Eastern Michigan Financial Corporation

EASTERN MICHIGAN FINANCIAL CORPORATION

2016 Annual Report

Mission Statement

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

Core Values

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

Our Promise

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

General Information

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

Investor Relations Contact

Errin M. McMillan, Vice President, Controller
Eastern Michigan Financial Corporation
65 N. Howard Avenue, Croswell, Michigan 48422
810.398.5135

Independent Auditors

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

Corporate Headquarters

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

Transfer Agent and Registrar

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

Stock Symbol

Over-The-Counter Bulletin Board: EFIN

Annual Meeting

The Eastern Michigan Financial Corporation annual meeting of company shareholders is scheduled for Tuesday, April 18 at 5:30 p.m. and will be held at Lakeview Hills Golf Resort, 6560 E. Peck Road, Lexington, Michigan 48450.

Mission Statement, Core Values, Promise — Inside Front Cover
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Administrative Offices
65 N. Howard Avenue
Croswell, Michigan 48422
810.679.2500

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

Deckerville Branch
3636 Main Street
Deckerville, Michigan 48427
810.376.2015

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

Lakeport Branch
7090 Lakeshore Road
Lakeport, Michigan 48059
810.385.3211

Lexington Branch
5446 Main Street
Lexington, Michigan 48450
810.359.5353

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

Marysville Branch
2970 Gratiot Boulevard
Marysville, Michigan 48040
810.364.4854

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

Ruth Branch
7004 E. Atwater Road
Ruth, Michigan 48470
989.864.3380

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

Corporate Website
easternmichiganbank.com

Board of Directors

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

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

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

Karen S. Flanagan, Director
Farmer
Sandusky

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

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

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

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

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

Director Announcements

George J. McNaughton retired from the boards of directors of Eastern Michigan Bank and Eastern Michigan Financial Corporation in April of 2016. Appointed in 2011, Mr. McNaughton currently resides in the Croswell area with his wife, Jackie, where he owns and operates a cash crop farming operation in partnership with his brother. We extend our best wishes to George for a long and happy retirement and offer our sincere thanks for his dedicated service.

George J. McNaughton

Eastern Michigan Financial Corporation Officers

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

Eastern Michigan Bank Senior Management Officers

Timothy M. Ward, *Chief Executive Officer*
William G. Oldford, Jr., *President*
Karen M. Lord, *Senior Vice President, Chief Financial Officer*

Eastern Michigan Bank Vice Presidents

William E. Cone, *Vice President, Commercial Loan Officer*
Chad W. Deaner, *Vice President, Commercial Loan Manager*
Christopher M. Flann, *Vice President, Commercial Loan Officer*
Gerald D. Hepfer, *Vice President, Commercial Loan Officer*
Errin M. McMillan, *Vice President, Controller*
L. Michael O'Vell, *Vice President, Consumer Loan Manager and Security Officer*
Jay A. Wofford, *Vice President, Commercial Loan Officer*
Kathleen M. Wurmlinger, *Vice President, Mortgage Manager*

Eastern Michigan Bank Assistant Vice Presidents

Stefanie M. Abbott, *Assistant Vice President, Lexington Branch Manager*
Christi Agostino-Erd, *Assistant Vice President, Mortgage Loan Officer*
Stacie L. Bales, *Assistant Vice President, Operations*
Joseph L. Brown, *Assistant Vice President, Appraiser*
Clariece C. Creguer, *Assistant Vice President, Deckerville Branch Manager*
Catherine L. Fitz, *Assistant Vice President, Marysville Branch Manager*
Kathi J. Jahn, *Assistant Vice President, Ruth Branch Manager*
Audra L. Levitte, *Assistant Vice President, Human Resources Director*
Kimberly C. Prax, *Assistant Vice President, Port Huron Branch Manager*
Tammy J. Williford, *Assistant Vice President, Marketing and Compliance Officer*

Eastern Michigan Bank Officers

Karen S. Biskey, *Computer Manager and Information Security Officer*
Trishette L. Davis, *Croswell Branch Manager*
Julie A. DeGrande, *Bank Secrecy Act Officer*
Rachel L. Galbraith, *Commercial Loan Officer*
Mary K. Heiden, *Loan Processing Manager*
Tracy L. Jackson-Wedge, *Sandusky Branch Manager*
Cindy M. Mugridge, *Lakeport Branch Manager*
Kathleen M. Saelens, *Fort Gratiot Branch Manager*
Kara L. Turcott, *Credit Manager*

Retirements

Ann E. Matthews

Senior Vice President, Operations

Ann Matthews retired from Eastern Michigan Bank in January 2016 after forty-two years of service. Ms. Matthews began her career with Eastern as a summer teller in 1974. Ann moved from teller to assistant auditor, then auditor before taking a position in the operations department, where she remained until her retirement. She was named senior vice president in 2013.

Karen M. Lord

Senior Vice President, Chief Financial Officer

Karen Lord retired from Eastern Michigan Bank in December 2016, after fourteen years of service. Ms. Lord joined Eastern in 2002 as cashier and was appointed chief financial officer in 2004, then senior vice president in 2012 . She has been a certified public accountant since 1983 and holds a bachelor of science in accounting from Ferris State University and an associate's degree in business from St. Clair County Community College. During her tenure with the bank, she served on the Michigan Bankers Association Tax Committee and as treasurer of the Blue Water Council of the Boy Scouts of America. Ms. Lord is also a member and past matron of the Mt. Vernon Chapter #461 of the Order of the Eastern Star.

Kyle W. Jacobs

Assistant Vice President, Branch Manager

Kyle Jacobs retired in July 2016 after eleven years of service to Eastern Michigan Bank and a thirty-two year career in the banking industry. Mr. Jacobs first joined Eastern in 2005 as assistant vice president, branch manager of our Sandusky location. During his time with the bank, he was also actively involved with the Sandusky Chamber of Commerce and served as treasurer of the Sanilac County Community Foundation's Silver Linings Awards Committee.

We thank Ann, Karen and Kyle for their service and wish them long and happy retirements.

Promotions

Gerald D. Hepfer *Vice President, Commercial Loan Officer*

Assistant Vice President, Commercial Loan Officer Gerald Hepfer was promoted to vice president in September 2016. Mr. Hepfer joined Eastern Michigan Bank in August 2010 as a credit analyst. He was promoted to commercial loan officer in 2011, then assistant vice president in 2015. Jerry holds a bachelor's degree in business administration from Saginaw Valley State University and an associate's degree in banking and finance from Kirtland Community College. He also has a diploma in commercial lending from the American Bankers Association and certifications in agricultural lending from Purdue University and Michigan State University. Jerry is active with a number of community organizations as well, volunteering his time with the Imagination Library in Caro, the Caro Exchange Club, the Community Health Fair and Sanilac County 4-H.

Audra L. Levitte *Assistant Vice President, Human Resources Director*

Human Resources Director Audra Levitte was promoted to assistant vice president in September 2016. Ms. Levitte joined Eastern Michigan Bank in May 2013 as human resources director, bringing with her seventeen years' experience as a firm administrator for a local certified public accounting practice. In addition to her professional experience, she holds a bachelor of science in business management from Ferris State University. Audra is active in the community as well, serving on the board of St. Edward on-the- Lake Catholic School, as treasurer of the Buckskin Horse Association of Michigan (BHAM) and chair of the Junior Buckskin Horse Association.

Kara L. Turcott *Credit Manager*

Credit Manager Kara Turcott was promoted to bank officer in September 2016. Ms. Turcott joined Eastern Michigan Bank in 2001 as a teller and held the positions of accounting clerk and commercial loan clerk before begin promoted to credit analyst in 2013. Kara is currently working towards an associate's degree in business through Baker College. She lives in Lexington with her husband, Gary.

New Hires

Chad W. Deaner *Vice President, Commercial Loan Manager*

Chad Deaner joined Eastern Michigan Bank in March 2016 as vice president, commercial loan manager. Mr. Deaner comes to Eastern with close to twenty years' experience in the local banking industry. He most recently served as market president, northeast region and managing director, commercial relationship manager for a regional bank in our market. Chad holds a bachelor of science in business administration and management from Ferris State University. He is active in his local community and currently serves as vice president of the Memphis Community Schools Board of Education and sits on the board of directors of the St. Clair County United Way.

Errin M. McMillan *Vice President, Controller*

Errin McMillan joined Eastern Michigan Bank in September 2016 as vice president, controller. Errin comes to Eastern with sixteen years' experience in the local banking industry. Most recently she served as the accounting director of a regional bank in our market. Errin assumed the responsibilities of Senior Vice President, Chief Financial Officer Karen Lord, who retired at the end of 2016. Errin holds a bachelor of business administration degree with a major in finance from Grand Valley State University and is currently enrolled at Walsh College in their masters in accountancy program.

Kimberly C. Prax *Assistant Vice President, Branch Manager*

Kimberly Prax joined Eastern Michigan Bank in April 2016 as assistant vice president, branch manager of our downtown Port Huron location. Ms. Prax comes to Eastern with thirteen years' experience in the local banking industry. Most recently she served as associate managing director of the Wadhams and Port Huron Township branches of a regional bank in our market. Kim holds a bachelor of science from Wayne State University and is active in the local community. She currently serves as secretary of the Landmark Academy Board of Education and sits on both the Port Huron Township DDA and McLaren Port Huron Women's Wellness advisory boards.

Tracy L. Jackson-Wedge *Branch Manager*

Tracy Jackson-Wedge joined Eastern Michigan Bank in July 2016 as branch manager of our Sandusky branch. Tracy comes to Eastern with more than nineteen years' of banking experience exclusively in the Sandusky area. Most recently she served as the relationship banker for a regional bank office in the Sandusky market. Tracy holds an associate's degree in business management from St. Clair County Community College. She is active in the local community and currently serves as the treasurer of the Sandusky Chamber of Commerce.

Eastern Michigan Bank is honored to recognize staff members who have celebrated milestone anniversaries with us in 2016.

35 Year Award

Karen Biskey, *Computer Manager and Information Security Officer, Administrative Offices*
Marian Romzek, *Assistant Branch Manager, Ruth*

30 Year Award

Clariece Creguer, *AVP, Branch Manager, Deckerville*

20 Year Award

Joseph Brown, *AVP, Appraiser, Fort Gratiot*
Mary Heiden, *Loan Processing Manager, Loan Center*

15 Year Award

Stacie Bales, *AVP, Operations, Administrative Offices*
Nancy Vogel, *Teller, Deckerville*
Trish Davis, *Branch Manager, Croswell*

10 Year Award

Tiffany Warczinski, *Commercial Loan Clerk, Loan Center*
Cathy Fitz, *AVP, Branch Manager, Marysville*

5 Year Award

Kathy Saelens, *Branch Manager, Fort Gratiot*
Ashley McCormick, *Assistant Branch Manager, Port Huron*

Eastern Michigan Financial Corporation completed 2016 with a strong financial performance. Net income topped two million dollars for the first time in ten years, finishing the year at $2,100,000. Dividends for 2016 totaled $0.60 per share, and included a $0.12 bonus dividend in the fourth quarter. Overall, this represented a nearly 10% increase in dividends paid over the previous year. The current tier 1 capital ratio remains strong at 9.70%, more than double the minimum capital requirement set forth by the Federal Deposit Insurance Corporation.

Our acquisition of Ruth Bank Corporation and its subsidiary, Ruth State Bank, was complete at the end of the first quarter of 2016 with the conversion of their computer system taking place in early June. The Ruth acquisition bolstered our balance sheet, helping push assets above 300 million dollars for the first time in our history. One-time expenses to complete the systems integration and terminate contracts for duplicate services were just over $140,000.

Our ability to retain key staff in Ruth helped smooth the transition for existing customers. Long-time employees Kathi Jahn and Marian Romzek have taken on the responsibilities of branch manager and assistant branch manager respectively. Both Kathi and Marian bring a broad range of skills to their new roles and have even shared some great ideas with us that we have implemented bank wide. We are so pleased to have them as well as the rest of the staff that stayed on.

On the whole, our presence in Ruth has been well received by the local community. In August, we held an open house that was well attended, with the both the lobby and outdoor reception tent filled with guests for an extended period of time. With the integration of our two operations, Ruth customers gained access to a variety of services not previously available to them, including online bill pay, mobile banking and mobile deposit. We also installed an ATM at Ruth in July.

Loan growth for the year was solid, with 50% of the increase coming from the acquisition of Ruth State Bank loans. Thanks to diligent calling efforts and an improving economy, we also generated good organic growth, much of it on the non-agricultural side of our business.

In the spring, we welcomed Chad Deaner as our new commercial loan manager. Chad has nearly twenty years of lending experience in the local banking industry as well as a niche lending expertise on which we have been able to expand our loan portfolio. He brings good business relationships within our markets and adds further depth to management.

Unfortunately, not everything is positive on the lending side of our business. Low milk prices for much of 2016 have put a strain on many of our dairy customers and local sugar beet growers learned late in the year they would not receive the final payment for their 2016 crop due to its low sugar content. As a community bank, we at least have some flexibility to modify loans to assist our customers in more challenging times. Our conservative underwriting guidelines also continue to serve us well (including conservative underwriting on farm land secured credits in prior years despite escalating land prices) as does our extensive use of Farm Service Agency loan guaranties.

We welcomed two new branch managers to the bank in 2016. Kim Prax joined us in April as branch manager of our Port Huron location and Tracy Jackson-Wedge became branch manager of our Sandusky office in July. Both Kim and Tracy are well known in their respective markets and we are confident in their ability to serve the existing customer base well and develop new business for the bank.

Ruth Branch

On June 6, we opened in Ruth as Eastern Michigan Bank.

In July, we installed an ATM in the Ruth drive thru.

In August, we held a community open house.

At the end of December, we reluctantly said good-bye to Chief Financial Officer Karen Lord, who retired after nearly fifteen years of service. Karen was a true "go to" employee and someone on whom we relied. While we will miss her greatly, we were fortunate to attract Errin McMillan to assume Karen's responsibilities. Errin is a Croswell native, and brings an educational background in both finance and accounting as well as sixteen years' experience in the local banking industry.

While our branch network continues to be critical to serving our customers and generating new relationships within the individual markets, the growing use of electronic banking channels means fewer transactions occurring at the branch level. After a thorough review of our operations and expenses, we implemented a new branch staffing model based upon customer transaction counts. As a result, we have been able to reduce staff at some branches solely through attrition, while still maintaining a high level of customer service. We have also reduced the hours at four of our branches to match the hours customers are using those branches, providing additional efficiency and cost savings.

With the Ruth transaction and subsequent computer conversion complete, we made the difficult decision to close our location in Minden City. Though the Minden City branch was only open 26 hours a week, with its deposit balance of about $6 million and the new Ruth branch only four miles away, closing Minden City was prudent. We have since been able to sell the building to a local business owner, both reducing our carrying costs and returning the building to use.

While there is a lot of talk regarding the regulatory burden faced by banks, especially small community banks like ours, we continue to work to assure we meet or exceed the regulations we currently face. In 2016, we spent a considerable amount of time assessing risks associated with cybersecurity and disaster recovery and implementing new policies, procedures and/or defenses against these threats.

We would like to end by publicly thanking all of the hard working, diligent people who work for our bank. There have been many changes over the last several years, and change is a constant in our business. Competition has never been stronger and without the dedication of all of our staff, we would not be in the position we are today.

We look forward to seeing you at this year's annual shareholders' meeting, to be held Tuesday, April 18, 2017, at 5:30 p.m. at Lakeview Hills in Lexington.

Sincerely,

Earl E DesJardins

Timothy M. Ward

Earl E. DesJardins
Chairman of the Board

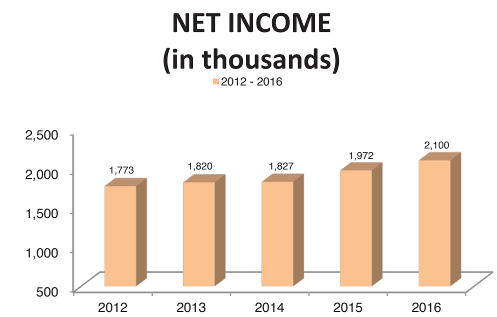
Timothy M. Ward
Vice Chairman of the Board, Chief Executive Officer

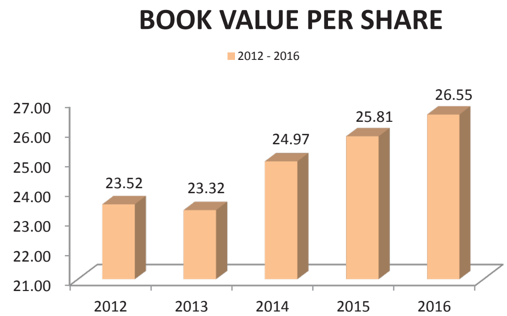
Our Ruth staff (L-R):
Anna-Marie Peresta, Head Teller
Marian Romzek, Assistant Branch Manager
Kathi Jahn, AVP, Branch Manager
Taylor Franzel, Teller
Nicole Wolschleger, Teller

2016 Highlights and Ten Year Financial Profile

2016 Highlights - Year In Brief

FOR THE YEAR (in thousands)	2016	2015	% Change
Net Interest Income	$ 9,086	$ 8,306	9.4%
Non-Interest Income	1,725	1,694	1.8%
Non-Interest Expense	7,856	7,448	5.5%
Net Income	2,100	1,972	6.5%
YEAR END (in thousands)			
Total Assets	$ 324,956	$ 293,028	10.9%
Loans, Net of Unearned Interest	154,265	137,535	12.2%
Allowance for Loan Losses	1,222	1,204	1.5%
Deposits	293,079	262,124	11.8%
Shareholders' Equity	30,643	29,572	3.6%
PER SHARE			
Net Income	$ 1.82	$ 1.73	5.2%
Book Value	26.55	25.81	2.9%
Cash Dividends	0.60	0.55	9.1%
Number of Shares Outstanding	1,154,370	1,145,731	0.8%





Ten Year Financial Profile

FOR THE YEAR (in thousands)	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Net Interest Income	$ 9,086	$ 8,306	$ 8,275	$ 8,175	$ 8,500	$ 8,674	$ 8,768	$ 8,369	$ 8,671	$ 9,209
Provision for Loan Losses	79	(144)	69	283	406	933	1,066	2,294	991	476
Non-Interest Income	1,725	1,694	1,530	1,669	1,571	1,278	1,531	1,659	240	1,105
Non-Interest Expense	7,856	7,448	7,291	7,223	7,395	7,132	7,170	7,068	7,050	7,058
Income Before Income Taxes	2,876	2,696	2,445	2,338	2,270	1,887	2,063	666	870	2,780
Less: Income Taxes	776	724	618	518	497	404	495	16	131	833
Net Income	2,100	1,972	1,827	1,820	1,773	1,483	1,568	650	739	1,947
AT YEAR END (in thousands)										
Total Investment Securities	$ 106,504	$ 110,344	$ 118,054	$ 113,141	$ 85,452	$ 72,389	$ 64,855	$ 38,149	$ 17,891	$ 27,234
Restricted Investments	1,056	980	1,022	916	916	905	952	982	922	922
Federal Funds Sold	582	-	-	-	-	-	-	1,631	4,523	4,401
Total Loans	154,265	137,535	137,025	136,487	139,580	144,116	155,858	170,633	174,926	168,443
Allowance for Loan Losses	1,222	1,204	1,688	1,765	2,758	2,796	3,155	3,716	2,233	1,901
Total Assets	324,956	293,028	283,251	279,362	270,472	259,757	259,966	250,424	226,950	223,366
Total Deposits	293,079	262,124	253,998	252,086	242,897	233,578	234,907	224,277	201,469	197,000
Borrowed Funds	-	-	-	-	-	-	-	2,000	2,000	2,000
Shareholders' Equity	30,643	29,572	28,394	26,489	26,616	25,103	23,983	23,056	22,373	23,484
PER SHARE										
Net Income	$ 1.82	$ 1.73	$ 1.61	$ 1.60	$ 1.57	$ 1.31	$ 1.39	$ 0.58	$ 0.64	$ 1.69
Book Value	26.55	25.81	24.97	23.32	23.52	22.24	21.25	20.43	19.82	20.36
Cash Dividends	0.60	0.55	0.55	0.55	0.55	0.48	0.48	0.48	0.96	0.96
Number of Shares Outstanding	1,154,370	1,145,731	1,137,294	1,135,669	1,131,649	1,128,737	1,128,737	1,128,737	1,128,737	1,153,667
Return on Average Assets	0.67%	0.69%	0.65%	0.67%	0.68%	0.58%	0.61%	0.28%	0.33%	0.87%
Return on Average Equity	6.90%	6.64%	6.65%	6.83%	6.83%	5.94%	6.48%	2.83%	3.20%	8.29%
Capital Ratio	9.70%	10.33%	9.95%	9.75%	9.76%	9.68%	8.98%	9.33%	9.85% *	10.22%

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

(Dollars in thousands except share data)

	December 31	
	2016	2015
ASSETS		
Cash and demand deposits due from banks	$ 5,035	$ 5,225
Interest bearing balances due from banks	17,836	22,429
Federal funds sold	582	-
Cash and cash equivalents	**23,453**	**27,654**
Certificates of deposit held in other banks	22,226	2,472
Investment securities		
Available-for-sale	92,335	102,628
Held-to-maturity	14,169	7,716
Restricted investments	1,056	980
Net loans	153,043	136,331
Accrued interest receivable	1,130	945
Premises and equipment, net	5,689	5,735
Foreclosed assets	923	1,191
Bank-owned life insurance	9,283	6,159
Other assets	1,649	1,217
Total assets	**$ 324,956**	**$ 293,028**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$ 75,828	$ 70,456
Interest-bearing	217,251	191,668
Total deposits	**293,079**	**262,124**
Accrued interest payable and other liabilities	1,234	1,332
Total liabilities	**294,313**	**263,456**
Commitments and contingencies (Notes 12, 14, and 15)		
Shareholders' equity		
Common stock, $5 par value; 3,000,000 shares authorized, 1,154,370 (1,145,731 in 2015) shares issued and outstanding	5,771	5,728
Additional paid-in-capital	1,999	1,864
Retained earnings	23,541	22,207
Accumulated other comprehensive loss	(668)	(227)
Total shareholders' equity	**30,643**	**29,572**
Total liabilities and shareholders' equity	**$ 324,956**	**$ 293,028**

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

Consolidated Statements of Income

(Dollars in thousands except per share data)

	Year Ended December 31	
	2016	2015
Interest and dividend income		
Loans (including fees)	$ 7,202	$ 6,650
Securities		
Taxable	1,568	1,596
Nontaxable	357	368
Other	92	97
Federal funds sold and deposits with banks	244	40
Total interest and dividend income	**9,463**	**8,751**
Interest expense	377	445
Net interest income	**9,086**	**8,306**
Provision for loan losses	79	(144)
Net interest income, after provision for loan losses	**9,007**	**8,450**
Noninterest income		
Service charges on deposit accounts	1,018	924
Other service charges and fees	228	221
Other	479	549
Total noninterest income	**1,725**	**1,694**
Noninterest expenses		
Compensation and benefits	4,243	4,045
Occupancy and equipment	934	1,026
Other	2,679	2,377
Total noninterest expenses	**7,856**	**7,448**
Income before federal income taxes	**2,876**	**2,696**
Federal income taxes	776	724
Net income	**$ 2,100**	**$ 1,972**
Net income per basic share of common stock	**$ 1.82**	**$ 1.73**
Net income per diluted share of common stock	**$ 1.81**	**$ 1.71**

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

(Dollars in thousands)

	Year Ended December 31	
	2016	**2015**
Available-for-sale securities		
Unrealized holding losses arising during the year	$ (668)	$ (394)
Reclassification adjustment for net realized gains included in net income	-	22
Comprehensive loss before income tax benefit	(668)	(372)
Income tax benefit related to other comprehensive loss	227	126
Other comprehensive loss	**(441)**	**(246)**
Net income	2,100	1,972
Comprehensive income	**$ 1,659**	**$ 1,726**

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

Consolidated Statements of Shareholders' Equity

(Dollars in thousands except per share data)

	Common Stock		Additional Paid-In-Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount				
Balances, January 1, 2015	**1,137,294**	**$ 5,686**	**$ 1,812**	**$ 20,877**	**$ 19**	**$ 28,394**
Comprehensive income	-	-	-	1,972	(246)	**1,726**
Common stock options recognized	-	-	2	-	-	**2**
Issuance of shares upon exercise of common stock options	9,614	48	50	-	-	**98**
Repurchase of common stock	(1,177)	(6)	-	(13)	-	**(19)**
Cash dividends paid ($0.55 per share)	-	-	-	(629)	-	**(629)**
Balances, December 31, 2015	**1,145,731**	**5,728**	**1,864**	**22,207**	**(227)**	**29,572**
Comprehensive income	-	-	-	2,100	(441)	**1,659**
Common stock options recognized	-	-	2	-	-	**2**
Issuance of shares upon exercise of common stock options	14,640	72	133	-	-	**205**
Repurchase of common stock	(6,001)	(29)	-	(74)	-	**(103)**
Cash dividends paid ($0.60 per share)	-	-	-	(692)	-	**(692)**
Balances, December 31, 2016	**1,154,370**	**$ 5,771**	**$ 1,999**	**$ 23,541**	**$ (668)**	**$ 30,643**

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

(Dollars in thousands except per share data)

	Year Ended December 31 2016	Year Ended December 31 2015
Cash flows from operating activities		
Net income	$ 2,100	$ 1,972
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	79	(144)
Depreciation	358	452
Provision for foreclosed assets	57	37
Net amortization of investment securities premiums	573	563
Share-based compensation	2	2
Net gain on sale of loans	(149)	(130)
Net gain on sale of equipment	(2)	(29)
Net gain on sale of foreclosed assets	(41)	(170)
Net gain on sale of securities	-	(22)
Increase in cash value of bank-owned life insurance	(221)	(150)
Deferred income tax (benefit) expense	(60)	203
Origination of loans held for sale	(4,477)	(4,159)
Proceeds from loan sales	4,626	4,289
Changes in operating assets and liabilities which provided (used) cash, net in 2016 of amounts acquired in Ruth acquisition		
Accrued interest receivable	14	1
Other assets	469	(31)
Accrued interest payable and other liabilities	(443)	473
Net cash provided by operating activities	**2,885**	**3,157**
Cash flows from investing activities		
Net change in certificates of deposit held in other banks	(15,518)	(1,243)
Activity in held-to-maturity securities		
Purchases	(8,132)	(7,718)
Maturities, prepayments, and calls	1,578	-
Activity in available-for-sale securities		
Purchases	(8,081)	(17,421)
Maturities, prepayments, calls and sales	36,507	31,936
(Purchase) redemption of restricted investments	(60)	42
Loan principal originations, net	(8,826)	(1,589)
Purchases of premises and equipment	(169)	(584)
Proceeds from sale of foreclosed assets	475	1,237
Proceeds from sale of equipment	7	117
Acquistion of Ruth, net of cash acquired	(1,336)	-
Net cash (used in) provided by investing activities	**(3,555)**	**4,777**
Cash flows from financing activities		
Acceptances and withdrawals of deposits, net	(2,941)	8,126
Proceeds from sale of common stock	205	98
Repurchase and retirement of stock	(103)	(19)
Cash dividends paid	(692)	(629)
Net cash (used in) provided by financing activities	**(3,531)**	**7,576**
Net (decrease) increase in cash and cash equivalents	**(4,201)**	**15,510**
Cash and cash equivalents, beginning of year	27,654	12,144
Cash and cash equivalents, end of year	**$ 23,453**	**$ 27,654**

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

1. BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

Summary of Significant Accounting Policies
Accounting policies used in preparation of the accompanying consolidated financial statements are in conformity with accounting principles generally accepted in the United States of America. The principles which materially affect the determination of the consolidated financial position and results of operations of the Corporation and its subsidiaries are summarized below.

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

Certificates of deposit held in other banks
Certificates of deposit held in other banks mature within 4 years and are carried at cost.

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

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

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

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

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

For a further discussion of Fair Value Measurements, refer to Note 3.

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

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

Available-for-sale equity securities are reviewed for other-than-temporary impairment at each reporting date. This evaluation considers a number of factors including, but not limited to, the length of time and extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer, and management's ability and intent to hold the securities until fair value recovers. If it is determined that management does not have the ability and intent to hold the securities until recovery or that there are conditions that indicate that a security may not recover in value, then the difference between the fair value and the cost of the security is recognized in earnings and is included in noninterest income. No such losses were recognized in 2016 or 2015.

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

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

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

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

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

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

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

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

The allowance consists of two primary components, specific reserves related to impaired loans and general reserves. The general component covers non-impaired loans and is based on historical losses adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Bank over the most recent two years. This actual loss experience is adjusted for economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Loans Held for Sale

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

Transfers of Financial Assets

Transfers of financial assets, including mortgage loans held for sale, are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when 1) the assets have been legally isolated from the Corporation, 2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and 3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. Other than servicing, as disclosed in Note 6, the Corporation has no substantive continuing involvement related to these loans. The Corporation sold to an unrelated third party residential mortgage loans with proceeds of $4,626 and $4,289 during 2016 and 2015, respectively, which resulted in a net gain of $149 and $130 for 2016 and 2015, respectively. Servicing fee income earned on such loans was $81 and $85 for 2016 and 2015, respectively, and is included in other noninterest income on the consolidated statements of income.

Servicing

Servicing assets are recognized as separate assets when rights are acquired through the purchase or sale of financial assets. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses.

Servicing assets or liabilities are amortized in proportion to and over the period of net servicing income or net servicing loss and are assessed for impairment or increased obligation based on the fair value of rights compared to amortized cost at each reporting date. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan type, and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Bank later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income.

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

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(Dollars in thousands except share data)

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

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

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

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

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

Acquisition Intangibles and Goodwill
During March 2016, the Corporation acquired Ruth Bank Corporation (“Ruth”) and its wholly owned subsidiary, Ruth State Bank (“RSB”), in a business combination accounted for as a purchase resulting in identified core deposit intangibles and goodwill (see Note 2). The acquisition of Ruth included amounts related to the valuation of customer deposit relationships (core deposit intangibles) which are being amortized on the straight line method over ten years. Goodwill, which is included in other assets, represents the excess of purchase price over identifiable assets and is not amortized but is evaluated by management for impairment at least annually, or at an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below the carrying value.

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

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

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, 2016, the most recent balance sheet presented herein, through February 14, 2017, the date these consolidated financial statements were available to be issued. No such events or transactions were identified.

New Accounting Pronouncement
ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, was issued with the intention of improving financial reporting by requiring timelier recording of credit losses on loans and certain other financial instruments held by financial institutions.

The ASU requires that the measurement of all expected credit losses for financial assets that are measured at amortized cost at the reporting date be based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions will also use forward-looking information to develop their credit loss estimates.

The ASU requires enhanced disclosures to assist investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an institution’s portfolio.

In addition, the ASU amends existing guidance on accounting for credit losses on available-for-sale debt securities, purchased financial assets with credit deterioration, and also applies to certain off-balance sheet credit exposures.

The ASU on credit losses will take effect for fiscal years beginning after December 15, 2020. Management is currently evaluating the provisions of ASU 2016-13 to determine the potential impact on the Company’s consolidated financial statements.

2. ACQUISITION OF RUTH STATE BANK

On March 31, 2016, the Corporation acquired all of the outstanding stock of Ruth Bank Corporation (“Ruth”), in an all cash transaction valued at $5,878. Ruth, a bank holding company, owned Ruth State Bank, which operated a full service branch office in Ruth, Michigan. Ruth State Bank was consolidated with and into Eastern Michigan Bank on April 1, 2016. In connection with the acquisition of Ruth, the Corporation recorded $283 of goodwill, which was primarily attributable to the synergies and economies of scale expected from combining the operations of the Corporation and Ruth. Additionally, the Corporation recorded $289 of core deposit intangible asset in connection with the acquisition.

The results of the merged Ruth are presented in the Corporation’s consolidated financial statements from the date of acquisition. Acquisition related expenses associated with the Ruth transaction totaled approximately $147 in 2016.

The allocation of the purchase price to the net assets of Ruth is presented below.

Assets	
Cash and demand deposits due from banks	$ 4,542
Certificates of deposits held in other banks	4,236
Investment securities	19,273
Restricted investments	16
Net loans	8,188
Accrued interest receivable	199
Premises and equipment, net	148
Bank-owned life insurance	2,903
Other assets	42
Total assets acquired	39,547
Liabilities	
Deposits	33,896
Accrued interest payable and other liabilities	345
Total liabilities assumed	34,241
Net assets acquired	5,306
Core deposit intangible	289
Goodwill	283
Total consideration paid	**$ 5,878**

The core deposit intangible is being amortized over ten years using the straight line amortization method. This resulted in amortization expense of $22 in 2016. Amortization expense is expected to approximate $29 annually through 2026. Goodwill, which is not amortized, is tested for impairment at least annually.

3. FAIR VALUE MEASUREMENTS

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

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

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

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

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

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

Loans
For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for fixed interest rate loans are estimated using discounted cash flow analyses, using interest rates currently being

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(Dollars in thousands except share data)

offered for loans with similar terms to borrowers of similar credit quality. The resulting amounts are adjusted to estimate the effect of declines, if any, in the credit quality of borrowers since the loans were originated. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

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

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

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

Mortgage Servicing Rights
Mortgage servicing rights are subject to impairment testing. A valuation model, which utilizes a discounted cash flow analysis using interest rates and prepayment speed assumptions currently quoted for comparable instruments and a discount rate determined by management, is used for impairment testing. If the valuation model reflects a value less than the carrying value, loan servicing rights are adjusted to fair value through a valuation allowance as determined by the model. As such, the Corporation classifies loan servicing rights subjected to nonrecurring fair value adjustments as Level 3. At December 31, 2016 and 2015, 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.

Goodwill
Goodwill is subject to impairment testing. Goodwill is qualitatively evaluated to determine if it is more likely than not that the carrying balance is impaired. If it is determined that the carrying balance of goodwill is more likely than not to be impaired, management performs a cash flow valuation to determine the extent of the potential impairment. This valuation method requires a significant degree of management judgment. If the testing resulted in impairment, the Company would classify goodwill subjected to nonrecurring fair value adjustments as Level 3. At December 31, 2016, no goodwill impairment was recorded and, therefore, no goodwill was recorded at fair value on a nonrecurring basis. There was no goodwill at December 31, 2015.

Core Deposit Intangible
Core deposit intangibles arising from acquisitions are being amortized over their estimated lives and evaluated for potential impairment on at least an annual basis through a qualitative analyses to determine whether or not an impairment is more likely than not. If an impairment is identified, the impaired core deposit intangible assets are subjected to nonrecurring fair value measurements as Level 3. At December 31, 2016, there was no impairment recorded for core deposit intangibles and, therefore, no core deposit intangible assets were recorded at fair value on a nonrecurring basis. There was no core deposit intangible at December 31, 2015.

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

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

Commitments to Extend Credit, Standby Letters of Credit, and Undisbursed Loans
The Corporation's unused loan commitments, standby letters of credit and undisbursed loans have no carrying amount and have been estimated to have no realizable fair value. Historically, a majority of the unused loan commitments have not been drawn upon and, generally, the Corporation does not receive fees in connection with these commitments.

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

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

2016	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Investment securities available-for-sale:				
U.S. treasury notes	$ 1,248	$ -	$ -	$ 1,248
U.S. government and federal agencies	-	25,113	-	25,113
Corporate bonds	-	2,767	-	2,767
Agency issued mortgage-backed securities	-	41,280	-	41,280
States and municipals	-	21,052	-	21,052
Money market preferred securities	-	875	-	875
Total assets at fair value	$ 1,248	$ 91,087	$ -	$ 92,335

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

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

2016	Assets at Carrying Value			
	Level 1	Level 2	Level 3	Total
Impaired loans (1)	$ -	$ -	$ 826	$ 826

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

(1) Certain impaired loans were remeasured and reported at fair value through a specific valuation allowance. Impaired loans of $826 and $2,265 as of December 31, 2016 and 2015, respectively, were reduced by a specific valuation allowance totaling $200 and $503 as of December 31, 2016 and 2015, respectively.

Quantitative information about Level 3 fair value measurements is as follows as of December 31, 2016:

Instrument	Level 3 Instruments			
	Fair Value	Valuation Technique	Unobservable Input	Weighted Average and/or Range
Impaired Loans	$ 826	Discounted Appraisal Value	Discount Applied to Collateral Appraisal	7 - 36 %

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

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

__Estimated Fair Values of Financial Instruments Not Recorded at Fair Value in their Entirety on a Recurring Basis__

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

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(Dollars in thousands except share data)

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

	2016		2015	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:				
Cash and cash equivalents	$ 23,453	$ 23,453	$ 27,654	$ 27,654
Certificates of deposit held in other banks	22,226	22,449	2,472	2,472
Investment securities held-to-maturity	14,169	13,950	7,716	7,668
Restricted investments	1,056	1,056	980	980
Net loans	153,043	153,933	136,331	136,529
Mortgage servicing rights	295	300	261	261
Accrued interest receivable	1,130	1,130	945	945
Liabilities:				
Noninterest-bearing deposits	$ 75,828	$ 75,828	$ 70,456	$ 70,456
Interest-bearing deposits	217,251	217,407	191,668	191,828
Accrued interest payable	14	14	16	16

4. 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:

2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity				
U.S. government and federal agencies	999	-	-	999
Agency issued mortgage-backed securities	10,264	-	205	10,059
States and municipals	2,906	-	14	2,892
Total held-to-maturity	**14,169**	**-**	**219**	**13,950**
Available-for-sale				
Debt securities:				
U.S treasury notes	1,263	-	15	1,248
U.S. government and federal agencies	25,132	27	46	25,113
Corporate bonds	2,775	-	8	2,767
Agency issued mortgage-backed securities	42,028	37	785	41,280
States and municipals	21,149	32	129	21,052
Total debt securities	92,347	96	983	91,460
Money market preferred securities	1,000	-	125	875
Total available-for-sale	**93,347**	**96**	**1,108**	**92,335**
Total	**$ 107,516**	**$ 96**	**$ 1,327**	**$ 106,285**

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

Investment securities with carrying values of $4,502 and $4,008 at December 31, 2016 and 2015, respectively, were pledged to secure public deposits or for other purposes as permitted or required by law.

The amortized cost and fair value of held-to-maturity securities and available-for-sale securities grouped by contractual maturity at December 31, 2016, are summarized as follows:

	Maturing					
	Due In One Year or Less	Due After One Year Through Five Years	Due After Five Years Through Ten Years	Over Ten Years	Securities With Variable Monthly Payments or No Contractual Maturity	Total
Held-to-maturity						
U.S. government and federal agencies	$ 999	$ -	$ -	$ -	$ -	$ 999
Agency issued mortgage-backed securities	-	-	-	-	10,264	10,264
States and municipals	-	2,906	-	-	-	2,906
Total held-to maturity	**999**	**2,906**	**-**	**-**	**10,264**	**14,169**
Available-for-sale						
Debt securities:						
U.S treasury note	-	1,263	-	-	-	1,263
U.S. government and federal agencies	5,994	19,138	-	-	-	25,132
Corporate bonds	1,001	1,774	-	-	-	2,775
Agency issued mortgage-backed securities	-	-	-	-	42,028	42,028
States and municipals	4,339	15,064	1,716	30	-	21,149
Total debt securities	**11,334**	**37,239**	**1,716**	**30**	**42,028**	**92,347**
Money market preferred securities	-	-	-	-	1,000	1,000
Total available-for-sale	**$ 11,334**	**$ 37,239**	**$ 1,716**	**$ 30**	**$ 43,028**	**$ 93,347**
Total amortized cost	**$ 12,333**	**$ 40,145**	**$ 1,716**	**$ 30**	**$ 53,292**	**$107,516**
Fair value	**$ 13,230**	**$ 39,997**	**$ 1,689**	**$ 30**	**$ 51,339**	**$106,285**

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

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

There were no sales of available-for-sale securities during 2016 and therefore were no gross realized gains or losses during 2016. During 2015, proceeds from sales of available for sale securities amounted to approximately $1,206. Gross realized gains amounted to $22 and resulted in reclassification of $22 ($15 net of tax) from accumulated other comprehensive income to gain on sale of securities in the consolidated statements of income for the year ended December 31, 2015.

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(Dollars in thousands except share data)

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:

2016	Less Than 12 Months Fair Value	Less Than 12 Months Gross Unrealized Loss	Over 12 Months Fair Value	Over 12 Months Gross Unrealized Loss	Fair Value	Total Gross Unrealized Losses
Securities held-to-maturity						
Agency issued mortgage-backed securities	$ 10,059	$ 205	$ -	$ -	$ 10,059	$ 205
State and municipals	2,392	14	-	-	2,392	14
Total securities held-to-maturity	**$ 12,451**	**$ 219**	**$ -**	**$ -**	**$ 12,451**	**$ 219**
Securities available-for-sale						
Debt securities:						
U.S treasury notes	$ 1,248	$ 15	$ -	$ -	$ 1,248	$ 15
U.S. government and federal agencies	15,609	46	-	-	15,609	46
Corporate bonds	2,767	8	-	-	2,767	8
Agency issued mortgage-backed securities	35,364	711	2,097	74	37,461	785
States and municipals	12,402	117	2,426	12	14,828	129
Total debt securities	67,390	897	4,523	86	71,913	983
Money market preferred securities	-	-	875	125	875	125
Total securities available-for-sale	**$ 67,391**	**$ 897**	**$ 5,398**	**$ 211**	**$ 72,788**	**$ 1,108**

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

As of December 31, 2016, the Corporation's investment security portfolio consisted of 285 securities, 138 of which were in an unrealized loss position. The unrealized losses are primarily related to the Corporation's U.S. government and federal agencies, agency issued mortgage-backed securities, and money market preferred securities as discussed below.

The Corporation has invested $1,000 in an auction rate money market preferred investment security instrument, which is classified as available-for-sale and reflected at estimated fair value. Due to credit market uncertainty, the trading for this security has been limited. Because the decline in the market value is attributable to changes in interest rates and limited trading, and not credit quality and because management does not intend to sell the security in an unrealized loss position, and it is more likely than not that the Corporation will not be required to sell the security before recovery of its cost basis, the Corporation does not consider this security instrument to be other-than-temporarily impaired at December 31, 2016.

As of December 31, 2016 and 2015, management conducted an analysis to determine whether all securities currently in an unrealized loss position, including auction rate money market preferred security, should be considered other-than-temporarily impaired. Such analyses considered, among other factors, the following criteria:

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

Based on the Corporation's analysis using the above criteria, the fact that management has asserted that it does not have the intent to sell these securities in an unrealized loss position, and that it is more likely than not the Corporation will not be required to sell the securities before recovery of their cost basis, management does not believe that the values of any securities are other-than-temporarily impaired as of December 31, 2016 or 2015.

5. LOANS AND ALLOWANCE FOR LOAN LOSSES

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

Loans are summarized as follows at December 31:

	2016	2015
Commercial and industrial	$ 27,793	$ 25,426
Agricultural	41,259	42,702
Real estate related industries	28,147	25,457
Other commercial	23,618	17,428
Residential real estate	23,818	18,284
Consumer and other	5,885	4,091
Home equity	3,745	4,147
Total loans	154,265	137,535
Allowance for loan losses	(1,222)	(1,204)
Loans, net	**$ 153,043**	**$ 136,331**

The allowance for loan losses and loans are as follows for the year ended December 31, 2016:

	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Residential Real Estate	Consumer and Other	Home Equity	Total
Allowance for loan losses:								
Balance at beginning of year	$ 123	$ 293	$ 264	$ 274	$ 182	$ 5	$ 63	$ 1,204
Provision for loan losses	8	25	(17)	169	(64)	39	(81)	79
Loans charged off	-	-	-	(209)	(23)	(27)	-	(259)
Recoveries of loans previously charged off	-	111	-	19	8	9	51	198
Balance at end of year	$ 131	$ 429	$ 247	$ 253	$ 103	$ 26	$ 33	$ 1,222
Allowance for loan losses attributable to loans:								
Individually evaluated for impairment	$ -	$ 3	$ 143	$ 37	$ -	$ -	$ 17	$ 200
Collectively evaluated for impairment	131	426	104	216	103	26	16	1,022
Total allowance for loan losses	$ 131	$ 429	$ 247	$ 253	$ 103	$ 26	$ 33	$ 1,222

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(Dollars in thousands except share data)

	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Residential Real Estate	Consumer and Other	Home Equity	Total
Loans:								
Individually evaluated for impairment	$ 28	$ 1,164	$ 1,587	$ 388	$ 254	$ -	$ 118	$ 3,539
Collectively evaluated for impairment	27,765	40,095	26,560	23,230	23,564	5,885	3,627	150,726
Total loans	$ 27,793	$ 41,259	$ 28,147	$ 23,618	$ 23,818	$ 5,885	$ 3,745	$154,265

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

	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Residential Real Estate	Consumer and Other	Home Equity	Total
Allowance for loan losses:								
Balance at beginning of year	$ 266	$ 170	$ 543	$ 413	$ 222	$ 19	$ 55	$ 1,688
Provision for loan losses	(124)	497	(280)	(205)	(25)	(7)	-	(144)
Loans charged off	(19)	(375)	-	-	(15)	(20)	(12)	(441)
Recoveries of loans previously charged off	-	1	1	66	-	13	20	101
Balance at end of year	$ 123	$ 293	$ 264	$ 274	$ 182	$ 5	$ 63	$ 1,204
Allowance for loan losses attributable to loans:								
Individually evaluated for impairment	$ 48	$ 4	$ 161	$ 179	$ 70	$ -	$ 41	$ 503
Collectively evaluated for impairment	75	289	103	95	112	5	22	701
Total allowance for loan losses	$ 123	$ 293	$ 264	$ 274	$ 182	$ 5	$ 63	$ 1,204
Loans:								
Individually evaluated for impairment	$ 599	$ 1,527	$ 1,536	$ 487	$ 237	$ -	$ 120	$ 4,506
Collectively evaluated for impairment	24,827	41,175	23,921	16,941	18,047	4,091	4,027	133,029
Total loans	$ 25,426	$ 42,702	$ 25,457	$ 17,428	$ 18,284	$ 4,091	$ 4,147	$137,535

The following table shows the loans allocated by management's internal risk ratings at December 31, 2016:

	Commercial Credit Risk Profile by Risk Rating				
	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Total
Risk rating					
Pass	$ 27,308	$ 39,196	$ 26,341	$ 22,507	$ 115,352
Watch	376	920	488	381	2,165
Special mention	-	313	219	-	532
Substandard	109	830	1,099	730	2,768
Total	$ 27,793	$ 41,259	$ 28,147	$ 23,618	$120,817

The following table shows the homogeneous loans allocated by payment activity as of December 31, 2016:

	Consumer Credit Risk Profile by Risk Rating			
	Residential Real Estate	Consumer and Other	Home Equity	Total
Payment activity				
Performing	$ 23,564	$ 5,885	$ 3,710	$ 33,159
Non-performing	254	-	35	289
Total	$ 23,818	$ 5,885	$ 3,745	$ 33,448

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

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

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

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

The following table shows an aging analysis of the loan portfolio by time past due as of December 31, 2016:

	Accruing Interest				
	Current	30-89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
Commercial and industrial	$ 27,455	$ 310	$ -	$ 28	$ 27,793
Agricultural	40,189	-	-	1,070	41,259
Real estate related industries	27,106	340	-	701	28,147
Other commercial	23,541	-	-	77	23,618
Residential real estate	23,174	390	-	254	23,818
Consumer and other	5,860	25	-	-	5,885
Home equity	3,710	-	-	35	3,745
Total	$ 151,035	$ 1,065	$ -	$ 2,165	$ 154,265

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

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

The following table presents information related to impaired loans as of December 31, 2016:

	Recorded Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial and industrial	$ 28	$ 28	$ -	$ 150	$ 1
Agricultural	1,143	1,679	-	1,335	20
Real estate related industries	1,189	1,819	-	1,170	47

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(Dollars in thousands except share data)

	Recorded Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Other commercial	$ 77	$ 135	$ -	$ 188	$ -
Residential real estate	254	464	-	172	-
Home equity	22	45	-	26	-
Loans with an allowance recorded					
Commercial and industrial	-	-	-	163	-
Agricultural	21	22	3	11	-
Real estate related industries	398	398	143	391	21
Other commercial	311	311	37	250	17
Residential real estate	-	-	-	73	-
Home equity	96	96	17	93	6
Total impaired loans					
Commercial and industrial	$ 28	$ 28	$ -	$ 313	$ 1
Agricultural	1,164	1,701	3	1,346	20
Real estate related industries	1,587	2,217	143	1,561	68
Other commercial	388	446	37	438	17
Residential real estate	254	464	-	245	-
Home equity	118	141	17	119	6
Total	$ 3,539	$ 4,997	$ 200	$ 4,022	$ 112

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

	Recorded Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial and industrial	$ 272	$ 272	$ -	$ 364	$ 12
Agricultural	1,527	1,792	-	1,779	37
Real estate related industries	1,151	1,272	-	1,130	36
Other commercial	298	330	-	382	15
Residential real estate	91	179	-	152	-
Home equity	31	62	-	20	2
Loans with an allowance recorded					
Commercial and industrial	327	327	48	300	17
Agricultural	-	10	4	210	-
Real estate related industries	385	1,409	161	437	16
Other commercial	189	215	179	377	7
Residential real estate	146	218	70	106	-
Home equity	89	89	41	112	6
Total impaired loans					
Commercial and industrial	599	599	48	664	29
Agricultural	1,527	1,802	4	1,989	37
Real estate related industries	1,536	2,681	161	1,567	52
Other commercial	487	545	179	759	22
Residential real estate	237	397	70	258	-
Home equity	120	151	41	132	8
Total	$ 4,506	$ 6,175	$ 503	$ 5,369	$ 148

The 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 2016 is as follows:

	Troubled Debt Restructurings		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Agricultural	2	$ 271	$ 28
Real estate related industries	1	644	644
Residential real estate	1	78	41
	4	$ 993	$ 713

The following table details the number of loans and the recorded investment in loans considered to be troubled debt restructurings ("TDRs") by type of modification during 2016:

	Total Modifications				
	Principal Deferrals		Interest Rate Reductions		
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	Total Modifications
Agricultural	-	$ -	2	$ 271	$ 271
Real estate related industries	1	644	-	-	644
Residential real estate	-	-	1	78	78
Total	1	$ 644	3	$ 349	$ 993

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

There were no TDRs for which there was a payment default whereby the borrower was past due with respect to principal and/or interest for 90 days or more during the 12 months ended December 31, 2016 and 2015, that had been modified during the 12-month period prior to default.

6. 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, 2016 and 2015, were $31,665 and $33,565, respectively; such loans are not included on the accompanying consolidated balance sheets.

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

	2016	2015
Mortgage servicing rights		
Balance at beginning of year	$ 261	$ 257
Mortgage servicing rights capitalized	58	49
Mortgage servicing rights amortized	(24)	(45)
Balance at end of year	$ 295	$ 261

7. FORECLOSED ASSETS

Real estate owned activity was as follows:

	2016	2015
Beginning balance of year	$ 1,191	$ 1,556
Loans transferred to real estate owned	223	739
Direct write-downs	(57)	(37)
Sales of real estate owned	(434)	(1,067)
End of year	$ 923	$ 1,191

At December 31, 2016 and 2015, the balance of real estate owned includes $71 of foreclosed residential real estate properties recorded as a result of obtaining physical possession of the property. At December 31, 2016 and 2015, the recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceeds are in process was $31 and $27, respectively.

Activity in the valuation allowance was as follows:

	2016	2015
Beginning balance of year	$ 209	$ 404
Reductions from sales of real estate owned	(57)	(232)
Direct write-downs	57	37
End of year	$ 209	$ 209

Expenses related to foreclosed assets include:

	2016	2015
Net gain on sales	$ (41)	$ (170)
Provision for unrealized losses	57	37
Operating expenses, net of rental income	44	41
Total expenses	$ 60	$ 92

8. PREMISES AND EQUIPMENT

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

	2016	2015
Bank premises and land	$ 8,557	$ 8,474
Furniture and equipment	4,244	4,147
Total	12,801	12,621
Less accumulated depreciation	7,112	6,886
Premises and equipment, net	$ 5,689	$ 5,735

Depreciation expense was $358 and $452 for 2016 and 2015, respectively.

Continued...

(Dollars in thousands except share data)

9. DEPOSITS

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

	2016	2015
Interest-bearing		
NOW accounts	$ 52,864	$ 47,441
Savings	66,025	53,330
Money market demand	53,011	50,648
Time, $250,000 and over	3,581	1,772
Other time	41,770	38,477
Total interest-bearing	217,251	191,668
Noninterest-bearing demand	75,828	70,456
Total deposits	$ 293,079	$ 262,124

Scheduled maturities of time deposits for each of the five years succeeding December 31, 2016, are summarized as follows:

Year	Amount
2017	$ 26,461
2018	6,632
2019	3,882
2020	4,886
2021	3,490
Total	$ 45,351

10. FEDERAL INCOME TAXES

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

	2016	2015
Currently payable	$ 836	$ 521
Deferred expense (benefit)	(60)	203
Income taxes	$ 776	$ 724

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:

	2016	2015
Income tax provision at statutory rate	$ 978	$ 917
Effect of tax-exempt interest income	(131)	(131)
Other, net	(71)	(62)
Income taxes	$ 776	$ 724

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

	2016	2015
Deferred tax assets		
Allowance for loan losses	$ 160	$ 133
Unrealized loss on available-for-sale securities	344	117
Nonaccrual loan interest	28	39
Deferred loan fees/costs	50	50
Other real estate	22	22
Other	213	189
Total deferred tax assets	817	550
Deferred tax liabilities		
Depreciation	119	148
Mortgage servicing rights	100	89
Other	59	61
Total deferred tax liabilities	278	298
Net deferred tax asset	$ 539	$ 252

The Corporation concluded that there are no significant uncertain tax positions requiring recognition in the Corporation's consolidated financial statements based on the evaluation performed for the years 2013 through 2016, the years which remain subject to examination by major tax jurisdictions as of December 31, 2016. 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, 2016 or 2015, and it is not aware of any claims for such amounts by federal or state income tax authorities.

11. RELATED PARTY TRANSACTIONS

Loans
In the ordinary course of business, the Bank grants loans to certain directors, executive officers and their affiliates. Such loans aggregated to $2,758 and $2,780 at December 31, 2016 and 2015, respectively.

Deposits
Deposits of Corporate directors, executive officers and their affiliates were $402 and $752 at December 31, 2016 and 2015, respectively.

12. 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, 2016 and 2015, the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount	
	2016	2015
Unfunded commitments under lines of credit	$ 31,841	$ 25,894
Commitments to grant loans	3,080	8,093
Commercial and standby letters of credit	1,163	982

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 letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments, if deemed necessary. Guarantees that are not derivative contracts have been recorded on the Corporation's consolidated balance sheets at their fair value at inception. The Bank considers standby letters of credit to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is not significant, a liability related to such guarantees is not recorded at December 31, 2016 or 2015.

13. COMMON STOCK ACTIVITY

During 2016 and 2015, the Corporation repurchased 6,001 and 1,177 shares of common stock (see Note 17). The repurchase price in excess of the amounts identified with the original issuance of the common stock was charged entirely to retained earnings.

14. REGULATORY REQUIREMENTS

Capital Requirements

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

Failure to meet capital requirements can initiate regulatory action. The final rules related to the implementation of the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III Rules) became effective for the Corporation on January 1, 2016, with full compliance of all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The capital conservation buffer as of December 31, 2016 is 0.625%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital.

Quantitative measurements established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth in the following table). Management believes, as of December 31, 2016 and 2015, that the Corporation and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2016 and 2015, the most recent notifications from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since the notification that management believes have changed the Bank's category. The Corporation's and the Bank's actual capital amounts and ratios as of December 31, 2016 and 2015 are also presented in the table.

Continued...

(Dollars in thousands except share data)

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
December 31, 2016	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk Weighted Assets:						
Consolidated	$ 32,533	18.59%	$ 15,096	8.625%	$ N/A	N/A
Bank	31,693	18.11	15,096	8.625	17,502	10.00%
Tier 1 (Core) Capital to Risk Weighted Assets:						
Consolidated	31,311	17.89	11,595	6.625	N/A	N/A
Bank	30,471	17.41	11,595	6.625	14,002	8.00
Common Tier 1 (CET1)						
Consolidated	31,311	17.89	8,970	5.125	N/A	N/A
Bank	30,471	17.41	8,970	5.125	11,377	6.50
Tier 1 (Core) Capital to Average Assets:						
Consolidated	31,311	9.70	12,917	4.00	N/A	N/A
Bank	30,471	9.45	12,899	4.00	16,124	5.00

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

Restrictions on Cash and Amounts Due from Banks

The Bank is required by regulatory agencies to maintain legal cash reserves based on the level of certain customer deposits. There was no required reserve balance at December 31, 2016 or 2015.

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.

15. 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, 2016.

16. EMPLOYEE BENEFIT PLAN

401(k) Plan

The Bank maintains a deferred compensation plan qualified under Section 401(k) of the Internal Revenue Code. Under this plan, eligible employees are permitted to contribute up to 25% of gross compensation into the retirement plan up to a maximum determined by the Internal Revenue Code; the Bank matches each employee contribution at a rate of up to 50% of the first 6% contributed by the employee. Expenses associated with the plan amounted to $73 and $77 in 2016 and 2015, respectively.

The 401(k) retirement plan also has a defined contribution profit sharing feature that covers substantially all of its employees. Contributions to the plan are based on an employee's earnings, as defined in the plan document. Expenses associated with the plan amounted to $164 and $155 in 2016 and 2015, respectively.

Bank-Owned Life Insurance

The Bank has invested in single premium, bank owned, whole life insurance policies on certain officers of the Bank. Bank owned life insurance is an alternative investment vehicle, generally non-liquid, which may produce additional earnings to offset, and later fund, various employee supplemental benefit expenses The earnings on the policies are not taxed unless withdrawn or surrendered prior to the death of the insured. The increase in cash surrender value of the policies, which was $221 and $150 in 2016 and 2015, respectively, is included in noninterest income in the accompanying consolidated statements of income.

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

17. COMMON STOCK COMPENSATION PLAN

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

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted average assumptions for the year ended December 31, 2016:

Risk-free interest rate	0.85% - 2.45%
Expected term	1 - 10 years
Expected stock price volatility	33.07%
Dividend yield or expected dividend	2.63% - 10.48%

Under the Corporation's 2012 Employee Stock Option Plan, the Corporation may grant options to its directors, officers and employees for the purchase of up to 128,000 shares of common stock, which can be increased annually up to 3% of the shares outstanding at January 1, 2013, ($1,131,649) or 33,949 shares. The exercise of each option equals the market price of the Corporation's stock on the date of grant and an option's maximum term is ten years. The options vest ratably over five years from date of grant. The Corporation also has options outstanding under a Plan established in 2000 and terminated in 2009. The terms of the 2000 Plan are essentially the same as the 2012 Plan. For the years ended December 31, 2016 and 2015, the Corporation recognized $2 in compensation expense for stock options in both years. There was an impact of $.01 to diluted earnings per share in 2016 and $0.02 in 2015. As of December 31, 2016, unrecognized compensation costs related to nonvested awards amounted to $4 and will be recognized over a remaining weighted average period of approximately 5 years.

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

In general, the Corporation's policy is to issue new shares upon the exercise of a stock option; however, the option holder has the option under the Plan to sell shares of stock owned by the holder to the Corporation to facilitate the exercise of options (see Note 13). A summary of the changes in the status of the Corporation's stock option plan is presented below:

	Common Shares Subject to Option	Weighted Average Exercise Price	Average Remaining Contractual Term (years)
Outstanding at January 1, 2015	130,125	$ 15.58	3.87
Granted	36,468	16.08	
Exercised	(9,614)	10.22	
Forfeited	(14,137)	18.78	
Outstanding at December 31, 2015	142,842	$ 15.76	4.27
Granted	32,876	17.10	
Exercised	(14,640)	14.05	
Forfeited	(23,867)	17.79	
Outstanding at December 31, 2016	137,211	$ 15.91	4.67

The fair value of options granted during 2016 and 2015 was $4 and $0, respectively.

As of December 31, 2016, 17,888 options under the 2009 plan are outstanding at an average exercise price of $20.48 (range of $10.10 – $22.30), all of which are exercisable. As of December 31, 2016, 119,323 options under the 2012 plan were outstanding at an average exercise price of $15.43 (range of $12.75 - $17.40) of which 41,425 are exercisable.

18. SUPPLEMENTAL CASH FLOWS INFORMATION

Other Cash Flows Information

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

	2016	2015
Interest	$ 379	$ 453
Income taxes	$ 731	$ 340

Non-Cash Investing Activities

Collateral repossessed on real estate loans having carrying values in the amount of $223 and $739 on the date of transfer was transferred to foreclosed assets in 2016 and 2015, respectively.

During 2016, options for the purchase of 14,640 common shares were exercised. In accordance with the Plan document, 6,001 outstanding shares of common stock were repurchased by the Corporation to facilitate the exercise of 8,839 options. Total value assigned to the repurchased shares was $104. Total consideration paid in connection with the exercise of 8,839 options was $20 plus the value of the repurchased shares. The remaining 5,801 options were exercised at a weighted average price of $14.05 with total cash consideration of $104.

End of Notes

Rehmann

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INDEPENDENT AUDITORS' REPORT

February 14, 2017

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

We have audited the accompanying consolidated financial statements of ***Eastern Michigan Financial Corporation*** (the Corporation), which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Independent Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ***Eastern Michigan Financial Corporation*** as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Rehmann Robson LLC

Rehmann is an independent member of Nexia International.

CPAs & Consultants   Wealth Advisors   Corporate Investigators

NEXIA INTERNATIONAL

Branch & Administrative Staff

Croswell Branch
Chelsea Bowerman, *Assistant Branch Manager*
Skye Hall, *Head Teller*
Jamie Goline, *Teller*
Amber Herzog-Solis, *Teller*
Katie Hurley, *Teller*
Brett Nemeckay, *Teller*
Colleen Newberry, *Teller*

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

Fort Gratiot Branch
Catherine Mugridge, *Assistant Branch Manager*
Diane Johnson, *Head Teller*
Cindy Carroll, *Teller*

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

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

Marysville Branch
Nancy Kulman, *Assistant Manager*
Karen Hubble, *Head Teller*
Terri Herman, *Teller*

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

Ruth Branch
Marian Romzek, *Assistant Branch Manager*
Anna-Marie Peresta, *Head Teller*
Hannah Trowhill, *Teller*
Taylor Franzel, *Teller*
Nicole Wolschleger, *Teller*

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

Loan Center (Croswell)
Kathleen Breckner, *Mortgage/Commercial Loan Clerk*
Alexander (Alex) Messing, *Commercial Lender*
Amanda Mosher, *Mortgage Specialist, Underwriter*
Nicki Parker, *Consumer Loan Documentation Specialist/Collections*
Crystal Sweet, *Consumer Loan Clerk/Courier*
Tiffany Warczinski, *Commercial Loan Clerk*
Jasmine Williams, *Credit Analyst*

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

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

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

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