



County Bank Corp

2011 Annual Report

## PRESIDENT'S LETTER

County Bank Corp

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To Our Stockholders, Customers and Friends:

Through the concerted efforts of our dedicated staff, the Corporation rebounded nicely in 2011 and posted 4-year highs in net profit, assets, deposits and stockholders' equity. Additionally, the Corporation paid a dividend for the 70th consecutive year, a notable achievement in the current banking environment.

For 2011, the Corporation's financial highlights include:

- Net income of \$2,118,000
- Total assets of \$300,941,000
- Total deposits of \$270,062,000
- Return on Assets of .71%
- Return on Equity of 7.50%
- Stockholders' equity of \$30,038,000

At year end, the Bank's Tier 1 leverage capital ratio, also known as the Tier 1 capital to average assets ratio, was a healthy 9.5%, an increase of .5 % from 2010. The Tier 1 leverage capital ratio is an important measurement of financial strength and is one of the most common assessments available when analyzing the health of a bank. According to regulatory agency definitions, a bank is considered well-capitalized if its Tier 1 leverage capital ratio is at least 5%. The higher the capital ratio; the better the capital ratio.

Our market area continues to be adversely affected by the prevailing economic conditions and many of our customers are still undergoing substantial financial difficulties. As a result, we have continued to build the allowance for loan and lease losses, closing the year at just under \$5,000,000. An additional sign of support is the financial commitment made by the members of our Board of Directors, who individually purchased in excess of 36,000 shares of County Bank Corp stock the past year.

In 2011, over 1,285 in-person customer calls resulted in new loans in excess of \$600,000, new deposits in excess of \$5,500,000, 111 new business debit cards, 113 new mobile banking accounts and many new remote deposit, merchant Visa®, and online banking accounts. We held two more sessions of LCBT University which provides direct sales training, personal growth information and product knowledge to customer contact employees. Email marketing campaigns resulted in the Business Connections eNewsletter being sent electronically to over 2,300 customers and prospects during the year.

Website testimonials from our business customers were doubled, we served as a major sponsor of community events including the Lapeer Area Citizens of the Year Banquet, Lapeer Days Festival, Lapeer Regional Medical Center Golf Classic and the Imlay City Blueberry Festival. We hosted three community shred days throughout the County, the 10th annual Ice Cream Social on the Courthouse lawn and with the Lapeer Symphony Orchestra, welcomed all Lapeer County citizens to our annual Christmas open house.

Through our numerous contributions, donations and community service, we continue to demonstrate all of the good things about community banking. Our Imlay City Branch Officer, Mr. Walt Bargaen, was recognized as the 2011 Imlay City Citizen of the Year.

We welcomed back, Mr. David Warrington as the Assistant Trust Officer and welcomed Mr. Gary Drainville, Vice President and Senior Trust Officer to the Bank. Mr. Drainville is a well known banker in southeast Michigan, spending most of his career in the trust and wealth management arenas.

Congratulations are in order to Ms. Nancy Sommerville, our Business Development Director, who retired after 23 years of dedicated service. Also retiring in 2011, were Ms. Char Morris, longtime retail lending specialist and Ms. Marilyn Smith, a teller at the main office. We wish them all well in retirement.

Also, effective December 31, 2011, Mr. Jim Harrington retired from the Board of Directors after 13 years of dedicated service. Mr. Harrington provided significant input and direction in his role as a bank director and he will be missed.

As in the past several years, the 2012 annual meeting will be at the Lapeer Country Club and will be held on Friday, April 20, beginning at 3:00 p.m. Please join me there.

Very truly yours,

Bruce J. Cady  
President & CEO



**Bruce J. Cady**  
 President & CEO  
 Lapeer County Bank  
 & Trust Co.



**Curt Carter**  
 Chairman  
 County Bank Corp



**Michael H. Blazo**  
 Retired



**David H. Bush**  
 Doctor of Optometry



**David J. Churchill**  
 Attorney at Law  
 Taylor, Butterfield, Howell,  
 Churchill & Jarvis, P.C.



**Patrick A. Cronin**  
 Agent  
 State Farm Insurance



**Ernest W. Lefever**  
 D.P.M.  
 Foot Specialists of Lapeer



**Timothy Oesch**  
 C.P.A.  
 President - Oesch & Sieting, P.C.



**Eric (Rick) Burrough**  
 Owner  
 JAMS Media and  
 Michigan Web Press



**James F. Harrington**  
 retired from the Board of Directors at the end  
 of 2011, after nineteen years as a dedicated  
 and active director. President of H&H Tool,  
 Inc., Jim remains active in the community.

## FINANCIAL SUMMARY

<b>AT YEAR END</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
<b>(000's omitted)</b>				
Assets	\$ <b>300,941</b>	\$ 289,317	\$ 294,362	\$ 255,965
Deposits	<b>270,062</b>	261,088	267,228	228,150
Loans	<b>181,652</b>	191,728	180,638	169,809
Securities	<b>94,992</b>	72,122	78,000	65,899
Stockholders' equity	<b>30,038</b>	27,253	26,370	26,824
<b>FOR THE YEAR</b>				
<b>(000's omitted)</b>				
Net income (loss)	\$ <b>2,118</b>	\$ 743	\$ 505	\$ (3,431)
Cash dividend declared	<b>108</b>	54	378	919
Return on average assets (%)	<b>.71</b>	.27	.18	(1.33)
Return on average stockholders' equity (%)	<b>7.50</b>	2.80	1.87	(11.61)
<b>PER SHARE</b>				
Book value	\$ <b>27.79</b>	\$ 25.21	\$ 24.39	\$ 24.82
Net income (loss)	<b>1.96</b>	.69	.47	(3.18)
Cash dividends declared	<b>.10</b>	.05	.35	.85

**CONSOLIDATED BALANCE SHEETS**  
(In Thousands Except Share Data)

	December 31	
	2011	2010
<b>ASSETS</b>		
Cash and due from banks	\$ 9,955	\$ 8,757
Federal funds sold	100	100
<b>Cash and cash equivalents</b>	<b>10,055</b>	<b>8,857</b>
Interest-bearing deposits in banks	5,811	3,691
Investment securities	94,992	72,122
Restricted investment securities	1,431	541
Loans held for sale	-	4,438
Net loans	176,719	188,220
Premises and equipment, net	5,014	5,231
FDIC insurance premium	1,028	1,506
Accrued interest receivable and other assets	5,891	4,711
<b>Total assets</b>	<b>\$ 300,941</b>	<b>\$ 289,317</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Deposits</b>		
Interest-bearing	\$ 227,724	\$ 223,866
Noninterest-bearing	42,338	37,222
<b>Total deposits</b>	<b>270,062</b>	<b>261,088</b>
Accrued interest payable and other liabilities	841	976
<b>Total liabilities</b>	<b>270,903</b>	<b>262,064</b>
Commitments and contingencies (Notes 10, 11 and 12)		
<b>Stockholders' equity</b>		
Common stock, \$5 par value, 3,000,000 shares authorized, 1,080,946 shares issued and outstanding	5,404	5,404
Surplus	8,634	8,634
Retained earnings	14,857	12,847
Accumulated other comprehensive income	1,143	368
<b>Total stockholders' equity</b>	<b>30,038</b>	<b>27,253</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 300,941</b>	<b>\$ 289,317</b>

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

## CONSOLIDATED STATEMENTS OF INCOME

(In Thousands Except Per Share Data)

	Year Ended December 31	
	2011	2010
<b>Interest income</b>		
Loans (including fees)	\$ 10,883	\$ 10,714
Investments	2,605	2,625
Interest on deposits with other banks	34	36
<b>Total interest income</b>	<b>13,522</b>	<b>13,375</b>
<b>Interest expense</b>	<b>1,919</b>	<b>2,968</b>
<b>Net interest income</b>	<b>11,603</b>	<b>10,407</b>
Provision for loan losses	3,100	4,150
<b>Net interest income, after provision for loan losses</b>	<b>8,503</b>	<b>6,257</b>
<b>Noninterest income</b>		
Service charges on deposit accounts	1,467	1,450
Net gain on sales or calls of investment securities	463	298
Trust income	714	609
Debit card income	371	315
Other	1,032	749
<b>Total noninterest income</b>	<b>4,047</b>	<b>3,421</b>
<b>Noninterest expenses</b>		
Salaries and employee benefits	5,354	5,103
Occupancy and equipment	939	961
FDIC assessment	595	465
Net loss on sale of other real estate	88	23
Other	2,649	2,405
<b>Total noninterest expenses</b>	<b>9,625</b>	<b>8,957</b>
<b>Income before federal income taxes</b>	<b>2,925</b>	<b>721</b>
Federal income taxes	807	(22)
<b>Net income</b>	<b>\$ 2,118</b>	<b>\$ 743</b>
<b>Net income per basic share of common stock</b>	<b>\$ 1.96</b>	<b>\$ 0.69</b>

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

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(In Thousands)

	Year Ended December 31	
	2011	2010
<b>Available-for-sale securities</b>		
Unrealized holding gains arising during the year	\$ 1,637	\$ 590
Reclassification adjustment for net realized gains included in net income	<u>(463)</u>	<u>(298)</u>
<b>Other comprehensive income before income tax expense</b>	<b>1,174</b>	<b>292</b>
Income tax expense related to other comprehensive income	<u>(399)</u>	<u>(98)</u>
<b>Other comprehensive income</b>	<b>775</b>	<b>194</b>
Net income	<u>2,118</u>	<u>743</u>
<b>Comprehensive income</b>	<u><b>\$ 2,893</b></u>	<u><b>\$ 937</b></u>

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

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

(In Thousands Except Share Data)

	Common Stock		Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Total
	Shares	Amount				
Balances, January 1, 2010	1,080,946	\$ 5,404	\$ 8,634	\$ 12,158	\$ 174	\$ 26,370
Comprehensive income	-	-	-	743	194	937
Cash dividends paid (\$0.05 per share)	-	-	-	(54)	-	(54)
<b>Balances, December 31, 2010</b>	<b>1,080,946</b>	<b>5,404</b>	<b>8,634</b>	<b>12,847</b>	<b>368</b>	<b>27,253</b>
Comprehensive income	-	-	-	2,118	775	2,893
Cash dividends paid (\$0.10 per share)	-	-	-	(108)	-	(108)
<b>Balances, December 31, 2011</b>	<b>1,080,946</b>	<b>\$ 5,404</b>	<b>\$ 8,634</b>	<b>\$ 14,857</b>	<b>\$ 1,143</b>	<b>\$ 30,038</b>

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



**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In Thousands)

	Year Ended December 31	
	2011	2010
<b>Cash flows from operating activities</b>		
Net income	\$ 2,118	\$ 743
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	3,100	4,150
Provision for foreclosed asset losses	443	189
Depreciation	375	394
Net amortization of investments	884	672
Deferred income tax benefit	(31)	(87)
Net gain on sales or calls of investment securities	(463)	(298)
Net gain on sale of loans	(290)	(103)
(Gain) loss on sales of foreclosed assets	(71)	23
Origination of loans held for sale	(6,669)	(8,846)
Proceeds from loan sales	6,901	8,949
Net changes in operating assets and liabilities which provided (used) cash		
FDIC insurance premium	478	428
Accrued interest receivable and other assets	(56)	746
Accrued interest payable and other liabilities	(135)	212
<b>Net cash provided by operating activities</b>	<b>6,584</b>	<b>7,172</b>
<b>Cash flows from investing activities</b>		
Net change in interest-bearing deposits in banks	(2,120)	8,671
Activity in available-for-sale securities		
Purchases	(71,448)	(47,876)
Maturities, prepayments, sales and calls	46,685	48,728
Activity in held-to-maturity securities		
Purchases	(52)	-
Maturities, prepayments and calls	2,698	4,944
Purchase of restricted investments	(890)	-
Loan principal originations and collections, net	6,041	(16,559)
(Sales) purchase of loans held for sale	4,496	(4,438)
Proceeds from sales of foreclosed assets	496	1,094
Premises and equipment expenditures	(158)	(194)
<b>Net cash used in investing activities</b>	<b>(14,252)</b>	<b>(5,630)</b>
<b>Cash flows from financing activities</b>		
Acceptances and withdrawals of deposits, net	8,974	(6,140)
Cash dividends paid	(108)	(54)
<b>Net cash provided by (used in) financing activities</b>	<b>8,866</b>	<b>(6,194)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>1,198</b>	<b>(4,652)</b>
Cash and cash equivalents, beginning of year	8,857	13,509
<b>Cash and cash equivalents, end of year</b>	<b>\$ 10,055</b>	<b>\$ 8,857</b>

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (In Thousands)

### 1. BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Consolidation and Nature of Business

The accompanying consolidated financial statements include the accounts of *County Bank Corp*, a registered bank holding company (the “Corporation”), and its wholly owned subsidiary, Lapeer County Bank & Trust Co. (the “Bank”). 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 seven branches located in the county of Lapeer 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 other manufacturing 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 and the Federal Reserve System. The Bank is supervised and regulated by the Michigan Office of Financial and Insurance Regulation (“OFIR”), the Federal Reserve Board (“FRB”), 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 expense 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, the valuation of foreclosed real estate, and the valuation of deferred tax 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. The principles which materially affect the determination of the financial position and results of operations of the Corporation and the Bank 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 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (In Thousands)

### *Interest-Bearing Deposits in Banks*

Interest-bearing deposits in banks mature within one year 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 on 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 investment 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 Bank 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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### (In Thousands)

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.

#### ***Restricted Investments***

The Bank is a member of the Federal Reserve Bank (“FRB”) and the Federal Home Loan Bank System of Indianapolis (“FHLBI”) and is required to invest in capital stock of the FRB and the “FHLBI.” The amount of the required investment in the FRB is determined by the FRB and is carried at cost based on the Bank’s capital and surplus. The amount of required investment in the FHLBI is based upon the available balance of the Bank outstanding home mortgage loans or advances from the FHLBI and is carried at cost plus the value assigned to stock dividends.

#### ***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 non-accrual 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 (120 days or more past due on real estate residential loans) 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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

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, general reserves and specific reserves related to impaired loans. 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. The Bank places more emphasis, or weight, on the more current quarters in the loss history period. 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 generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the 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 its 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 and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

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 past due in accordance with the loans' original contractual terms, are considered in a nonperforming status for purposes of credit quality evaluation.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### (In Thousands)

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 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 five 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.

**Special Mention (or Watch):** Loans classified as special mention (watch) 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 (watch) 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 portfolio is 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 and residential 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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

resolution, which generally occurs fairly rapidly and often through repossession and foreclosure. Credit quality for the entire consumer and residential 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, commercial real estate, real estate construction, residential real estate, and consumer and other 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.

**Commercial Real Estate:** Commercial real estate loans generally possess a higher inherent risk of loss than other real estate portfolio segments. Adverse economic developments or an overbuilt market impact commercial 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.

**Real Estate Construction:** Real estate construction loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within a specified cost and time line. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

**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, credit cards, 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.

Although management believes the allowance to be appropriate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the appropriateness of the allowance, 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 Banks's primary regulators review the appropriateness of the allowance.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### (In Thousands)

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***

Loans originated and held for sale in the secondary market are carried at the lower of cost or fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance of which the provision is accounted for in the consolidated statements of income. Additionally, during 2010, the Corporation purchased a group of loans from another bank, which were considered held for sale. In 2011, the Corporation sold this group of loans.

#### ***Transfers of Financial Assets***

Transfers of financial assets, including mortgage loans held-for-sale, as described above, 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 Bank, 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 Bank 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 Bank has no substantive continuing involvement related to these loans. The Bank sold residential mortgage loans to unrelated third parties with proceeds of \$11,397 and \$8,949 during 2011 and 2010, respectively, which resulted in a net gain of \$290 and \$103 in 2011 and 2010, respectively. Servicing fee income earned on such loans was \$12 and \$16 in 2011 and 2010, respectively, and is included in other noninterest income.

#### ***Servicing***

Servicing assets are recognized as separate assets when rights are acquired through the purchase or sale of financial assets. Generally, purchased servicing rights are capitalized at the cost to acquire the rights. 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 are measured at fair value at each reporting date and changes in fair value are recorded in earnings in the periods in which the changes occur. Capitalized servicing rights are reported in other assets on the consolidated balance sheets.

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 noninterest income on the accompanying consolidated statements of income.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

### *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. 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 net expenses from foreclosed assets. Foreclosed assets of \$2,813 and \$1,321 are included in accrued interest receivable and other assets on the accompanying consolidated balance sheets at December 31, 2011 and 2010, respectively. Foreclosed assets, as of those dates are presented net of a valuation allowance of \$501 and \$263, respectively. Expenses related to foreclosed assets amounted to \$339 and \$309 in 2011 and 2010, respectively, and are included in other noninterest expenses on the accompanying 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.

### *FDIC Insurance Premium*

The Bank was required to prepay quarterly FDIC risk-based assessments for the fourth quarter of 2009 and each of the quarters in the years ending December 31, 2010, 2011 and 2012. The assessments for subsequent years have been deferred on the accompanying December 31, 2011 and 2010 consolidated balance sheets as a prepaid asset, and are expected to be expensed on a ratable basis quarterly through December 31, 2012.

### *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.

### Advertising Costs

The cost of advertising and promotions are expensed as incurred. The Corporation incurred \$84 and \$115 in advertising costs in 2011 and 2010, respectively.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (In Thousands)

### Net Income Per Share

Net income per basic share of common stock represents income available to common stockholders divided by the weighted average number of common shares outstanding during the year, which was 1,081 in 2011 and 2010.

### Reclassifications

Certain amounts as reported in the 2010 consolidated financial statements have been reclassified to conform with the 2011 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, 2011, the most recent balance sheet presented herein, through February 10, 2012, the date these consolidated financial statements were available to be issued. No significant such events or transactions were identified.

## 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 investment securities held-to-maturity, 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 Federal funds sold, approximate fair values.

### **Interest-Bearing Deposits in Banks**

The carrying amounts of interest-bearing deposits with unaffiliated banks approximate their 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,

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (In Thousands)

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, 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 like 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. Treasury securities, mortgage-backed securities issued by government-sponsored entities, municipal bonds and corporate debt securities in active markets.

### Restricted Investment Securities

The carrying value of Federal Reserve Bank Stock and Federal Home Loan Bank Stock approximates fair value based on the redemption provisions of the Federal Reserve and Federal Home Loan Bank.

### Loans Held for Sale

Loans held for sale are carried at the lower of cost or fair value. The fair value of loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, the Corporation classifies loans subjected to nonrecurring fair value adjustments as Level 2.

### 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 non-performing 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, fair value of similar debt, enterprise 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. At December 31, 2011 and 2010, substantially all of the impaired loans were evaluated based on the fair value of the collateral. 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### (In Thousands)

#### **Accrued Interest Receivable**

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

#### **Foreclosed Assets**

The carrying amounts for foreclosed assets are reported in the consolidated balance sheets in other 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 classifies 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 classifies 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, 2011 and 2010, 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 values.

#### **Commitments to Extend Credit, Standby Letters of Credit, and Undisbursed Loans**

The Bank'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 Bank 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

### Assets Recorded at Fair Value on a Recurring Basis

The following table sets forth by level, within the fair value hierarchy, the recorded amount of assets measured at fair value on a recurring basis as of December 31:

2011	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Investment securities available-for-sale:				
Government-sponsored enterprises	\$ -	\$ 61,165	\$ -	\$ 61,165
States and municipal	-	4,485	-	4,485
Corporate	-	2	-	2
Mortgage-backed securities	-	22,918	-	22,918
<b>Total assets at fair value</b>	<b>\$ -</b>	<b>\$ 88,570</b>	<b>\$ -</b>	<b>\$ 88,570</b>

2010	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Investment securities available-for-sale:				
Government-sponsored enterprises	\$ -	\$ 24,339	\$ -	\$ 24,339
States and municipal	-	6,664	-	6,664
Corporate	-	2	-	2
Mortgage-backed securities	-	32,238	-	32,238
<b>Total assets at fair value</b>	<b>\$ -</b>	<b>\$ 63,243</b>	<b>\$ -</b>	<b>\$ 63,243</b>

### Assets Recorded at Fair Value on a Nonrecurring Basis

The following table sets 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:

2011	Assets at Carrying Value			
	Level 1	Level 2	Level 3	Total
Impaired loans (1)	\$ -	\$ -	\$ 13,687	\$ 13,687
Foreclosed assets (2)	-	-	2,813	2,813

  

2010	Assets at Carrying Value			
	Level 1	Level 2	Level 3	Total
Impaired loans (1)	\$ -	\$ -	\$ 7,049	\$ 7,049
Foreclosed assets (2)	-	-	1,321	1,321

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

- (1) Impaired loans as of December 31, 2011 and 2010, which are measured for impairment using the present value of future cash flows method for loans identified as troubled debt or restructured or loans using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$13,687 and \$7,049, respectively, resulting in an additional provision for loan losses of \$516 and \$392 for the years then ended, respectively.
- (2) Foreclosed assets as of December 31, 2011 and 2010, respectively, which are carried at the lower of carrying value or fair value less cost to sell, were written down from cost to \$2,813 and \$1,321 resulting in charges of \$443 and \$189, included in other noninterest expenses on the consolidated income statements for the years then ended.

### 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 financial liabilities on a recurring and non-recurring 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:

	2011		2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Assets:</b>				
Cash and equivalents	\$ 10,055	\$ 10,055	\$ 8,857	\$ 8,857
Interest-bearing deposits in other banks	5,811	5,811	3,691	3,691
Investment securities held-to-maturity	6,422	6,699	8,879	9,032
Restricted investment securities	1,431	1,431	541	541
Net loans	176,719	176,333	188,220	188,387
Accrued interest receivable	1,620	1,620	1,585	1,585
Foreclosed assets	2,813	2,813	1,321	1,321
Mortgage servicing rights	291	361	277	393

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

	2011		2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Liabilities:</b>				
Interest-bearing deposits	\$ 227,724	\$ 228,411	\$ 223,886	\$ 225,209
Noninterest-bearing deposits	42,328	42,338	37,222	37,222
Accrued interest payable	126	126	173	173

### 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:

2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Held-to-maturity</b>				
Mortgage-backed securities	\$ 258	\$ 8	\$ -	\$ 266
States and municipal	<u>6,164</u>	<u>270</u>	<u>1</u>	<u>6,433</u>
<b>Total held-to-maturity</b>	<b><u>6,422</u></b>	<b><u>278</u></b>	<b><u>1</u></b>	<b><u>6,699</u></b>
<b>Available-for-sale</b>				
Government-sponsored enterprises	60,213	1,236	284	61,165
States and municipal	4,176	310	1	4,485
Corporate	7	-	5	2
Mortgage-backed securities	<u>22,445</u>	<u>479</u>	<u>6</u>	<u>22,918</u>
<b>Total available-for-sale</b>	<b><u>86,841</u></b>	<b><u>2,025</u></b>	<b><u>296</u></b>	<b><u>88,570</u></b>
<b>Total</b>	<b><u>\$ 93,263</u></b>	<b><u>\$ 2,303</u></b>	<b><u>\$ 297</u></b>	<b><u>\$ 95,269</u></b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Held-to-Maturity</b>				
Mortgage-backed securities	\$ 363	\$ 8	\$ -	\$ 371
States and municipal	<u>8,516</u>	<u>172</u>	<u>27</u>	<u>8,661</u>
<b>Total held-to-maturity</b>	<b><u>8,879</u></b>	<b><u>180</u></b>	<b><u>27</u></b>	<b><u>9,032</u></b>
<b>Available-for-Sale</b>				
Government-sponsored enterprises	24,023	340	24	24,339
States and municipal	6,484	203	23	6,664
Corporate	7	-	5	2
Mortgage-backed securities	<u>32,174</u>	<u>244</u>	<u>180</u>	<u>32,238</u>
<b>Total available-for-sale</b>	<b><u>62,688</u></b>	<b><u>787</u></b>	<b><u>232</u></b>	<b><u>63,243</u></b>
<b>Total</b>	<b><u>\$ 71,567</u></b>	<b><u>\$ 967</u></b>	<b><u>\$ 259</u></b>	<b><u>\$ 72,275</u></b>

Investment securities with carrying values of approximately \$5,970 and \$8,770 at December 31, 2011 and 2010, respectively, were pledged to secure public deposits or for other purposes as permitted or required by law.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

The amortized cost and fair value of held-to-maturity securities and available-for-sale securities grouped by contractual maturity at December 31, 2011, are summarized as follows:

	Maturing				Securities With Variable Monthly Payments	Total
	Due In One Year or Less	Due After One Year Through Five Years	Due After Five Years Through Ten Years	Over Ten Years		
<b>Held-to-maturity</b>						
Mortgage-backed securities	\$ -	\$ -	\$ -	\$ -	\$ 258	\$ 258
States and municipal	465	3,178	2,070	451	-	6,164
<b>Total held-to-maturity</b>	<b>\$ 465</b>	<b>\$ 3,178</b>	<b>\$ 2,070</b>	<b>\$ 451</b>	<b>\$ 258</b>	<b>\$ 6,422</b>
<b>Available-for-sale</b>						
Government-sponsored enterprises	\$ -	\$ 1,765	\$ 26,811	\$ 31,637	\$ -	\$ 60,213
States and municipal	175	1,742	578	1,681	-	4,176
Corporate	-	-	-	-	7	7
Mortgage-backed securities	-	-	-	-	22,445	22,445
<b>Total available-for-sale</b>	<b>\$ 175</b>	<b>\$ 3,507</b>	<b>\$ 27,389</b>	<b>\$ 33,318</b>	<b>\$ 22,452</b>	<b>\$ 86,841</b>
<b>Total amortized cost</b>	<b>\$ 640</b>	<b>\$ 6,685</b>	<b>\$ 29,459</b>	<b>\$ 33,769</b>	<b>\$ 22,710</b>	<b>\$ 93,263</b>
<b>Fair value</b>	<b>\$ 640</b>	<b>\$ 6,989</b>	<b>\$ 30,217</b>	<b>\$ 34,238</b>	<b>\$ 23,185</b>	<b>\$ 95,269</b>

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

Because of their variable monthly payments, mortgage-backed securities and Corporate securities are not reported by a specific maturity group.

During 2011 and 2010, proceeds from sales of available-for-sale securities amounted to approximately \$19,362 and \$33,660, respectively. Gross realized gains amounted to \$463 and \$356 during 2011 and 2010, respectively. Gross realized losses amounted to \$58 during 2010. There were no gross realized losses in 2011.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

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:

2011	Less Than 12 Months		Over 12 Months		Fair Value	Total Gross Unrealized Losses
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss		
<b>Held-to-maturity</b>						
States and municipal	\$ 278	\$ 1	\$ -	\$ -	\$ 278	\$ 1
<b>Available-for-sale</b>						
Government-sponsored enterprises	\$ 22,716	\$ 280	\$ 2,996	\$ 4	\$ 25,712	\$ 284
Corporate			2	5	2	5
Mortgage-backed securities	-	-	464	6	464	6
States and municipal	-	-	175	1	175	1
<b>Total securities available-for-sale</b>	<b>\$ 22,716</b>	<b>\$ 280</b>	<b>\$ 3,637</b>	<b>\$ 16</b>	<b>\$ 26,353</b>	<b>\$ 296</b>
2010	Less Than 12 Months		Over 12 Months		Fair Value	Total Gross Unrealized Losses
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss		
<b>Held-to-maturity</b>						
States and municipal	\$ 1,201	\$ 26	\$ 19	\$ 1	\$ 1,220	\$ 27
<b>Available-for-sale</b>						
Government-sponsored enterprises	\$ 5,976	\$ 24	\$ -	\$ -	\$ 5,976	\$ 24
Corporate	2	5	-	-	2	5
Mortgage-backed securities	15,867	172	687	8	16,554	180
States and municipal	767	22	300	1	1,067	23
<b>Total securities available-for-sale</b>	<b>\$ 22,612</b>	<b>\$ 223</b>	<b>\$ 987</b>	<b>\$ 9</b>	<b>\$ 23,599</b>	<b>\$ 232</b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (In Thousands)

As of December 31, 2011, the Corporation's investment security portfolio consisted of 190 securities, 28 of which were in an unrealized loss position. The majority of unrealized losses are related to the Corporation's government-sponsored enterprise securities, as discussed below.

At December 31, 2011, the Corporation held 1 mortgage-backed security in an unrealized loss position, which was issued by Freddie Mac, a U.S. government-sponsored agency, which the government has affirmed its commitment to support. Additionally, the Corporation held 19 government-sponsored enterprise securities in an unrealized loss position. Because the decline in the market value is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Corporation does not have the intent to sell these mortgage-backed securities or government-sponsored enterprise securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Corporation does not consider these securities to be other than temporary impaired at December 31, 2011.

As of December 31, 2011 and 2010, management conducted an analysis to determine whether all securities currently in an unrealized loss position should be considered other-than-temporarily-impaired ("OTTI"). 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, 2011 or 2010.

### 4. LOANS AND ALLOWANCE FOR LOAN LOSSES

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

Loans are summarized as follows at December 31:

	2011	2010
Commercial and industrial	\$ 20,640	\$ 21,333
Commercial real estate	88,532	95,797
Real estate construction	9,294	10,272
Residential real estate	43,217	44,910
Consumer and other	19,969	19,416
Total loans	181,652	191,728
Allowance for loan losses	4,933	3,508
<b>Loans, net</b>	<b>\$ 176,719</b>	<b>\$ 188,220</b>

The allowance for loan losses and recorded investment in loans is as follows for the year ended December 31, 2011:

	Commercial and Industrial	Commercial Real Estate	Real Estate Construction	Residential Real Estate	Consumer And Other	Unallocated	Total
<b>Allowance for Loan Losses:</b>							
Balance at beginning of year	\$ 199	\$ 2,321	\$ 1,231	\$ 271	\$ 900	\$ (1,414)	\$ 3,508
Provision for loan losses	19	698	(182)	221	(58)	2,402	3,100
Loans charged-off	(27)	(1,106)	(255)	(172)	(235)	-	(1,795)
Recoveries	2	-	15	58	45	-	120
Balance at end of year	<u>\$ 193</u>	<u>\$ 1,913</u>	<u>\$ 809</u>	<u>\$ 378</u>	<u>\$ 652</u>	<u>\$ 988</u>	<u>\$ 4,933</u>
Ending balance: Individually evaluated for impairment	\$ 48	\$ 401	\$ -	\$ 7	\$ -	\$ -	\$ 456
Ending balance: Collectively evaluated for impairment	145	1,512	809	371	652	988	4,477
Total allowance for loan losses	<u>\$ 193</u>	<u>\$ 1,913</u>	<u>\$ 809</u>	<u>\$ 378</u>	<u>\$ 652</u>	<u>\$ 988</u>	<u>\$ 4,933</u>
<b>Loans:</b>							
Ending balance: Individually evaluated for impairment	\$ 773	\$ 12,367	\$ -	\$ 547	\$ -	\$ -	\$ 13,687
Ending balance: Collectively evaluated for impairment	19,867	76,165	9,294	42,670	19,969	-	167,965
Total loans	20,640	88,532	9,294	43,217	19,969	-	181,652
Accrued interest receivable	79	245	28	171	69	-	592
Total recorded investment	<u>\$ 20,719</u>	<u>\$ 88,777</u>	<u>\$ 9,322</u>	<u>\$ 43,388</u>	<u>\$ 20,038</u>	<u>\$ -</u>	<u>\$ 182,244</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

Changes in the allowance for loan losses are as follows during 2010:

Balance at beginning of year	\$	3,595
Provision for loan losses		4,150
Loans charged off		(4,320)
Recoveries		83
<b>Balance at end of year</b>	<b>\$</b>	<b><u>3,508</u></b>

The following table shows the loans allocated by management's internal risk ratings as of December 31, 2011:

	Commercial Credit Risk Profile Risk Rating			
	Commercial and Industrial	Commercial Real Estate	Real Estate Construction	Total
<b>Risk Rating</b>				
Pass	\$ 17,626	\$ 66,580	\$ 7,037	\$ 91,243
Special mention or watch	1,729	4,028	69	5,826
Substandard	<u>1,285</u>	<u>17,924</u>	<u>2,188</u>	<u>21,397</u>
<b>Total</b>	<b><u>\$ 20,640</u></b>	<b><u>\$ 88,532</u></b>	<b><u>\$ 9,294</u></b>	<b><u>\$ 118,466</u></b>

The following table shows the homogeneous loans allocated by payment activity as of December 31, 2011:

	Consumer Credit Risk Profile by Payment Activity		
	Residential Real Estate	Consumer and Other	Total
<b>Payment activity</b>			
Performing	\$ 43,018	\$ 19,811	\$ 62,829
Non-performing	<u>199</u>	<u>158</u>	<u>357</u>
<b>Total</b>	<b><u>\$ 43,217</u></b>	<b><u>\$ 19,969</u></b>	<b><u>\$ 63,186</u></b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

The following table shows an aging analysis of the loan portfolio by time past due as of December 31, 2011:

	Accruing Interest			Total Nonaccrual	Total Loans
	Current	30-89 Days Past Due	More Than 90 Days Past Due		
Commercial and industrial	\$ 20,330	\$ -	\$ -	\$ 310	\$ 20,640
Commercial real estate	87,706	36	260	530	88,532
Real estate construction	7,959	94	-	1,241	9,294
Residential real estate	42,590	428	22	177	43,217
Consumer and other	19,435	376	-	158	19,969
<b>Total</b>	<b>\$ 178,020</b>	<b>\$ 934</b>	<b>\$ 282</b>	<b>\$ 2,416</b>	<b>\$ 181,652</b>

At December 31, 2010, the Bank had \$3,040 of nonaccrual loans. Loans 90 days or more past due that are still accruing interest were not significant at December 31, 2010.

The following table presents information related to impaired loans as of December 31, 2011:

	Loan Balance	Unpaid Principal Balance	Related Allowance	Average Loan Balance	Interest Income Recognized
<b>Loans with no related allowance recorded</b>					
Commercial and industrial	\$ 89	\$ 89	\$ -	\$ 91	\$ 3
Commercial real estate	4,363	4,363	-	4,382	203
<b>Loans with an allowance recorded</b>					
Commercial and industrial	\$ 684	\$ 684	\$ 48	\$ 588	\$ 4
Commercial real estate	8,004	8,119	401	8,008	369
Residential real estate	547	547	7	547	6
<b>Total impaired loans</b>					
Commercial and industrial	\$ 773	\$ 773	\$ 48	\$ 679	\$ 7
Commercial real estate	12,367	12,482	401	12,390	572
Residential real estate	547	547	7	547	6
<b>Total</b>	<b>\$ 13,687</b>	<b>\$ 13,802</b>	<b>\$ 456</b>	<b>\$ 13,616</b>	<b>\$ 585</b>

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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

The following is a summary of information pertaining to impaired loans as of, and for the year ended December 31, 2010:

Impaired loans with a valuation allowance	\$ 4,519
Impaired loans without a valuation allowance	<u>2,530</u>
<b>Total impaired loans</b>	<b><u>\$ 7,049</u></b>
Valuation allowance related to impaired loans	\$ 392
Year to date average outstanding balance of impaired loans	\$ 6,294

Interest income recognized on impaired loans was not significant in 2010.

A summary of loans that were modified in troubled debt restructurings during 2011 is as follows:

Troubled Debt Restructurings			
	Number of Loans	Pre- Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial and industrial	4	\$ 1,076	\$ 1,076
Commercial real estate	16	12,482	12,482
Real estate construction	2	1,314	1,220
Residential real estate	4	816	816
Consumer and other	<u>1</u>	<u>6</u>	<u>6</u>
<b>Total</b>	<b><u>27</u></b>	<b><u>\$ 15,694</u></b>	<b><u>\$ 15,600</u></b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

The following table details the number of loans and the recorded investment in loans considered to be TDRs by type of modification during 2011:

	Total Modification						Total Modifications
	Principal Deferrals		Interest Rate Reductions		Principal Forgiveness		
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	
Commercial and industrial	1	\$ 90	3	\$ 986	-	\$ -	\$ 1,076
Commercial real estate	4	2,645	12	9,837	-	-	12,482
Real estate construction	1	979	-	-	1	241	1,220
Residential real estate	-	-	4	816	-	-	816
Consumer and other	-	-	1	6	-	-	6
<b>Total</b>	<b><u>6</u></b>	<b><u>\$ 3,714</u></b>	<b><u>20</u></b>	<b><u>\$ 11,645</u></b>	<b><u>1</u></b>	<b><u>\$ 241</u></b>	<b><u>\$ 15,600</u></b>

The following presents information on 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, 2011, that had been modified during the 12-month period prior to the default:

	With Payment Defaults During 2011:	
	Number of Loans	Recorded Investment (as of period end) (1)
Commercial real estate	1	\$ 264
Consumer and other	<u>1</u>	<u>6</u>
<b>Total</b>	<b><u>2</u></b>	<b><u>\$ 270</u></b>

- (1) The period end balances are inclusive of all partial paydowns and charge-offs since the modification date, if any. Loans modified in a TDR that were fully paid down, charged-off, or foreclosed upon by period end are not reported.

Loans that were modified in troubled debt restructurings during the year ended December 31, 2010, amounted to \$12,921.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

### 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, 2011 and 2010, approximated \$45,290 and \$46,646, respectively; such loans are not included on the accompanying consolidated balance sheets.

The recorded values and activity pertaining to mortgage servicing rights were not significant during 2011 or 2010.

### 6. PREMISES AND EQUIPMENT

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

	2011	2010
Land and improvements	\$ 1,443	\$ 1,434
Buildings and improvements	5,796	5,752
Furniture and equipment	3,872	3,783
Construction in process	16	-
Total	11,127	10,969
Less accumulated depreciation	6,113	5,738
<b>Premises and equipment, net</b>	<b><u>\$ 5,014</u></b>	<b><u>\$ 5,231</u></b>

Depreciation expense was \$375 and \$394 for 2011 and 2010, respectively.

### 7. DEPOSITS

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

	2011	2010
<b>Interest-bearing</b>		
Money market and NOW accounts	\$ 125,689	\$ 120,131
Savings	29,798	28,492
Time, \$100,000 and over	26,698	31,560
CDARS*	4,902	-
Other time	40,637	43,683
Total interest-bearing	227,724	223,866
Noninterest-bearing demand	42,338	37,222
<b>Total deposits</b>	<b><u>\$ 270,062</u></b>	<b><u>\$ 261,088</u></b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

(\*) The Certificate of Deposit Account Registry Service.

Interest expense on time deposits issued in denominations of \$100,000 or more was \$480 in 2011 and \$961 in 2010.

Scheduled maturities of time deposits for each of the five years succeeding December 31, 2011, are summarized as follows:

Year	Amount
2012	\$ 57,767
2013	4,806
2014	5,566
2015	2,716
2016	<u>1,382</u>
<b>Total</b>	<b><u>\$ 72,237</u></b>

### 8. FEDERAL INCOME TAXES

The federal income tax provision (benefit) consists of the following components for the years ended December 31:

	2011	2010
Currently payable	\$ 838	\$ 65
Deferred tax benefit	<u>(31)</u>	<u>(87)</u>
<b>Income taxes</b>	<b><u>\$ 807</u></b>	<b><u>\$ (22)</u></b>

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:

	2011	2010
Income tax benefit at statutory rate	\$ 995	\$ 246
Effect of tax-exempt interest income	(195)	(318)
Other - net	<u>7</u>	<u>50</u>
<b>Income taxes</b>	<b><u>\$ 807</u></b>	<b><u>\$ (22)</u></b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

The net deferred income tax assets presented on the accompanying consolidated balance sheets in other assets are comprised of the following amounts as of December 31:

	2011	2010
<b>Deferred tax assets</b>		
Allowance for loan losses	\$ 617	\$ 129
Other real estate	218	137
AMT credit carryover	349	665
Non-accrual interest	24	106
Other	<u>79</u>	<u>248</u>
<b>Total deferred tax assets</b>	<b><u>1,287</u></b>	<b><u>1,285</u></b>
<b>Deferred tax liabilities</b>		
Mortgage servicing rights	99	94
Depreciation	291	327
Net unrealized gains on securities available-for-sale	587	188
Accretion	9	11
Prepaid expenses	48	47
Other	<u>3</u>	<u>-</u>
<b>Total deferred tax liabilities</b>	<b><u>1,037</u></b>	<b><u>667</u></b>
<b>Net deferred tax asset</b>	<b><u>\$ 250</u></b>	<b><u>\$ 618</u></b>

The Corporation has evaluated the provisions of ASC Topic 740, *Accounting for Uncertainty in Income Taxes*. The evaluation was performed for the years 2008 through 2011, the years which remain subject to examination by major tax jurisdictions as of December 31, 2011. The Corporation concluded that there are no significant uncertain tax positions requiring recognition in the Corporation's consolidated financial statements. 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, 2011 or 2010, and it is not aware of any claims for such amounts by federal or state income tax authorities.

## 9. 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 approximately \$6,302 and \$7,800 as of December 31, 2011 and 2010, respectively.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

### Deposits

Deposits of Corporate directors, executive officers, and their affiliates were approximately \$1,715 and \$2,063 at December 31, 2011 and 2010, respectively.

## 10. 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, 2011 and 2010, the following financial instruments were outstanding whose contract amounts represent potential credit risk:

	Contract Amount	
	2011	2010
Unfunded commitments under lines of credit	\$ 25,947	\$ 26,997
Commitments to grant loans	2,635	7,074
Commercial and standby letters of credit	251	113

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 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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

letters of credit is essentially the same as that involved in extending loan facilities to customers. 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, 2011 or 2010.

### 11. REGULATORY REQUIREMENTS

#### Capital Requirements

The Corporation (on a consolidated basis) and the Bank are subject to various regulatory capital requirements 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 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.

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) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and Tier 1 capital to average assets (as defined). Management believes, as of December 31, 2011 and 2010, that the Corporation and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2011, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following tables. 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, 2011 and 2010 are also presented in the table.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

December 31, 2011	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk						
Weighted Assets:						
Consolidated	\$ 31,235	16.9%	\$ 14,748	8.0%	\$ N/A	N/A%
Bank	30,782	16.8	14,663	8.0	18,329	10.0
Tier 1 Capital to Risk						
Weighted Assets:						
Consolidated	28,898	15.7	7,374	4.0	N/A	N/A
Bank	28,458	15.5	7,331	4.0	10,997	6.0
Tier 1 Capital to Average Assets:						
Consolidated	28,898	9.6	12,033	4.0	N/A	N/A
Bank	28,458	9.5	12,047	4.0	15,059	5.0

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

December 31, 2010	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk						
Weighted Assets:						
Consolidated	\$ 28,585	14.9%	\$ 15,373	8.0%	\$ N/A	N/A%
Bank	28,242	14.7	15,387	8.0	19,233	10.0
Tier 1 Capital to Risk						
Weighted Assets:						
Consolidated	26,169	13.6	7,686	4.0	N/A	N/A
Bank	25,824	13.4	7,693	4.0	11,540	6.0
Tier 1 Capital to Average Assets:						
Consolidated	26,169	9.0	11,540	4.0	N/A	N/A
Bank	25,824	9.0	11,540	4.0	14,425	5.0

### 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. The required reserve balances were \$5,656 and \$4,631 at December 31, 2011 and 2010, respectively.

### 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.

The Corporation is required to obtain approval from the Federal Reserve Board (the "FRB") prior to the declaration or payment of dividends to its shareholders and is restricted from the purchase or redemption of its holding company stock without prior FRB approval.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands)

### 12. 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, 2011.

### 13. EMPLOYEE BENEFIT PLANS

#### 401(k) Plan

The Bank sponsors a defined contribution savings plan qualified under Section 401(k) of the Internal Revenue Code. Substantially all employees of the Bank are covered under the plan. The Bank contributes up to 20% of employees pre-tax contributions, up to 5% of compensation. The cost of the plan amounted to \$17 and \$23 in 2011 and 2010, respectively.

#### Profit-sharing Plan

The Bank maintains a defined contribution profit-sharing plan in which all qualified employees participate. Contributions to the plan are made at the discretion of the Board of Directors. Contributions to the plan were \$214 and \$75 in 2011 and 2010, respectively.

### 14. SUPPLEMENTAL CASH FLOWS INFORMATION

#### Other Cash Flows Information Income

Cash paid for interest amounted to \$1,967 and \$3,210 during 2011 and 2010, respectively.

Cash paid for income taxes amounted to \$1,215 during 2011. There were no cash payments made for income taxes during 2010.

#### Non-Cash Investing Activities

Collateral repossessed on real estate loans having carrying values in the amount of \$2,360 and \$1,232 on the date of transfer was transferred to foreclosed assets in 2011 and 2010, respectively.







5800 Gratiot Rd., Suite 201  
Saginaw, MI 48638  
Ph: 866.799.9580  
Fx: 989.799.0227  
www.rehmann.com

## INDEPENDENT AUDITORS' REPORT

February 10, 2012

Shareholders and Board of Directors  
County Bank Corp  
Lapeer, Michigan

We have audited the accompanying consolidated balance sheets of *County Bank Corp* (the "Corporation") as of December 31, 2011 and 2010, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of *County Bank Corp* as of December 31, 2011 and 2010, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

A handwritten signature in cursive script that reads "Rehmann Johnson".



**5 YEARS OF SERVICE**

left: Christina Denton  
right: Jennifer Hubbard



**10 YEARS OF SERVICE**

l-r: Debra LaValley, Amy Nowak, Susan Osentoski, Erin Landers



**15 YEARS OF SERVICE**

standing: Danielle Chateauvert, Cherry Newlon, Rosemary Schlaud  
seated: Laurie Chateauvert, Allen Butler



**20 YEARS OF SERVICE**

l-r: Colleen L. Sutton, Mary B. Schroeder



**25 YEARS OF SERVICE**

l-r: Denise C. Schlaud, Kimberly S. Hill



**40 YEARS OF SERVICE**

l-r: Laurie J. Verbeke, Bernadette Talaski



**WELCOME BACK**

**DAVID A. WARRINGTON**

Assistant Trust Officer

In August, Dave was welcomed back as an Assistant Trust Officer. He is a Certified Trust & Financial Advisor, responsible for trust and wealth management for Bank clients.



**WELCOME**

**GARY DRAINVILLE**

Vice President and Senior Trust Officer

Gary joined the Bank in December 2011. He is responsible for the management and administration of the Trust Department, including investment, wealth management and client services.



**RETIREMENT**

**NANCY F. SOMMERVILLE**

Business Development Director

Nancy retired at the end of 2011 after 23 years with the Bank.



## OFFICERS

**BRUCE J. CADY** President and Chief Executive Officer

**JOSEPH H. BLACK** Chief Financial Officer

**BERNADETTE TALASKI** Senior Vice President and Branch Administrator

**SHELLY M. CHILDERS** Senior Vice President and Director of IT

**GARY P. DRAINVILLE** Vice President and Senior Trust Officer

**ALAN J. CURTIS** Vice President and Senior Lender

**PETER BATISTONI** Commercial Loan Manager

**WILLIAM E. O'CONNOR** Commercial Loan Officer

**ASHLEY A. WINTER** Commercial Loan Officer

**BETH A. HENDERSON** Retail Lending Director

**COLLEEN SUTTON** Retail Lending Officer

**NANCY F. SOMMERVILLE** Business Development Director

**LOREN SCHAFFER** Human Resources Director

**CINDY K. STRICH** Auditor

**PAULA K. BOEGNER** Compliance and Security Officer

**MARSHA A. KALAKAY** Sales Officer

**ROBERT LENNOX** Financial Officer

**DAVID A. WARRINGTON** Assistant Trust Officer

**LOUISE VERMILLION** Check Processing Officer

**KIMBERLY S. HILL** Deerfield Branch Officer

**DEBRA M. COE** Southgate Branch Officer

**MARY B. SCHROEDER** Metamora Branch Officer

**ELIZABETH McVETY** Attica Branch Officer

**JENNIFER WARD** Elba Branch Officer

**WALTER BARGEN** Business Development Specialist  
and Imlay City Branch Officer



## County Bank Corp

Lapeer County Bank & Trust Co.  
Post Office Box 250  
Lapeer, Michigan 48446  
[LCBT.com](http://LCBT.com)