COUNTY BANK CORP
Lapeer, Michigan

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2014 and 2013

COUNTY BANK CORP
Lapeer, Michigan

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2014 and 2013

CONTENTS

Crowe Horwath.

Crowe Horwath LLP
Independent Member Crowe Horwath International

INDEPENDENT AUDITOR'S REPORT

Stockholders and Board of Directors
County Bank Corp
Lapeer, Michigan

Report on the Financial Statements

We have audited the accompanying financial statements of County Bank Corp, which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income (loss), stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 from 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 the auditor's 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 entity'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 entity'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.

(Continued)

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of County Bank Corp as of December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

Grand Rapids, Michigan
February 17, 2015

COUNTY BANK CORP

CONSOLIDATED BALANCE SHEETS
December 31, 2014 and 2013
(Dollars In Thousands Except Per Share Data)

	2014	2013
ASSETS		
Cash and due from banks	$ 9,813	$ 11,054
Federal funds sold	-	100
Cash and cash equivalents	9,813	11,154
Interest-bearing deposits in banks	483	1,931
Available for sale investment securities	125,842	116,654
Held-to-maturity investment securities (fair value of $0 and $4,928 in 2014 and 2013)	-	4,770
Restricted investment securities	1,575	1,431
Net loans	168,650	157,962
Premises and equipment, net	6,691	6,372
Bank owned life insurance	4,287	4,172
Accrued interest receivable and other assets	4,185	7,498
Total assets	$ 321,526	$ 311,944
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Deposits		
Interest bearing	$ 226,268	$ 234,856
Non-interest bearing	50,676	47,618
Total deposits	276,944	282,474
Other borrowings	7,916	-
Accrued interest payable and other liabilities	1,841	1,150
Total liabilities	286,701	283,624
Stockholders' equity		
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	21,613	19,213
Accumulated other comprehensive loss	(826)	(4,931)
Total stockholders' equity	34,825	28,320
Total liabilities and stockholders' equity	$ 321,526	$ 311,944

See accompanying notes to consolidated financial statements.

COUNTY BANK CORP

CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2014 and 2013
(In Thousands Except Per Share Data)

	2014	2013
Interest income		
Loans (including fees)	$ 8,302	$ 8,692
Investments		
Taxable	2,750	2,345
Non-taxable	564	603
Interest on deposits with other banks	15	23
Total interest income	11,631	11,663
Interest expense on deposits	694	782
Net interest income	10,937	10,881
Provision for loan losses	(650)	360
Net interest income, after provision for loan losses	11,587	10,521
Noninterest income		
Services charges on deposit accounts	1,264	1,398
Net gain (loss) on sale or calls of investment securities	(193)	114
Net gains on sale of loans	114	248
Net gain on sale of other real estate owned	149	725
Trust income	732	691
Debit card income	479	445
Other	763	1,017
Total noninterest income	3,308	4,638
Noninterest expenses		
Salaries and employee benefits	5,515	5,608
Occupancy and equipment	1,005	985
Professional fees	1,003	932
FDIC Insurance	179	290
Other	2,096	2,420
Total noninterest expenses	9,798	10,235
Income before income tax expense	5,097	4,924
Income tax expense	1,454	1,462
Net income	$ 3,643	$ 3,462
Net income per basic share of common stock	$ 3.37	$ 3.20

See accompanying notes to consolidated financial statements.

COUNTY BANK CORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
Years ended December 31, 2014 and 2013
(In Thousands)

	2014	2013
Net income	$ 3,643	$ 3,462
Other comprehensive income (loss):		
Available-for-sale investment securities:		
Unrealized holding gains (losses) arising during the year	6,027	(7,962)
Reclassification adjustment for net realized (gains) losses included in net income (presented in net gain (loss) on sale or calls of investment securities)	193	(114)
Other comprehensive income (loss) before income tax expense (benefit)	6,220	(8,076)
Income tax expense (benefit) related to other comprehensive income (loss) (Income tax expense includes ($66) and $39 related to reclassification adjustments)	(2,115)	2,745
Total other comprehensive income (loss)	4,105	(5,331)
Comprehensive income (loss)	$ 7,748	$ (1,869)

See accompanying notes to consolidated financial statements.

COUNTY BANK CORP
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Years ended December 31, 2014 and 2013
(Dollars In Thousands Except Per Share Data)

	Common Stock Shares	Common Stock Amount	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance, January 1, 2013	1,080,946	$ 5,404	$ 8,634	$ 16,454	$ 400	$ 30,892
Net income	-	-	-	3,462	-	3,462
Other comprehensive loss	-	-	-	-	(5,331)	(5,331)
Cash dividends paid ($.65 per share)	-	-	-	(703)	-	(703)
Balance, December 31, 2013	1,080,946	5,404	8,634	19,213	(4,931)	28,320
Net income	-	-	-	3,643	-	3,643
Other comprehensive income	-	-	-	-	4,105	4,105
Cash dividends paid ($1.15 per share)	-	-	-	(1,243)	-	(1,243)
Balance, December 31, 2014	1,080,946	$ 5,404	$ 8,634	$ 21,613	$ (826)	$ 34,825

See accompanying notes to consolidated financial statements.

COUNTY BANK CORP

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2014 and 2013
(In Thousands)

	2014	2013
Cash flows from operating activities		
Net income	$ 3,643	$ 3,462
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	(650)	360
Provision for other real estate owned losses	-	150
Depreciation	459	466
Net amortization of investments	708	1,027
Net (gain) loss on sales or calls of investment securities	193	(114)
Net gain on sale of loans	(114)	(248)
Net gain on sales of other real estate owned	(149)	(725)
Earnings from bank owned life insurance	(115)	(117)
Origination of loans held for sale	(4,531)	(10,947)
Proceeds from loan sales	4,585	11,195
Net changes in operating assets and liabilities which provided cash:		
Accrued interest receivable and other assets	1,215	800
Accrued interest payable and other liabilities	691	287
Net cash provided by operating activities	5,935	5,596
Cash flows from investing activities		
Net change in interest-bearing deposits in banks	1,448	2,793
Activity in available-for-sale investment securities:		
Purchases	-	(47,216)
Maturities, prepayments, sales and calls	20,261	18,399
Activity in held-to-maturity investment securities:		
Purchases	(20,186)	(775)
Maturities, prepayments, sales and calls	826	1,354
Purchase of restricted investment securities	(144)	-
Loan principal originations and collections, net	(10,370)	4,919
Proceeds from sales of other real estate owned	524	2,234
Premises and equipment expenditures	(778)	(1,287)
Net cash used in investing activities	(8,419)	(19,579)
Cash flows from financing activities		
Acceptances and withdrawals of deposits, net	(5,530)	12,421
Proceeds from other borrowings	7,916	-
Cash dividends paid	(1,243)	(703)
Net cash provided by financing activities	1,143	11,718
Net decrease in cash and cash equivalents	(1,341)	(2,265)
Cash and cash equivalents, beginning of year	11,154	13,419
Cash and cash equivalents, end of year	$ 9,813	$ 11,154
Supplemental cash flow information		
Transfer of loans to other real estate owned	$ 392	$ 1,424
Transfer of held-to-maturity investments securities to available for sale investment securities	24,036	-
Cash paid for interest	718	792
Cash paid for income taxes	1,200	1,143

See accompanying notes to consolidated financial statements.

NOTE 1 – BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of County Bank Corp, (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.

Nature of Business: 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 the state of 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 residential real estate loans, commercial loans of various types and consumer loans. The Bank does not have significant concentrations with respect to any one industry, customer, or depositor.

Regulatory Governance: 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 Department of Insurance and Financial Services ("DIFS"), 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.

Subsequent Events: The Corporation has evaluated subsequent events for recognition and disclosures through February 17, 2015, which is the date the consolidated financial statements were available to be issued.

Use of Estimates: To prepare consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the consolidated financial statements and the disclosures provided, and actual results could differ.

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.

Interest-Bearing Deposits in Banks: Interest-bearing deposits in banks mature within one year and are carried at cost.

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 (loss). 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 noninterest income on the trade date and are determined using the specific identification method.

(Continued)

NOTE 1 – BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

During 2014, management concluded that they no longer had the intent to hold all held-to-maturity securities until maturity. As a result, all outstanding held-to-maturity securities with an amortized cost and fair value of $24,036 and $24,373, respectively, were transferred to the available-for-sale classification. No securities will be designated as held-to-maturity for the foreseeable future.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least an annual basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through the consolidated statements of income. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the consolidated statements of income and 2) OTTI related to other factors, which is recognized in other comprehensive income (loss). The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through the consolidated statements of income.

<u>Restricted Investments</u>: 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 residential real estate loans or advances from the FHLBI and is carried at cost plus the value assigned to stock dividends.

<u>Loans Held For Sale</u>: 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. As of December 31, 2014 and 2013, loans held for sale were $221 and $161, respectively, which were included in net loans on the consolidated balance sheets.

<u>Loans</u>: 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 commercial and industrial, commercial real estate, real estate construction and residential real estate 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 and other 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.

(Continued)

NOTE 1 – BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 residential real estate loans) and loans modified under troubled debt restructurings (nonperforming originated loans).

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

The allowance consists of two primary components, specific reserves and general reserves. The specific component relates to loans that are individually classified as impaired. The general component covers all other 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.

The Bank maintains a separate allowance for loan losses reserve 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.

(Continued)

NOTE 1 – BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

There are no classes of loans identified within the above mentioned portfolio segments.

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 industrial, commercial real estate and real estate 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 other and residential real estate loans for impairment disclosures unless such loans are the subject of a troubled debt restructuring agreement.

(Continued)

NOTE 1 – BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Bank evaluates the credit quality of loans in the consumer and other and residential real estate loan portfolios, 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.

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. Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Bank determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The Bank assigns a risk rating to all loans except pools of homogeneous loans (residential real estate and consumer and other loans) and on a quarterly basis 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.

(Continued)

NOTE 1 – BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The majority of the Bank's consumer and other and residential real estate 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 these 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 and other and residential real estate loan portfolios is measured by the periodic delinquency rate, nonaccrual amounts and actual losses incurred.

Although management believes the allowance for loan losses to be appropriate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the appropriateness of the allowance for loan losses, 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 for loan losses is adjusted. In addition, the Bank's primary regulators review the appropriateness of the allowance for loan losses. The regulatory agencies may require changes to the allowance for loan losses based on their judgment about information available at the time of their examination.

Transfers of Financial Assets: Transfers of financial assets, including 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 that are sold. The Bank sold residential real estate loans to unrelated third parties with proceeds of $4,585 and $11,195 during 2014 and 2013, respectively, which resulted in net gains of $114 and $248 in 2014 and 2013, respectively.

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 residential real estate 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 for potential impairment at each reporting date and changes in fair value resulting in impairment is recorded in other non-interest expense on the consolidated statements of income in the periods in which the impairment occurred. Capitalized servicing rights are reported in accrued interest receivable and 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. Servicing fee income earned on such loans is included in other noninterest income and was not material during 2014 and 2013.

(Continued)

NOTE 1 – BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 other noninterest income on the consolidated statements of income. Foreclosed assets of $1,168 and $1,330 are included in accrued interest receivable and other assets on the consolidated balance sheets at December 31, 2014 and 2013, respectively. Foreclosed assets, as of those dates are presented net of a valuation allowance of $278 and $459, respectively. Expenses related to foreclosed assets amounted to $91 and $304 in 2014 and 2013, 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.

Bank Owned Life Insurance: The Bank has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

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.

Comprehensive Income (Loss): Comprehensive income (loss) consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale which are also recognized as separate components of stockholders' equity.

Fair Values of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions as discussed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Income Taxes: Income tax expense is the sum of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax consequences of temporary differences between the carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

(Continued)

NOTE 1 – BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense on the consolidated statements of income.

Advertising Costs: The cost of advertising and promotions are expensed as incurred. The Corporation incurred $63 and $59 in advertising costs in 2014 and 2013, respectively.

Net Income Per Basic Share of Common Stock: 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 both 2014 and 2013.

Reclassifications: Certain amounts as reported in the 2013 consolidated financial statements have been reclassified to conform to the 2014 presentation.

Adoption of New Accounting Standards: In February 2013, the FASB amended existing guidance related to reporting amounts reclassified out of accumulated other comprehensive income (ASU 2013-02, *Comprehensive Income (Topic 220) – Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income)*. These amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. These amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income (loss) by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive loss by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional details about these amounts. The adoption of this standard did not have a material effect on the Corporation’s operating results or financial condition.

NOTE 2 - 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.

(Continued)

NOTE 2 - FAIR VALUE MEASUREMENTS (Continued)

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.

Following is a description of the valuation methodologies and key inputs used to measure financial assets recorded at fair value on a recurring or non-recurring basis:

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, 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. 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. The Corporation does not currently hold any investment securities designated as Level 3.

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available and, further, adjustments to appraised values are made by management in response to market conditions and other factors. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

Upon transfer from the loan portfolio, other real estate owned are recorded at fair value less costs to sell. They are subsequently carried at the lower of the initial value or current 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 other real estate owned as nonrecurring Level 3.

Appraisals for both collateral-dependent impaired loans and other real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Corporation. Management reviews the assumptions and approaches utilized in the appraisal. Management periodically evaluates the appraised values and will discount a property’s appraised value to account for a number of factors including but not limited to the cost of liquidating the collateral, the age of the appraisal, observable deterioration since the appraisal, or other factors unique to the property.

(Continued)

(In Thousands)

NOTE 2 - FAIR VALUE MEASUREMENTS (Continued)

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, 2014 and 2013, 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.

Assets Measured 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:

	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
2014				
Available for sale investment securities:				
Government-sponsored enterprises	$ -	$ 53,898	$ -	$ 53,898
States and municipal	-	25,299	-	25,299
Corporate	-	15	-	15
Mortgage-backed securities: residential	-	14,739	-	14,739
Mortgage-backed securities: commercial	-	31,891	-	31,891
Total assets at fair value	$ -	$ 125,842	$ -	$ 125,842
2013				
Available for sale investment securities:				
Government-sponsored enterprises	$ -	$ 41,471	$ -	$ 41,471
States and municipal	-	23,327	-	23,327
Corporate	-	21	-	21
Mortgage-backed securities: residential	-	35,694	-	35,694
Mortgage-backed securities: commercial	-	16,141	-	16,141
Total assets at fair value	$ -	$ 116,654	$ -	$ 116,654

(In Thousands)

NOTE 2 - FAIR VALUE MEASUREMENTS (Continued)

Assets Measured at Fair Value on a Non-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 nonrecurring basis as of December 31:

	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
2014				
Impaired loans				
Commercial real estate	$ -	$ -	$ 635	$ 635
Other real estate owned				
Commercial and industrial	-	-	1,168	1,168
2013				
Impaired loans				
Commercial real estate	$ -	$ -	$ 2,440	$ 2,440
Other real estate owned				
Commercial and industrial	-	-	1,251	1,251

Impaired loans as of December 31, 2014 and 2013 measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $635, after a specific allowance allocation of $83 and $2,440 after a specific allowance allocation of $835, respectively, resulting in an additional provision for loan losses of $0 and $486 for the years then ended, respectively.

Other real estate owned as of December 31, 2014 and 2013, respectively, carried at fair value were $1,168 and $1,251 resulting in charges of $0 and $150 for the years then ended.

As discussed previously, the fair values of impaired loans and other real estate owned carried at fair value are determined by third party appraisals. Management makes adjustments to these appraised values based on the age of the appraisal and the type of the property. The following table presents quantitative information about level 3 fair value measurements for the larger classes of financial instruments measured at fair value on a non-recurring basis at December 31, 2014 and 2013, respectively:

2014	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired loans				
Commercial real estate	$ 635	Sales comparison approach	Management discount for property type and recent market volatility	19% (19%)
		Income approach	Capitalization rate	12% (12%)
Other real estate owned - Commercial and industrial	$ 1,168	Sales comparison approach	Management discount for property type and recent market volatility	2% - 100% (29%)

(Continued)

(In Thousands)

NOTE 2 - FAIR VALUE MEASUREMENTS (Continued)

2013	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired loans				
Commercial real estate	$ 2,440	Sales comparison approach	Management discount for property type and recent market volatility	20% - 22% (22%)
		Income approach	Capitalization rate	8% - 10% (9%)
Other real estate owned - Commercial and industrial	$ 1,251	Sales comparison approach	Management discount for property type and recent market volatility	8% - 100% (27%)

Fair Value of Financial Instruments

The carrying amount and estimated fair value of financial instruments, not recorded at fair value in their entirety on a recurring basis, were as follows at December 31 year-end:

	2014		2013	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:				
Cash and cash equivalents	$ 9,813	$ 9,813	$ 11,154	$ 11,154
Interest-bearing deposits in banks	483	483	1,931	1,931
Held-to-maturity investment securities	-	-	4,770	4,928
Restricted investment securities	1,575	N/A	1,431	N/A
Net loans	168,650	169,264	157,962	159,531
Accrued interest receivable	1,296	1,296	1,884	1,884
Liabilities:				
Interest-bearing deposits	$ 226,268	$ 226,250	$ 234,856	$ 234,932
Noninterest-bearing deposits	50,676	50,676	47,618	47,618
Other borrowings	7,916	7,916	-	-
Accrued interest payable	39	39	63	63

The following methods and assumptions were used to estimate fair value for financial instruments:

Cash and Cash Equivalents
The carrying amounts of cash and balances due from banks, 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.

Held-to-Maturity Investment Securities
Held-to-maturity securities are recorded at fair value on a nonrecurring basis, only when an other-than-temporary impairment is recorded. The fair value methodologies for held-to-maturity investment securities are similar to those disclosed for available-for-sale investment securities.

(Continued)

NOTE 2 - FAIR VALUE MEASUREMENTS (Continued)

Restricted Investment Securities
It is not practicable to determine the fair value of Federal Reserve Bank Stock and Federal Home Loan Bank Stock due to restrictions placed on their transferability.

Net 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.

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

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.

Other Borrowings
The carrying amounts reported in the consolidated balance sheets for other borrowings approximate their fair values given the short-term duration of the borrowings.

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 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.

(Continued)

(In Thousands)

NOTE 3 - INVESTMENT SECURITIES

The amortized cost and fair value of held-to-maturity and available for sale investment securities, including gross unrecognized/unrealized gains and losses, were as follows as of December 31:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2014				
Available-for-sale				
Government- sponsored enterprises	$ 55,180	$ 19	$ 1,301	$ 53,898
States and municipal	24,847	574	122	25,299
Corporate	8	7	-	15
Mortgage-backed securities: commercial	15,068	10	339	14,739
Mortgage-backed securities: residential	31,990	187	286	31,891
Total	$ 127,093	$ 797	$ 2,048	$ 125,842
2013				
Held-to-maturity				
Mortgage-backed securities: residential	$ 154	$ 5	$ -	$ 159
States and municipal	4,616	153	-	4,769
Total held-to-maturity	4,770	158	-	4,928
Available-for-sale				
Government- sponsored enterprises	46,475	-	5,004	41,471
States and municipal	24,071	210	954	23,327
Corporate	8	13	-	21
Mortgage-backed securities: commercial	16,613	54	526	16,141
Mortgage-backed securities: residential	36,958	105	1,369	35,694
Total available-for-sale	124,125	382	7,853	116,654
Total	$ 128,895	$ 540	$ 7,853	$ 121,582

Investment securities with fair values of $19,336 and $22,971 at December 31, 2014 and 2013, respectively, were pledged to secure public deposits or for other purposes as permitted or required by law.

(Continued)

(In Thousands)

NOTE 3 - INVESTMENT SECURITIES (Continued)

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

2014	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	Total
Available-for-sale						
Government- sponsored enterprises	$ -	$ 8,782	$ 11,998	$ 34,400	$ -	$ 55,180
States and municipal	357	4,917	14,843	4,730	-	24,847
Corporate	-	-	-	8	-	8
Mortgage-backed securities: residential	-	-	-	-	31,990	31,990
Mortgage-backed securities: commercial	-	-	-	-	15,068	15,068
Total available-for-sale	357	13,699	26,841	39,138	47,058	127,093
Total amortized cost	$ 357	$ 13,699	$ 26,841	$ 39,138	$ 47,058	$ 127,093
Fair value	$ 360	$ 13,809	$ 26,753	$ 38,290	$ 46,630	$ 125,842

(Continued)

(In Thousands)

NOTE 3 - INVESTMENT SECURITIES (Continued)

	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	Total
2013						
Held-to-maturity						
Mortgage-backed securities: residential	$ -	$ 154	$ -	$ -	$ -	$ 154
States and municipal	1,245	2,613	443	315	-	4,616
Total held-to-maturity	1,245	2,767	443	315	-	4,770
Available-for-sale						
Government- sponsored enterprises	71	-	6,998	39,406	-	46,475
States and municipal	870	2,199	18,120	2,882	-	24,071
Corporate	-	-	-	8	-	8
Mortgage-backed securities: residential	-	-	-	-	36,958	36,958
Mortgage-backed securities: commercial	-	-	-	-	16,613	16,613
Total available-for-sale	941	2,199	25,118	42,296	53,571	124,125
Total amortized cost	$ 2,186	$ 4,966	$ 25,561	$ 42,611	$ 53,571	$ 128,895
Fair value	$ 2,137	$ 5,193	$ 24,258	$ 38,159	$ 51,835	$ 121,582

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

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

During 2014 and 2013, proceeds from sales of available-for-sale investment securities amounted to approximately $12,122 and $9,549, respectively. Gross realized gains amounted to $25 and $116 during 2014 and 2013, respectively and gross unrealized losses amounted to $218 and $2 during 2014 and 2013, respectively.

(In Thousands)

NOTE 3 - INVESTMENT SECURITIES (Continued)

Information pertaining to securities with unrecognized/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:

	Less than 12 Months		Over 12 Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Losses
2014						
Available-for-sale						
Government-sponsored enterprises	$ 5,038	$ 7	$ 44,650	$ 1,294	$ 49,688	$ 1,301
Mortgage-backed securities: residential	2,599	5	21,284	281	23,883	286
Mortgage-backed securities: commercial	1,540	2	11,713	337	13,253	339
States and municipal	2,130	38	3,402	84	5,532	122
Total available-for-sale investment securities	$ 11,307	$ 52	$ 81,049	$ 1,996	$ 92,356	$ 2,048
2013						
Available-for-sale						
Government-sponsored enterprises	$ 24,942	$ 3,033	$ 16,458	$ 1,971	$ 41,400	$ 5,004
Mortgage-backed securities: residential	14,467	695	17,842	674	32,309	1,369
Mortgage-backed securities: commercial	7,047	53	7,503	473	14,550	526
States and municipal	12,866	540	4,477	414	17,343	954
Total available-for-sale investment securities	$ 59,322	$ 4,321	$ 46,280	$ 3,532	$ 105,602	$ 7,853

(Continued)

(In Thousands)

NOTE 3 - INVESTMENT SECURITIES (Continued)

As of December 31, 2014, the Corporation's investment security portfolio consisted of 254 securities, 83 of which were in an unrealized loss position.

At December 31, 2014, the Corporation held 32 mortgage-backed securities in an unrealized loss position of which 23 were issued by Ginnie Mae, Fannie Mae and Freddie Mac, U.S. government-sponsored agencies, which the government has affirmed its commitment to support. The remaining 9 mortgage-backed securities were issued by the Small Business Administration and are collateralized by commercial loans as opposed to residential mortgage loans which collateralize the Ginnie Mae, Fannie Mae and Freddie Mac mortgage-backed securities. Additionally, the Corporation held 35 government-sponsored enterprise securities and 16 state and municipal 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, because the Corporation does not have the intent to sell these 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, 2014.

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans were as follows at December 31:

	2014	2013
Commercial and industrial	$ 21,442	$ 17,806
Commercial real estate	91,648	86,570
Real estate construction	4,119	4,664
Residential real estate	38,130	36,633
Consumer and other	16,032	16,286
Total loans	171,371	161,959
Allowance for loan losses	2,721	3,997
Net loans	$ 168,650	$ 157,962

(Continued)

(In Thousands)

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following tables present activity in the allowance for loan losses and the recorded investment in loans, by portfolio segment and based on impairment method, at December 31:

	Commercial and Industrial	Commercial Real Estate	Real Estate Construction	Residential Real Estate	Consumer and Other	Unallocated	Total
2014							
Allowance for loan losses:							
Balance at beginning of year	$ 229	$ 3,160	$ 13	$ 209	$ 337	$ 49	$ 3,997
Provision for loan losses	21	(751)	104	(44)	-	20	(650)
Loans charged-off	(53)	(498)	(12)	(5)	(156)	-	(724)
Recoveries	9	30	8	-	51	-	98
Balance at end of year	$ 206	$ 1,941	$ 113	$ 160	$ 232	$ 69	$ 2,721
Ending balance: Individually evaluated for impairment	$ 155	$ 231	$ 8	$ 42	$ -	$ -	$ 436
Ending balance: Collectively evaluated for impairment	51	1,710	105	118	232	69	2,285
Total allowance for loan losses	$ 206	$ 1,941	$ 113	$ 160	$ 232	$ 69	$ 2,721
Loans:							
Ending balance:							
Individually evaluated for impairment	$ 1,623	$ 4,369	$ 791	$ 587	$ 162		$ 7,532
Ending balance:							
Collectively evaluated for impairment	19,819	87,279	3,328	37,543	15,870		163,839
Total loans	21,442	91,648	4,119	38,130	16,032		171,371
Accrued interest receivable	58	260	11	119	53		501
Total recorded investment	$ 21,500	$ 91,908	$ 4,130	$ 38,249	$ 16,085		$ 171,872

(Continued)

(In Thousands)

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	Commercial and Industrial	Commercial Real Estate	Real Estate Construction	Residential Real Estate	Consumer and Other	Unallocated	Total
2013							
Allowance for loan losses:							
Balance at beginning of year	$ 257	$ 2,349	$ 71	$ 286	$ 444	$ 340	$ 3,747
Provision for loan losses	(28)	757	(75)	(59)	56	(291)	360
Loans charged-off	-	(1,126)	-	(40)	(294)	-	(1,460)
Recoveries	-	1,180	17	22	131	-	1,350
Balance at end of year	$ 229	$ 3,160	$ 13	$ 209	$ 337	$ 49	$ 3,997
Ending balance: Individually evaluated for impairment	$ 163	$ 1,009	$ 13	$ 43	$ 60	$ -	$ 1,288
Ending balance: Collectively evaluated for impairment	66	2,151	-	166	277	49	2,709
Total allowance for loan losses	$ 229	$ 3,160	$ 13	$ 209	$ 337	$ 49	$ 3,997
Loans:							
Ending balance:							
Individually evaluated for impairment	$ 876	$ 6,730	$ 934	$ 607	$ 155		$ 9,302
Ending balance:							
Collectively evaluated for impairment	16,930	79,840	3,730	36,026	16,131		152,657
Total loans	17,806	86,570	4,664	36,633	16,286		161,959
Accrued interest receivable	58	278	14	114	57		521
Total recorded investment	$ 17,864	$ 86,848	$ 4,678	$ 36,747	$ 16,343		$ 162,480

(Continued)

(In Thousands)

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following table shows the loans allocated by management's internal risk ratings as of December 31 year-end:

	Commercial Credit Risk Profile Risk Rating			
	Commercial and Industrial	Commercial Real Estate	Real Estate Construction	Total
2014				
Risk Rating				
Pass	$ 18,216	$ 81,106	$ 3,328	$ 102,650
Special mention or watch	2,469	8,547	-	11,016
Substandard	757	1,995	791	3,543
Total	$ 21,442	$ 91,648	$ 4,119	$ 117,209
2013				
Risk Rating				
Pass	$ 16,201	$ 70,581	$ 2,526	$ 89,308
Special mention or watch	946	8,996	1,140	11,082
Substandard	659	6,993	998	8,650
Total	$ 17,806	$ 86,570	$ 4,664	$ 109,040

The following table shows the homogeneous loans allocated by payment activity as of December 31 year-end:

	Consumer Credit Risk Profile by Payment Activity		
	Residential Real Estate	Consumer and Other	Total
2014			
Payment activity			
Performing	$ 37,791	$ 15,965	$ 53,756
Non-performing	339	67	406
Total	$ 38,130	$ 16,032	$ 54,162
2013			
Payment activity			
Performing	$ 36,527	$ 16,275	$ 52,802
Non-performing	106	11	117
Total	$ 36,633	$ 16,286	$ 52,919

(Continued)

(In Thousands)

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following table shows an aging analysis of the loan portfolio by time past due as of December 31 year-end:

	Current	30-89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
2014					
Commercial and industrial	$ 21,227	$ 111	$ -	$ 104	$ 21,442
Commercial real estate	90,694	-	6	948	91,648
Real estate construction	4,119	-	-	-	4,119
Residential real estate	37,759	32	-	339	38,130
Consumer and other	15,903	62	-	67	16,032
Total	$ 169,702	$ 205	$ 6	$ 1,458	$ 171,371
2013					
Commercial and industrial	$ 17,761	$ 45	$ -	$ -	$ 17,806
Commercial real estate	82,843	-	-	3,727	86,570
Real estate construction	4,664	-	-	-	4,664
Residential real estate	36,466	61	-	106	36,633
Consumer and other	15,969	306	-	11	16,286
Total	$ 157,703	$ 412	$ -	$ 3,844	$ 161,959

(Continued)

(In Thousands)

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following table presents information related to impaired loans as of December 31 year-end:

2014	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded:					
Commercial and industrial	$ 970	$ 970	$ -	$ 621	$ 10
Commercial real estate	2,134	2,134	-	2,137	139
Real estate construction	607	607	-	612	37
Residential real estate	84	85	-	84	8
Consumer and other	162	162	-	163	7
	3,957	3,958	-	3,617	201
Loans with an allowance recorded:					
Commercial and industrial	653	653	155	655	12
Commercial real estate	2,235	2,694	231	1,779	64
Real estate construction	184	184	8	284	15
Residential real estate	503	503	42	505	31
Consumer and other	-	-	-	-	-
	3,575	4,034	436	3,223	122
Total	$ 7,532	$ 7,992	$ 436	$ 6,840	$ 323

(Continued)

(In Thousands)

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
2013					
Loans with no related allowance recorded:					
Commercial and industrial	$ 97	$ 97	$ -	$ 98	$ 7
Commercial real estate	4,409	4,987	-	4,975	198
Real estate construction	643	643	-	88	16
Residential real estate	88	88	-	647	3
Consumer and other	155	155	-	156	6
	5,392	5,970	-	5,964	230
Loans with an allowance recorded:					
Commercial and industrial	779	779	163	785	16
Commercial real estate	2,321	2,321	1,009	2,440	136
Real estate construction	291	291	13	295	15
Residential real estate	519	519	43	521	9
Consumer and other	-	-	60	-	-
	3,910	3,910	1,288	4,041	176
Total	$ 9,302	$ 9,880	$ 1,288	$ 10,005	$ 406

The recorded investment in loans excludes accrued interest receivable and loan origination fees, net due to immateriality. For purposes of this disclosure, the unpaid principal balance is not reduced for partial charge-offs.

(Continued)

(In Thousands)

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

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.

A summary of loans that were modified in troubled debt restructurings during 2014 and 2013 is as follows:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
2014			
Commercial and industrial	2	$ 653	$ 653
Commercial real estate	4	1,183	1,183
Real estate construction	-	-	-
Residential real estate	-	-	-
Consumer and other	-	-	-
Total	6	$ 1,836	$ 1,836
2013			
Commercial and industrial	1	$ 121	$ 121
Commercial real estate	9	2,160	2,160
Real estate construction	-	-	-
Residential real estate	1	156	156
Consumer and other	1	53	53
Total	12	$ 2,490	$ 2,490

(Continued)

(In Thousands)

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following table details the number of loans and the recorded investment in loans considered to be troubled debt restructurings by type of modification made during 2014 and 2013:

	Total Modifications						
	Principal Deferrals		Interest Rate Reductions		Principal Forgiveness		
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	Total Modifications
2014							
Commercial and industrial	-	$ -	2	$ 653	-	$ -	$ 653
Commercial real estate	2	277	2	906	-	-	1,183
Real estate construction	-	-	-	-	-	-	-
Residential real estate	-	-	-	-	-	-	-
Consumer and other	-	-	-	-	-	-	-
Total	2	$ 277	4	$ 1,559	-	$ -	$ 1,836
2013							
Commercial and industrial	-	$ -	1	$ 121	-	$ -	$ 121
Commercial real estate	1	64	8	2,096	-	-	2,160
Real estate construction	-	-	-	-	-	-	-
Residential real estate	-	-	1	156	-	-	156
Consumer and other	1	53	-	-	-	-	53
Total	2	$ 117	10	$ 2,373	-	$ -	$ 2,490

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 12 months to 5 years. Modifications involving an extension of the maturity date were for periods ranging from 12 month(s) to 5 years. The troubled debt restructurings described above increased the allowance for loan losses by $70 and $30 and resulted in an immaterial amount of charge offs during the years ending December 31, 2014 and 2013.

(Continued)

(In Thousands)

NOTE 4 - LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

During 2014 and 2013, there were no troubled debt restructurings 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, 2014 and 2013, respectively, that had been modified during the 12-month period prior to the default. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

NOTE 5 - SERVICING

The Corporation 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, 2014 and 2013, approximated $42,856 and $48,094, respectively, of which such loans are not included on the consolidated balance sheets.

The carrying values of originated mortgage servicing rights were $296 and $362, respectively, at December 31, 2014 and 2013 and are included in accrued interest receivable and other assets on the consolidated balance sheets.

NOTE 6 - PREMISES AND EQUIPMENT

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

	2014	2013
Land and improvements	$ 1,978	$ 1,957
Buildings and improvements	6,434	6,396
Furniture and equipment	5,033	4,918
Construction in process	620	17
Total	14,065	13,288
Less accumulated depreciation	7,374	6,916
Premises and equipment, net	$ 6,691	$ 6,372

Depreciation expense was $459 and $466 for 2014 and 2013, respectively.

The construction in process consists of $512 related to the renovations and remodeling of a branch location which is expected to be completed in 2015.

(Continued)

(In Thousands)

NOTE 7 - DEPOSITS

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

	2014	2013
Money market and NOW accounts	$ 135,781	$ 138,337
Savings	43,861	39,700
Time, $250 and over	3,193	5,612
CDARS*	6,798	6,679
Other time	36,635	44,528
Total interest-bearing	226,268	234,856
Noninterest-bearing demand	50,676	47,618
Total deposits	$ 276,944	$ 282,474

(*) The Certificate of Deposit Account Registry Service.

Interest expense on time deposits including time deposits issued in denominations of $250 or more and CDARS, was $336 in 2014 and $429 in 2013.

Scheduled maturities of time deposits for each of the five years succeeding December 31, 2014, are summarized as follows:

Year	Amount
2015	$ 29,065
2016	8,795
2017	4,875
2018	2,468
2019	1,423
Total	$ 46,626

NOTE 8 - INCOME TAXES

The income tax provision expense consists of the following components for the years ended December 31:

	2014	2013
Currently payable	$ 1,229	$ 1,285
Deferred tax expense	225	177
Income tax expense	$ 1,454	$ 1,462

(Continued)

(In Thousands)

NOTE 8 - INCOME TAXES (Continued)

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

	2014	2013
Income tax expense at statutory rate	$ 1,733	$ 1,675
Effect of tax-exempt interest income	(196)	(208)
Other – net	(83)	(5)
Income tax expense	$ 1,454	$ 1,462

The net deferred income tax assets is presented on the consolidated balance sheets in accrued interest receivable and other assets and are comprised of the following amounts as of December 31:

	2014	2013
Deferred tax assets		
Allowance for loan losses	$ -	$ 76
Other real estate owned	1	78
Non-accrual interest	1	23
Deferred compensation	188	152
Net unrealized losses on available-for-sale investment securities	425	2,540
Accrued liabilities	124	118
Other	50	33
Total deferred tax assets	789	3,020
Deferred tax liabilities		
Mortgage servicing rights	101	123
Depreciation	244	267
Allowance for loan losses	145	-
Accretion	9	10
Prepaid expenses	18	11
Other	5	2
Total deferred tax liabilities	522	413
Net deferred tax asset	$ 267	$ 2,607

The Corporation has evaluated the provisions of ASC Topic 740, *Accounting for Uncertainty in Income Taxes.* The evaluation was performed for the years 2011 through 2014, the years which remain subject to examination by major tax jurisdictions as of December 31, 2014. 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, 2014 or 2013, and it is not aware of any claims for such amounts by federal or state income tax authorities. The Corporation and its subsidiary are subject to U.S. federal income tax. The Corporation is no longer subject to examination by taxing authorities for years before 2011.

(Continued)

(In Thousands)

NOTE 9 - RELATED PARTY TRANSACTIONS

Loans
In the ordinary course of business, the Corporation grants loans to certain directors, executive officers and their affiliates. Such loans aggregated approximately $7,627 and $8,170 as of December 31, 2014 and 2013, respectively.

Deposits
Deposits of certain directors, executive officers, and their affiliates were approximately $1,172 and $1,140 at December 31, 2014 and 2013, respectively.

NOTE 10 - OFF-BALANCE SHEET ACTIVITIES

The Corporation 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 Corporation's exposure to credit loss is represented by the contractual amount of these commitments. The Corporation 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, 2014 and 2013, the following financial instruments were outstanding whose contract amounts represent potential credit risk:

	Contract Amount	
	2014	2013
Unfunded commitments under lines of credit	$ 30,054	$ 25,188
Commitments to grant loans	2,486	2,715
Commercial and standby letters of credit	72	73

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 Corporation 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 Corporation, is based on management's credit evaluation of the customer.

Commercial and standby letters of credit are conditional commitments issued by the Corporation 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 Corporation 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, 2014 or 2013.

(Continued)

(In Thousands)

NOTE 11 - REGULATORY REQUIREMENTS

Capital Requirements

The Bank is 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 Bank and the Corporation's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, 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.

Quantitative measurements established by regulation to ensure capital adequacy require 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, 2014 and 2013, that the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2014, 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 Bank's actual capital amounts and ratios as of December 31, 2014 and 2013 are also presented in the table.

	Actual		Minimum Required For Capital Adequacy Purposes		Minimum Required To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2014						
Total capital to risk weighted assets:						
Bank	$ 37,530	20.4%	$ 14,693	8.0%	$ 18,366	10.0%
Tier 1 capital to risk weighted assets:						
Bank	35,229	19.2	7,346	4.0	11,020	6.0
Tier 1 capital to average assets:						
Bank	35,229	11.1	12,744	4.0	15,930	5.0
2013						
Total capital to risk weighted assets:						
Bank	$ 35,062	19.8%	$ 14,185	8.0%	$ 17,731	10.0%
Tier 1 capital to risk weighted assets:						
Bank	32,824	18.5	7,092	4.0	10,639	6.0
Tier 1 capital to average assets:						
Bank	32,824	10.7	12,312	4.0	15,390	5.0

(Continued)

NOTE 11 - REGULATORY REQUIREMENTS (Continued)

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 $2,936 and $2,597 at December 31, 2014 and 2013, 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 common 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.

NOTE 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, 2014 and 2013, respectively.

NOTE 13 - EMPLOYEE BENEFIT PLANS

401(k) Plan
The Corporation sponsors a defined contribution savings plan qualified under Section 401(k) of the Internal Revenue Code. Substantially all employees of the Corporation are covered under the plan. The Corporation contributes up to 20% of employees pre-tax contributions, up to 5% of compensation. The cost of the plan amounted to $21 and $16 in 2014 and 2013, respectively.

Profit-sharing Plan
The Corporation 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 $368 and $346 in 2014 and 2013, respectively.