictions as of December 31, 2015. The Corporation does not expect the total amount of unrecognized tax benefits ("UTB") (e.g. tax deductions, exclusions, or credits claimed or expected to be claimed) to significantly change in the next 12 months. The Corporation does not have any amounts accrued for interest and penalties related to UTBs at December 31, 2015 or 2014, and it is not aware of any claims for such amounts by federal or state income tax authorities.

10. RELATED PARTY TRANSACTIONS

Loans
In the ordinary course of business, the Bank grants loans to certain directors, executive officers and their affiliates. Such loans aggregated to $2,780 and $2,781 at December 31, 2015 and 2014, respectively.

Deposits
Deposits of Corporate directors, executive officers and their affiliates were $752 and $829 at December 31, 2015 and 2014, respectively.

11. OFF-BALANCE SHEET ACTIVITIES

The Bank is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank follows the same credit policy in making commitments, including requirements for collateral, as it does for on-balance-sheet instruments; no significant losses are anticipated as a result of these commitments.

At December 31, 2015 and 2014, the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount	
	2015	2014
Unfunded commitments under lines of credit	$ 25,894	$ 19,810
Commitments to grant loans	8,093	4,701
Commercial and standby letters of credit	982	986

Unfunded commitments under commercial lines of credit, revolving home equity lines of credit and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. The commitments for equity lines of credit may expire without being drawn upon. 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. A majority of such commitments are at fixed rates of interest; a portion is unsecured.

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 may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral

Continued...

(Dollars in thousands except share data)

obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments, if deemed necessary. Guarantees that are not derivative contracts have been recorded on the Corporation's consolidated balance sheets at their fair value at inception. The Bank considers standby letters of credit to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is not significant, a liability related to such guarantees is not recorded at December 31, 2015 or 2014.

12. COMMON STOCK ACTIVITY

During 2015, the Corporation repurchased 1,177 shares of common stock (see note 16). The repurchase price in excess of the amounts identified with the original issuance of the common stock was charged entirely to retained earnings. There were no repurchases of common stock in 2014.

13. REGULATORY REQUIREMENTS

__Capital Requirements__

The Corporation (on a consolidated basis) and the Bank are subject to various regulatory capital requirements, including restrictions on dividends, administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, capital and certain off-balance-sheet items as defined in the regulations and calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Failure to meet capital requirements can initiate regulatory action. The final rules related to the implementation of the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III Rules) became effective for the Corporation on January 1, 2015, with full compliance of all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Capital amounts and ratios for December 31, 2014, and are calculated using Basel I rules.

Quantitative measurements established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth in the following table). Management believes, as of December 31, 2015 and 2014, that the Corporation and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2015 and 2014, the most recent notifications from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since the notification that management believes have changed the Bank's category. The Corporation's and the Bank's actual capital amounts and ratios as of December 31, 2015 and 2014 are also presented in the table.

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
December 31, 2015	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk Weighted Assets:						
Consolidated	$ 31,004	19.08%	$ 13,002	8.00%	$ N/A	N/A
Bank	29,640	18.24	13,002	8.00	16,252	10.00%
Tier 1 (Core) Capital to Risk Weighted Assets:						
Consolidated	29,799	18.34	9,751	6.00	N/A	N/A
Bank	28,435	17.50	9,751	6.00	13,002	8.00
Commom Tier 1 (CET1)						
Consolidated	29,799	10.33	12,983	4.50	N/A	N/A
Bank	28,435	9.86	12,983	4.50	18,754	6.50
Tier 1 (Core) Capital to Average Assets:						
Consolidated	29,799	10.33	11,541	4.00	N/A	N/A
Bank	28,435	9.86	11,541	4.00	14,426	5.00

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
December 31, 2014	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk Weighted Assets:						
Consolidated	$ 30,038	19.30%	$ 12,449	8.00%	$ N/A	N/A
Bank	29,854	19.19	12,449	8.00	15,561	10.00%
Tier 1 Capital to Risk Weighted Assets:						
Consolidated	28,350	18.22	6,224	4.00	N/A	N/A
Bank	28,166	18.10	6,224	4.00	9,337	6.00
Tier 1 Capital to Average Assets:						
Consolidated	28,350	9.95	11,396	4.00	N/A	N/A
Bank	28,166	9.89	11,396	4.00	14,245	5.00

__Restrictions on Cash and Amounts Due from Banks__
The Bank is required by regulatory agencies to maintain legal cash reserves based on the level of certain customer deposits. There was no required reserve balance at December 31, 2015 or 2014.

__Restrictions on Dividends, Loans and Advances__
Federal and state banking regulations place certain restrictions on the amount of loans or advances that can be extended to the Corporation by the Bank and dividends that can be paid to the Corporation by the Bank. The total amount of dividends which may be paid at any date is generally limited to the retained earnings of the Bank, and loans or advances are limited to 10% of the Bank's capital stock and surplus on a secured basis. In addition, dividends paid by the Bank to the Corporation would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

14. CONTINGENCIES

__Litigation__
The Corporation is party to litigation arising during the normal course of business. In the opinion of management, based on consultation with legal counsel, the resolution of such litigation is not expected to have a material effect on the consolidated financial statements.

__Environmental Issues__
As a result of acquiring real estate from foreclosure proceedings, the Corporation is subject to potential claims and possible legal proceedings involving environmental matters. No such claims have been asserted as of December 31, 2015.

15. EMPLOYEE BENEFIT PLAN

__401(k) Plan__
The Bank maintains a deferred compensation plan qualified under Section 401(k) of the Internal Revenue Code. Under this plan, eligible employees are permitted to contribute up to 25% of gross compensation into the retirement plan up to a maximum determined by the Internal Revenue Code; the Bank matches each employee contribution at a rate of up to 50% of the first 6% contributed by the employee. Expenses associated with the plan amounted to $77 and $68 in 2015 and 2014, respectively.

The 401(k) retirement plan also has a defined contribution profit sharing feature that covers substantially all of its employees. Contributions to the plan are based on an employee's earnings, as defined in the plan document. Expenses associated with the plan amounted to $155 and $138 in 2015 and 2014, respectively.

__Bank-Owned Life Insurance__
The Bank has invested in single premium, bank owned, whole life insurance policies on certain officers of the Bank. Bank owned life insurance is an alternative investment vehicle, generally non-liquid, which may produce additional earnings to offset, and later fund, various employee supplemental benefit expenses The earnings on the policies are not taxed unless withdrawn or surrendered prior to the death of the insured. The increase in cash surrender value of the policies, which was $150 and $148 in 2015 and 2014, respectively, is included in noninterest income in the accompanying consolidated statements of income.

The benefit promised by the Bank to the covered officers is established at one times the officer's salary at date of death; such benefit expires if the officers' employment is terminated for any reason other than death, including voluntary or involuntary termination or retirement. Based primarily on the ages of the covered officers, the Bank believes that the payment of such benefits is not probable; accordingly, the Bank has not recorded a liability for such benefits.

16. COMMON STOCK COMPENSATION PLAN

Share-based compensation cost related to employee stock options is measured on the grant date, based on the fair value of the award calculated at that date, and is recognized over the employee's requisite service period, which generally is the options' vesting period. Fair value is calculated using the Black-Scholes option pricing model.

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(Dollars in thousands except share data)

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted average assumptions for the year ended December 31, 2015:

Risk-free interest rate	2.25%
Expected term	10 years
Expected stock price volatility	23.56%
Dividend yield or expected dividend	6.49%

Under the Corporation's 2012 Employee Stock Option Plan, the Corporation may grant options to its directors, officers and employees for the purchase of up to 128,000 shares of common stock, which can be increased annually up to 3% of the shares outstanding at January 1, 2013, (1,131,649) or 33,949 shares. The exercise of each option equals the market price of the Corporation's stock on the date of grant and an option's maximum term is ten years. The options vest ratably over five years from date of grant. The Corporation also has options outstanding under a Plan established in 2000 and terminated in 2009. The terms of the 2000 Plan are essentially the same as the 2012 Plan. For the years ended December 31, 2015 and 2014, the Corporation recognized $2 in compensation expense for stock options in both years. There was an impact of $0.02 and $0.01 to diluted earnings per share in 2015 and 2014, respectively. As of December 31, 2015, unrecognized compensation costs related to nonvested awards amounted to $5 and will be recognized over a remaining weighted average period of approximately 4 years.

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

In general, the Corporation's policy is to issue new shares upon the exercise of a stock option; however, the option holder has the option under the Plan to sell shares of stock owned by the holder to the Corporation to facilitate the exercise of options (see Note 12). A summary of the changes in the status of the Corporation's stock option plan is presented below:

	Common Shares Subject to Option	Weighted Average Exercise Price	Average Remaining Contractual Term (years)
Outstanding at January 1, 2014	**102,594**	**$ 15.57**	**3.74**
Granted	31,716	16.00	
Exercised	(1,625)	10.10	
Forfeited	(2,560)	23.50	
Outstanding at December 31, 2014	**130,125**	**$ 15.58**	**3.87**
Granted	36,468	16.08	
Exercised	(9,614)	10.22	
Forfeited	(14,137)	18.78	
Outstanding at December 31, 2015	**142,842**	**$ 15.76**	**4.27**

The fair value of options granted during 2015 and 2014 was $0 and $8, respectively.

As of December 31, 2015, 29,885 options under the 2009 plan are outstanding at an average exercise price of $18.48 (range of $10.10 – $22.30), all of which are exercisable. As of December 31, 2015, 112,957 options under the 2012 plan were outstanding at an average exercise price of $15.09 (range of $12.75 - $17.40) of which 30,887 are exercisable.

17. SUPPLEMENTAL CASH FLOWS INFORMATION

Other Cash Flows Information

Cash paid for interest and income taxes amounted to the following during the years ended December 31:

	2015	2014
Interest	$ 453	$ 656
Income taxes	$ 340	$ 678

Non-Cash Investing Activities

Collateral repossessed on real estate loans having carrying values in the amount of $739 and $1,162 on the date of transfer was transferred to foreclosed assets in 2015 and 2014, respectively. Additionally, $151 of bank owned property was transferred from premises and equipment to other assets during 2015 and subsequently sold.

During 2015, options for the purchase of 9,614 common shares were exercised. In accordance with the Plan document, 1,177 outstanding shares of common stock were repurchased by the Corporation to facilitate the exercise of 1,905 options. Total value assigned to the repurchased shares was $19. Total consideration paid in connection with the exercise of 1,905 options was $0 plus the value of the repurchased shares. The remaining 7,709 options were exercised at a weighted average price of $10.22 with total cash consideration of $79.

18. ACQUISITION (SUBSEQUENT EVENT)

The Corporation entered into an acquisition agreement with Ruth Bank Corporation ("Ruth") on November 5, 2015. Under the terms of this agreement, the Corporation will assume all of the assets, liabilities, and equity of Ruth in an all cash transaction.

End of Notes

Rehmann

Rehmann Robson
5800 Gratiot Rd.
Suite 201
Saginaw, MI 48638
Ph: 989.799.9580
Fx: 989.799.0227
rehmann.com

INDEPENDENT AUDITORS' REPORT

February 5, 2016

Shareholders and Board of Directors
Eastern Michigan Financial Corporation
Croswell, Michigan

We have audited the accompanying consolidated financial statements of ***Eastern Michigan Financial Corporation*** (the Corporation), which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Independent Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on auditor judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Corporation's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ***Eastern Michigan Financial Corporation*** as of December 31, 2015 and 2014, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Rehmann Robson LLC

ADMINISTRATION BUILDING REMODEL

As referenced in our June 30, 2015 financial statement, we completed the remodel of our administration building in Croswell in early summer, creating the additional work space necessary to move our bookkeeping and accounting staff from their previous location two miles away. Having all of our administrative staff under one roof has been even better than we could have imagined in terms of increased efficiency and the remodel itself turned out beautifully. The photos really do not do our new space justice. We have received many compliments from local residents, area business people and vendors when they visit.


The east half of the building used to house our Croswell branch location. The former lobby space now holds a small reception area as well as our human resources offices. The former vault is now our mail, copy and supply room.


In addition to new chairs, carpet and wall covering, we added a unique v-shaped table to our board room, designed to maximize the capacity of the space. Electrical and USB ports are available along the table's inner edge.


The northeast corner where the teller line used to be was framed in and now houses our bookkeeping and accounting departments.


Back offices received new furniture, carpet and wall coverings. A spare office was converted into a small conference space.

WE'VE STOOD THE TEST OF TIME

easternmichiganbank.com

Eastern Michigan Bank
65 N. Howard Avenue | Croswell, MI 48422
810.679.2500 | 800.397.2504