Annual Report 2017

Eastern Michigan Financial Corporation®

Eastern Michigan Financial Corporation

2017 ANNUAL REPORT

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

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.

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, Chief Financial Officer
Eastern Michigan Financial Corporation
65 N. Howard Avenue
Croswell, Michigan 48422
810.398.5135

INDEPENDENT AUDITORS

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

CORPORATE HEADQUARTERS

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

TRANSFER AGENT AND REGISTRAR

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

STOCK SYMBOL

Over-The-Counter Bulletin Board: EFIN

ANNUAL MEETING

The Eastern Michigan Financial Corporation annual meeting of company shareholders is scheduled for Tuesday, April 10, 2018 at 5:30 p.m. and will be held at Lakeview Hills Golf Resort, 6560 E. Peck Road, Lexington, Michigan 48450.

BOARD OF DIRECTORS

Earl E. DesJardins, Chairman
Retired 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

OFFICERS

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*

Errin M. McMillan, *Vice President, Chief Financial Officer*

EASTERN MICHIGAN BANK SENIOR MANAGEMENT OFFICERS

Timothy M. Ward, *Chief Executive Officer*

William G. Oldford, Jr., *President*

Errin M. McMillan, *Vice President, Chief Financial Officer*

EASTERN MICHIGAN BANK VICE PRESIDENTS

Stacie L. Bales, *Vice President, Operations*

Joseph L. Brown, *Vice President, Appraiser*

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

Christopher M. Flann, *Vice President, Commercial Loan Officer*

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

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 A. Agostino-Erd, *Assistant Vice President, Mortgage Loan Officer*

Kimberly C. Bowman, *Assistant Vice President, Port Huron Branch Manager*

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*

Tammy J. Williford, *Assistant Vice President, Marketing and Compliance Officer*

EASTERN MICHIGAN BANK OFFICERS

Karen S. Biskey, *IT Support and Vendor Management Specialist*

Kelly A Brickner, *Fort Gratiot Branch Manager*

Trishette L. Davis, *Croswell Branch Manager*

Julie A. Chapdelaine, *Bank Secrecy Act Officer*

Rachel L. Galbraith, *Commercial Loan Officer*

Mary K. Heiden, *Loan Processing Manager*

Tracy L. Jackson-Wedge, *Sandusky Branch Manager*

Alexander J. Messing, *Commercial Loan Officer*

Cindy M. Mugridge, *Lakeport Branch Manager*

Kara L. Turcott, *Credit Manager*

RETIREMENTS

William E. Cone
Vice President,
Commercial Loan Officer

William Cone retired in December after 29 years of service to Eastern Michigan Bank and a 38 year career in the banking industry. Mr. Cone joined Eastern Michigan Bank in 1988 as a commercial loan officer. He was promoted to vice president in 1994, and served as Senior Lender from 1996-1999 and Commercial Loan Manager from 2013-2015. During his time with the Bank, Bill was also actively involved with the Port Huron Rotary, the Compass Christian Business Alliance and the Blue Water Community Action Agency.

We thank Bill for his service and wish him a long and happy retirement.

OFFICER PROMOTIONS AND NEW HIRES

PROMOTIONS

Assistant Vice President, Operations Officer Stacie L. Bales was promoted to Vice President in September 2017. Since joining Eastern Michigan Bank in 2001, Stacie has also served as human resources assistant, administrative assistant, administrative specialist and Bank Secrecy Act officer.

Stacie L. Bales, *Vice President, Operations*

Joseph L. Brown, *Vice President, Appraisal Officer*

Assistant Vice President, Appraisal Officer Joseph L. Brown was promoted to Vice President in September 2017. Joe began his career as an appraisal officer for Eastern Michigan Bank in 1996. He holds a bachelor's degree in business administration from Central Michigan University, and is a Michigan Certified Appraiser as well as a member of the Eastern Thumb Association of Realtors.

Commercial Lender Alexander J. Messing was promoted to Commercial Loan Officer in January 2017. Alex joined Eastern Michigan Bank in April 2016 as a loan officer trainee. As a commercial loan officer, he will serve business and agricultural customers in the Deckerville, Ruth and Sandusky markets. Alex is a graduate of Northwood University and has a Bachelors in Business Administration with a major in Accounting. He is a native of the Ruth/Deckerville area and currently resides in Deckerville with his family.

Alexander J. Messing, *Commercial Loan Officer*

NEW HIRES

Kelly A. Brickner, *Branch Manager, Fort Gratiot*

Kelly A. Brickner joined Eastern Michigan Bank in May 2017 as Branch Manager of our Fort Gratiot location. Kelly comes to Eastern with nine years' experience in the local retail and banking industries. Most recently she served as a relationship banker for a national bank in our market. Kelly is a native of Smiths Creek where she still resides with her husband and daughter. She attended St. Clair County Community College.

Kelly takes over as Branch Manager from Kathy Saelens, who has taken a management position at our Lakeport branch.

BRANCH AND ADMINISTRATIVE STAFF

CROSWELL BRANCH
Skye Bolsby, *Head Teller*
Bralicia Burrell, *Teller*
Jamie Goline, *Teller*
Amber Herzog-Solis, *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
Jennifer Briolat, *Assistant Branch Manager*
Diane Johnson, *Head Teller*
Cindy Carroll, *Teller*
Katie Hurley, *Teller*

LAKEPORT BRANCH
Kathleen Saelens, *Assistant Branch Manager*
Donna Gentner, *Head Teller*
Karen Hubble, *Teller*

LEXINGTON BRANCH
Krista Short, *Assistant Branch Manager*
Paula Mullen, *Head Teller*
Deborah Dickinson, *Teller*
Suzanne Hedges, *Teller*

MARYSVILLE BRANCH
Nancy Kulman, *Assistant Branch Manager*
Amanda Warner, *Head Teller*
Terri Herman, *Teller*

PORT HURON BRANCH
Elizabeth Symon, *Assistant Branch Manager*
Chelsea Grant, *Head Teller*
Stephanie Blake, *Float Head Teller*
Debra Bevins, *Teller*
Amanda Rennie, *Teller*

RUTH BRANCH
Anna-Marie Peresta, *Assistant Branch Manager*
Hannah Trowhill, *Head Teller*
Nicole Wolschleger, *Teller*

SANDUSKY BRANCH
Rita Berberich, *Assistant Branch Manager*
Alicia Reinke, *Head Teller*
Chelsea Spiegel, *Float Head Teller*
Mindy Fetting, *Teller*
Roxann Green, *Teller*

LOAN CENTER (CROSWELL)
Kathleen Breckner, *Mortgage/Commercial Loan Clerk*
Amanda Mosher, *Mortgage Specialist, Underwriter*
Nicki Parker, *Consumer Loan Documentation Specialist/Collections*
Marian Romzek, *Commercial Loan Clerk*
Crystal Sweet, *Consumer Loan Clerk/Courier*
Jasmine Williams, *Credit Analyst*

ADMINISTRATIVE STAFF
Nikki Butler, *Deposit Operations Manager*
Chelsea DuPree, *Human Resources Assistant*
Melissa Gelinski, *Accountant*
Darlene Innes, *Courier*
Ashley Lindke, *Deposit Operations Specialist*
Dru Moran, *Deposit Operations Specialist*
Brett Nemeckay, *Accounting Clerk*
Mechel Smith, *Deposit Operations Specialist*
Kari Wagner, *Deposit Operations Specialist*

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

Eastern Michigan Investment Services®

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

Located at:
Eastern Michigan Bank
5446 Main Street
Lexington, Michigan 48450
810.398.5129
easternmichiganinvestments.com

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

MILESTONES

Eastern Michigan Bank is pleased to recognize staff members who have celebrated milestone anniversaries with us in 2017. They are valued members of our banking family and we thank them for their dedication and contributions.

30 YEAR AWARD

Rita Berberich, *Assistant Branch Manager, Sandusky*

20 YEAR AWARD

Nikki Butler, *Deposit Operations Manager, Administrative Offices*

15 YEAR AWARD

Rachel Galbraith, *Commercial Loan Officer, Croswell*
Melissa Gelinski, *Accountant, Administrative Offices*

10 YEAR AWARD

Scott Cameron, *Teller, Deckerville*
Kara Turcott, *Credit Manager, Loan Center*
Donna Gentner, *Head Teller, Lakeport*
Nicole Wolschleger, *Teller, Ruth*

5 YEAR AWARD

Christopher Flann, *VP, Commercial Loan Officer, Port Huron*
Kathleen Wurmlinger, *VP, Mortgage Manager, Loan Center*
Karen Hubble, *Teller, Lakeport*

LETTER TO SHAREHOLDERS

We are pleased to report that 2017 represented one of Eastern Michigan Financial Corporation's best years ever. Net Income for the year just ended was $2.4 million. Including a $0.13 bonus dividend in the fourth quarter, dividends increased 5% over 2016 to $0.63 per share.

During the fourth quarter of 2017, we received payment in full on a land contract that was originated in 2009 to facilitate the sale of other real estate owned. At the time of payoff, we were able to recognize a gain related to the transaction. The payoff resulted in a one-time, six-figure gain.

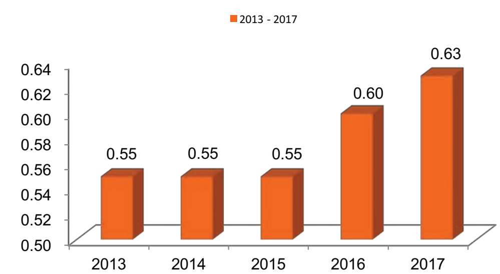
In addition to the one-time gain mentioned above, interest income for the final quarter was up nicely as it was the first full quarter of increased loan interest income from the loan growth we saw in the third quarter. Overall, loans increased just over 11% for the year, and while the loan volume came principally from our commercial loan portfolio, it was from a diverse group of borrowers within that portfolio. Several nice new loan relationships were obtained from borrowers in our new Ruth branch market, the result of higher legal lending limits than Ruth State Bank and a concerted effort on behalf of the Ruth branch manager and the commercial lenders in that market.

Loan requests from many of our agricultural borrowers increased in 2017, but not all of those requests came as good news. With the low crop and milk prices, some of these borrowers are needing to stretch their payments over longer than anticipated periods of time. Fortunately, with the increase in land prices over the last decade, most of these borrowers have strong equity positions in their land and we were able to help them. We also continue to utilize Farm Service Agency loan guarantees in situations where this guarantee makes good credit sense.

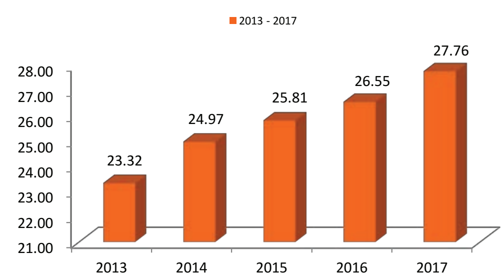
Early in the year, we adjusted the hours at several of our branches to more closely match current customer traffic patterns and market competition. This has allowed us to better schedule our staff and drive greater efficiencies throughout the branch network. Like all financial institutions, our branch traffic and transaction counts continue to decline, but the branch remains, and will remain, our primary point of contact with our customers.

While our customers still want to be able to visit a branch when the need arises, they are also demanding more technology to provide 24/7 access to conduct their business. Our mobile banking product saw over a 20% increase in users in 2017 with the specific function of remotely depositing a check seeing a 25% increase from January to December. Even though these electronic products and services are considered "must haves" to remain competitive, they are increasingly expensive to provide. Thus it is important that we achieve increased efficiencies in all areas of the bank.

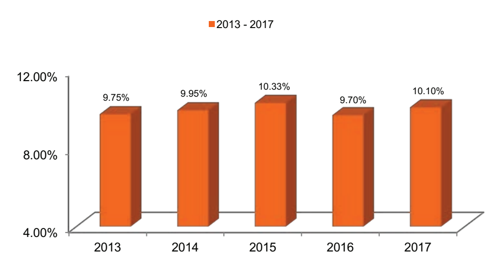
CASH DIVIDENDS PER SHARE



BOOK VALUE PER SHARE



CAPITAL RATIO



LETTER TO SHAREHOLDERS (con't)

Deposit balances increased modestly in 2017. While overall interest expense on deposits was down from the previous year, we are seeing the first signs of increased competition for deposits. Moving forward, our plan is to remain competitive but be very deliberate in setting deposit rates. Despite our loan growth in 2017, our loan to deposit ratio remains under 60%, resulting in high liquidity expected to provide any necessary loan growth funding.

As of December 31, 2017, our investment portfolio totaled $95.4 million, representing almost 29% of our assets. By design, a large portion of this portfolio will mature in the next two years. As a result, with an expected increase in short term interest rates, we will be in a position to improve the average yield produced by this portfolio in both 2018 and 2019, either through investing in bonds or making loans.

We are proud of the hard work and effort put forth by all of our people. While we were fortunate to have a positive one-time event, there is no doubt that the asset growth and its positive effect on our earnings is a result of a strong team effort from everyone within our organization. We expect to continue with our asset growth in 2018 while maintaining strong credit quality.

As always, we extend our sincere appreciation to our shareholders for their support. We look forward to seeing you at this year's annual shareholders' meeting on Tuesday, April 10, 2018 at 5:30 p.m. at Lakeview Hills in Lexington.

Sincerely,

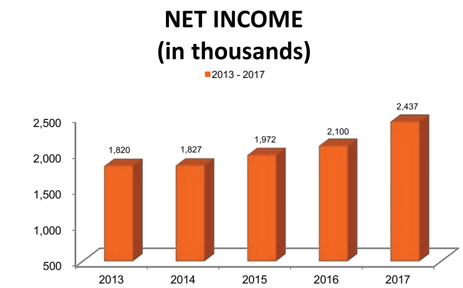
Earl E. DesJardins
Chairman of the Board

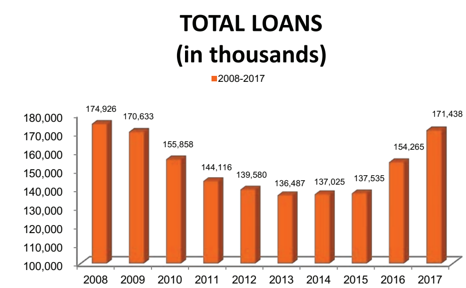
Timothy M. Ward
Vice Chairman of the Board,
Chief Executive Officer

2017 HIGHLIGHTS AND TEN YEAR FINANCIAL PROFILE

2017 HIGHLIGHTS - YEAR IN BRIEF

FOR THE YEAR (in thousands)	2017	2016	% Change
Net Interest Income	$ 9,244	$ 9,086	1.7%
Non-Interest Income	2,095	1,725	21.4%
Non-Interest Expense	7,637	7,856	-2.8%
Net Income	2,437	2,100	16.0%
YEAR END (in thousands)			
Total Assets	$ 329,426	$ 324,956	1.4%
Loans, Net of Unearned Interest	171,438	154,265	11.1%
Allowance for Loan Losses	1,330	1,222	8.8%
Deposits	295,923	293,079	1.0%
Shareholders' Equity	32,649	30,643	6.5%
PER SHARE			
Net Income	$ 2.36	$ 1.82	29.7%
Book Value	27.76	26.55	4.6%
Cash Dividends	0.63	0.60	5.0%
Number of Shares Outstanding	1,176,011	1,154,370	1.9%





TEN YEAR FINANCIAL PROFILE

FOR THE YEAR (in thousands)	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Net Interest Income	$ 9,244	$ 9,086	$ 8,306	$ 8,275	$ 8,175	$ 8,500	$ 8,674	$ 8,768	$ 8,369	$ 8,671
Provision for Loan Losses	173	79	(144)	69	283	406	933	1,066	2,294	991
Non-Interest Income	2,095	1,725	1,694	1,530	1,669	1,571	1,278	1,531	1,659	240
Non-Interest Expense	7,637	7,856	7,448	7,291	7,223	7,395	7,132	7,170	7,068	7,050
Income Before Income Taxes	3,529	2,876	2,696	2,445	2,338	2,270	1,887	2,063	666	870
Less: Income Taxes	1,092	776	724	618	518	497	404	495	16	131
Net Income	2,437	2,100	1,972	1,827	1,820	1,773	1,483	1,568	650	739
AT YEAR END (in thousands)										
Total Investment Securities	$ 94,370	$ 106,504	$ 110,344	$ 118,054	$ 113,141	$ 85,452	$ 72,389	$ 64,855	$ 38,149	$ 17,891
Restricted Investments	1,056	1,056	980	1,022	916	916	905	952	982	922
Federal Funds Sold	176	582	-	-	-	-	-	-	1,631	4,523
Total Loans	171,438	154,265	137,535	137,025	136,487	139,580	144,116	155,858	170,633	174,926
Allowance for Loan Losses	1,330	1,222	1,204	1,688	1,765	2,758	2,796	3,155	3,716	2,233
Total Assets	329,426	324,956	293,028	283,251	279,362	270,472	259,757	259,966	250,424	226,950
Total Deposits	295,923	293,079	262,124	253,998	252,086	242,897	233,578	234,907	224,277	201,469
Borrowed Funds	-	-	-	-	-	-	-	-	2,000	2,000
Shareholders' Equity	32,649	30,643	29,572	28,394	26,489	26,616	25,103	23,983	23,056	22,373
PER SHARE										
Net Income	$ 2.36	$ 1.82	$ 1.73	$ 1.61	$ 1.60	$ 1.57	$ 1.31	$ 1.39	$ 0.58	$ 0.64
Book Value	27.76	26.55	25.81	24.97	23.32	23.52	22.24	21.25	20.43	19.82
Cash Dividends	0.63	0.60	0.55	0.55	0.55	0.55	0.48	0.48	0.48	0.96
Number of Shares Outstanding	1,176,011	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
Return on Average Assets	0.74%	0.67%	0.69%	0.65%	0.67%	0.68%	0.58%	0.61%	0.28%	0.33%
Return on Average Equity	7.70%	6.90%	6.64%	6.65%	6.83%	6.83%	5.94%	6.48%	2.83%	3.20%
Capital Ratio	10.10%	9.70%	10.33%	9.95%	9.75%	9.76%	9.68%	8.98%	9.33%	9.85% *

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

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands except per share data)

	December 31 2017	December 31 2016
ASSETS		
Cash and demand deposits due from banks	$ 6,341	$ 5,035
Interest bearing balances due from banks	19,440	17,836
Federal funds sold	176	582
Cash and cash equivalents	**25,957**	**23,453**
Certificates of deposit held in other banks	20,000	22,226
Investment securities		
Available-for-sale	83,178	92,335
Held-to-maturity	11,192	14,169
Restricted, at cost	1,056	1,056
Net loans	170,108	153,043
Accrued interest receivable	1,282	1,130
Premises and equipment, net	5,524	5,689
Foreclosed assets	91	923
Bank-owned life insurance	9,523	9,283
Other assets	1,515	1,649
Total assets	**$ 329,426**	**$ 324,956**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$ 80,697	$ 75,828
Interest-bearing	215,226	217,251
Total deposits	**295,923**	**293,079**
Accrued interest payable and other liabilities	854	1,234
Total liabilities	**296,777**	**294,313**
Commitments and contingencies (Notes 12, 14, and 15)		
Shareholders' equity		
Common stock, $5 par value; 3,000,000 shares authorized, 1,176,011 (1,154,370 in 2016) shares issued and outstanding	5,880	5,771
Additional paid-in-capital	2,158	1,999
Retained earnings	25,291	23,541
Accumulated other comprehensive loss	(680)	(668)
Total shareholders' equity	**32,649**	**30,643**
Total liabilities and shareholders' equity	**$ 329,426**	**$ 324,956**

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	
	2017	2016
Interest and dividend income		
Loans (including fees)	$ 7,343	$ 7,202
Securities		
Taxable	1,330	1,568
Nontaxable	391	357
Other	99	92
Federal funds sold and deposits with banks	447	244
Total interest and dividend income	**9,610**	**9,463**
Interest expense	366	377
Net interest income	**9,244**	**9,086**
Provision for loan losses	173	79
Net interest income, after provision for loan losses	**9,071**	**9,007**
Noninterest income		
Service charges on deposit accounts	1,067	1,018
Other service charges and fees	240	228
Other	788	479
Total noninterest income	**2,095**	**1,725**
Noninterest expenses		
Compensation and benefits	4,358	4,243
Occupancy and equipment	846	934
Other	2,433	2,679
Total noninterest expenses	**7,637**	**7,856**
Income before federal income taxes	**3,529**	**2,876**
Federal income taxes	1,092	776
Net income	**$ 2,437**	**$ 2,100**
Net income per common share		
Basic	**$ 2.36**	**$ 1.82**
Diluted	**$ 2.31**	**$ 1.81**

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands except per share data)

	December 31	
	2017	2016
Other comprehensive income (loss)		
Unrealized holding gains (losses) on available-for-sale securities arising during the year	$ 150	$ (668)
Income tax (expense) benefit related to other comprehensive income (loss)	(51)	227
Other comprehensive income (loss)	**99**	**(441)**
Net income	2,437	2,100
Comprehensive income	**$ 2,536**	**$ 1,659**

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, 2016	**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**
Comprehensive income	-	-	-	2,437	99	2,536
Common stock options recognized	-	-	4	-	-	4
Issuance of restricted stock awards	4,876	24	(5)	-	-	19
Issuance of shares upon exercise of common stock options	20,118	102	160	-	-	262
Repurchase of common stock	(3,353)	(17)	-	(61)	-	(78)
Cash dividends paid ($0.63 per share)	-	-	-	(737)	-	(737)
Reclassification resulting from enactment of federal tax legislation	-	-	-	111	(111)	-
Balances, December 31, 2017	**1,176,011**	**$ 5,880**	**$ 2,158**	**$ 25,291**	**$ (680)**	**$ 32,649**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands except per share data)

	December 31	
	2017	2016
Cash flows from operating activities		
Net income	$ 2,437	$ 2,100
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	173	79
Depreciation	304	358
Provision for foreclosed assets	47	57
Net amortization of investment securities premiums	771	573
Share-based compensation	23	2
Net gain on sale of loans	(106)	(149)
Net gain on sale of equipment	-	(2)
Net gain on sale of foreclosed assets	(338)	(41)
Increase in cash value of bank-owned life insurance	(240)	(221)
Deferred income tax expense (benefit)	252	(60)
Origination of loans held for sale	(3,476)	(4,477)
Proceeds from loan sales	3,582	4,626
Changes in operating assets and liabilities which (used) provided cash, net in 2016 of amounts acquired in Ruth acquisition		
Accrued interest receivable	(152)	14
Other assets	(169)	469
Accrued interest payable and other liabilities	(380)	(443)
Net cash provided by operating activities	**2,728**	**2,885**
Cash flows from investing activities		
Net change in certificates of deposit held in other banks	2,226	(15,518)
Activity in held-to-maturity securities		
Purchases	-	(8,132)
Maturities, prepayments, and calls	2,872	1,578
Activity in available-for-sale securities		
Purchases	(11,836)	(8,081)
Maturities, prepayments, calls and sales	20,477	36,507
Purchase of restricted investments	-	(60)
Loan principal originations, net	(17,799)	(8,826)
Purchases of premises and equipment	(139)	(169)
Proceeds from sale of foreclosed assets	1,684	475
Proceeds from sale of equipment	-	7
Acquisition of Ruth, net of cash acquired	-	(1,336)
Net cash used in investing activites	**(2,515)**	**(3,555)**
Cash flows from financing activities		
Acceptances and withdrawals of deposits, net	2,844	(2,941)
Net proceeds from sale of common stock	262	205
Repurchase and retirement of stock	(78)	(103)
Cash dividends paid	(737)	(692)
Net cash provided by (used in) financing activities	**2,291**	**(3,531)**
Net increase (decrease) in cash and cash equivalents	**2,504**	**(4,201)**
Cash and cash equivalents, beginning of year	23,453	27,654
Cash and cash equivalents, end of year	**$ 25,957**	**$ 23,453**

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

(Dollars in thousands except per share data)

1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business and Consolidation

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 3 years and are carried at cost.

Fair Value Measurements

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

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

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

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

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

For a further discussion of Fair Value Measurements, refer to Note 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 2017 or 2016.

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.

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

Loans

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

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

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

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

Allowance for Loan Losses

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

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

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired.

Continued...

(Dollars in thousands except per share data)

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 $3,582 and $4,626 during 2017 and 2016, respectively, which resulted in a net gain of $106 and $149 for 2017 and 2016, respectively. Servicing fee income earned on such loans was $76 and $81 for 2017 and 2016, respectively, and is included in other noninterest income on the consolidated statements of income.

Servicing

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

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

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

Foreclosed Assets

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

Continued...

(Dollars in thousands except per share data)

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, including common stock option grants and restricted stock awards, 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 generally 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.

Business 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 its 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.

See Note 10 for a discussion of the impact of federal tax legislation (Tax Cuts and Jobs Act), which was enacted on December 22, 2017.

Net Income Per Share

Basic earnings per share represent income available to common shareholders divided by the weighted-average number of common shares outstanding less unvested restricted stock during the year. Diluted earnings per share reflects 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 to outstanding common stock options and restricted stock awards, 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, 2017, the most recent balance sheet presented herein, through February 21, 2018, the date these consolidated financial statements were available to be issued. No such events or transactions were identified, other than the new accounting pronouncement issued in February 2018 as described below.

New Accounting Pronouncements

ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, was issued in 2016 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.

ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, was issued in February 2018 to eliminate the stranded tax effects associated with the change in the federal corporate income tax rate included in the Tax Cuts and Jobs Act of 2017. The amendments in the update allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the newly enacted change in the federal corporate income tax rate. The amount of the reclassification is based on the difference between the historical corporate income tax rate and the enacted 21 percent corporate income tax rate, or approximately $111 in 2017. Although the update is effective for fiscal years beginning after December 31, 2018, the Corporation has elected to early adopt the guidance in 2017.

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 and $29 in 2017. 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.

Continued...

(Dollars in thousands except per share data)

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

Restricted Investments

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

Loans

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

The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with accounting standards for subsequent measurement of receivables. The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans.

Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the impaired loan as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the impaired loan as nonrecurring Level 3.

Accrued Interest Receivable

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

Foreclosed Assets

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

Mortgage Servicing Rights

Mortgage servicing rights are subject to impairment testing. A valuation model, which utilizes a discounted cash flow analysis using interest rates and prepayment speed assumptions currently quoted for comparable instruments and a discount rate determined by management, is used for impairment testing. If the valuation model reflects a value less than the carrying value, loan servicing rights are adjusted to fair value through a valuation allowance as determined by the model. As such, the Corporation classifies loan servicing rights subjected to nonrecurring fair value adjustments as Level 3. At December 31, 2017 and 2016, 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 Corporation would classify goodwill subjected to nonrecurring fair value adjustments as Level 3. At December 31, 2017 and 2016, no goodwill impairment was recorded and, therefore, no goodwill was recorded at fair value on a nonrecurring basis.

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, 2017 and 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.

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:

	Assets at Fair Value			
2017	**Level 1**	**Level 2**	**Level 3**	**Total**
Investment securities available-for-sale:				
U.S. treasury notes	$ 1,249	$ -	$ -	$ 1,249
U.S. government and federal	-	21,253	-	21,253
Corporate bonds	-	2,171	-	2,171
Agency issued mortgage-backed securities	-	32,973	-	32,973
States and municipals	-	24,592	-	24,592
Money market preferred securities	-	940	-	940
Total assets at fair value	$ 1,249	$ 81,929	$ -	$ 83,178

	Assets at Fair Value			
2016	**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	-	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

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 and liabilities measured at fair value on a recurring basis as of December 31:

	Assets of Carrying Value			
2017	**Level 1**	**Level 2**	**Level 3**	**Total**
Impaired Loans (1)	$ -	$ -	$ 2,149	$ 2,149

	Assets of Carrying Value			
2016	**Level 1**	**Level 2**	**Level 3**	**Total**
Impaired Loans (1)	$ -	$ -	$ 826	$ 826

(1) Certain impaired loans were remeasured and reported at fair value through a specific valuation allowance. Impaired loans of $2,149 and $826 as of December 31, 2017 and 2016, respectively, were reduced by a specific valuation allowance totaling $264 and $200 as of those dates.

Quantitative information about Level 3 fair value measurements is as follows as of December 31, 2017:

	Level 3 Instruments			
Instrument	**Fair Value**	**Valuation Technique**	**Unobservable Input**	**Weighted Average and/or Range**
Impaired Loans	$ 2,149	Discounted Appraisal Value	Applied to Collateral Appraisal	.002-41%

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

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

Continued...

(Dollars in thousands except per share data)

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

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

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

	2017		2016	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets				
Cash and cash equivalents	$ 25,957	$ 25,957	$ 23,453	$ 23,453
Certificates of deposit held in other banks	20,000	20,141	22,226	22,449
Investment securities held-to-maturity	11,192	10,987	14,169	13,950
Restricted investments	1,056	1,056	1,056	1,056
Net loans	170,108	169,661	153,043	153,933
Mortgage servicing rights	276	287	295	300
Accrued interest receivable	1,282	1,282	1,130	1,130
Liabilities				
Noninterest-bearing deposits	$ 80,697	$ 80,697	$ 75,828	$ 75,828
Interest-bearing deposits	215,226	215,387	217,251	217,407
Accrued interest payable	10	10	14	14

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:

2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity				
Agency issued mortgage-backed securities	$ 8,304	$ -	$ 196	$ 8,108
States and municipals	2,888	1	10	2,879
Total held-to-maturity	11,192	1	206	10,987
Available-for-sale				
Debt securities				
U.S. treasury notes	1,261	-	12	1,249
U.S. government and federal agencies	21,331	1	79	21,253
Corporate bonds	2,177	-	6	2,171
Agency issued mortgage-backed securities	33,550	16	593	32,973
States and municipals	24,721	15	144	24,592
Total debt securities	83,040	32	834	82,238
Money market preferred securities	1,000	-	60	940
Total available-for-sale	84,040	32	894	83,178
Total	$ 95,232	$ 33	$ 1,100	$ 94,165

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

Investment securities with carrying values of $4,486 and $4,502 at December 31, 2017 and 2016, 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, 2017, 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						
Agency issued mortgage-backed securities	$ -	$ -	$ -	$ -	$ 8,304	$ 8,304
States and municipals	500	2,388	-	-	-	2,888
Total held-to-maturity	500	2,388			8,304	11,192
Available-for-sale						
Debt securities						
U.S. treasury notes	$ 750	$ 511	$ -	$ -	$ -	$ 1,261
U.S. government and federal agencies	14,557	6,774	-	-	-	21,331
Corporate bonds	1,677	500	-	-	-	2,177
Agency issued mortgage-backed securities	-	-	-	-	33,550	33,550
State and municipals	4,654	18,447	1,620	-	-	24,721
Total debt securities	21,638	26,232	1,620	-	33,550	83,040
Money market preferred securities	-	-	-	-	1,000	1,000
Total available-for-sale	$ 21,638	$ 26,232	$ 1,620	$ -	$ 34,550	$ 84,040
Total amortized cost	$ 22,138	$ 28,620	$ 1,620	$ -	$ 42,854	$ 95,232
Fair value	$ 22,099	$ 28,432	$ 1,613	$ -	$ 42,021	$ 94,165

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 2017 or 2016; therefore were no gross realized gains or losses during 2017 or 2016.

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:

	Less Than 12 Months		Over 12 Months			Total
2017	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Losses
Securities held-to-maturity						
Agency issued mortgage-backed securities	$ -	$ -	$ 8,109	$ 196	$ 8,109	$ 196
States and municipals	2,378	10	-	-	2,378	10
Total securities held-to-maturity	$ 2,378	$ 10	$ 8,109	$ 196	$ 10,487	$ 206
Securities available-for-sale						
Debt securities						
U.S. treasury notes	$ -	$ -	$ 1,249	$ 12	$ 1,249	$ 12
U.S. government and federal agencies	13,815	46	5,440	33	19,255	79
Corporate bonds	497	3	1,674	3	2,171	6
Agency issued mortgage-backed	11,495	97	19,071	496	30,566	593
States and municipals	19,469	110	3,062	34	22,531	144
Total debt securities	45,276	256	30,496	578	75,772	834
Money market preferred securities	-	-	940	60	940	60
Total securities available-for-sale	$ 45,276	$ 256	$ 31,436	$ 638	$ 76,712	$ 894

Continued...

(Dollars in thousands except per share data)

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	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	$ 67,390	$ 897	$ 5,398	$ 211	$ 72,788	$ 1,108

As of December 31, 2017, the Corporation's investment security portfolio consisted of 286 securities, 180 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, 2017.

As of December 31, 2017 and 2016, 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, 2017 or 2016.

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:

	2017	2016
Commercial and industrial	$ 35,401	$ 27,793
Agricultural	46,397	41,259
Real estate related industries	27,944	28,147
Other commercial	25,984	23,618
Residential real estate	23,568	23,818
Consumer and other	7,597	5,885
Home equity	4,547	3,745
Total loans	171,438	154,265
Allowance for loan losses	(1,330)	(1,222)
Loans, net	$ 170,108	$ 153,043

The allowance for loan losses and loans are as follows for the year ended December 31, 2017:

	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	$ 131	$ 429	$ 247	$ 253	$ 103	$ 26	$ 33	$ 1,222
Provision for loan losses	79	10	1	(3)	26	65	(5)	173
Loans charged off	(14)	-	-	-	(16)	(51)	(8)	(89)
Recoveries of loans previously charged off	-	2	9	1	-	8	4	24
Balance at end of year	$ 196	$ 441	$ 257	$ 251	$ 113	$ 48	$ 24	$ 1,330
Allowance for loan losses attributable to loans								
Individually evaluated for impairment	$ 41	$ 19	$ 155	$ 17	$ 27	$ -	$ 5	$ 264
Collectively evaluated for impairment	155	422	102	234	86	48	19	1,066
Total allowance for loan losses	$ 196	$ 441	$ 257	$ 251	$ 113	$ 48	$ 24	$ 1,330
Loans								
Individually evaluated for impairment	$ 772	$ 1,321	$ 473	$ 360	$ 278	$ 17	$ 93	$ 3,314
Collectively evaluated for impairment	34,629	45,076	27,471	25,624	23,290	7,580	4,454	168,124
Total loans	$ 35,401	$ 46,397	$ 27,944	$ 25,984	$ 23,568	$ 7,597	$ 4,547	$ 171,438

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
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 following table shows the loans allocated by management's internal risk ratings at December 31, 2017:

	Commercial Credit Risk Profile by Risk Rating				
	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Total
Risk Rating					
Pass	$ 34,279	$ 43,686	$ 27,470	$ 25,385	$ 130,820
Watch	1,122	994	27	232	2,375
Special mention	-	757	-	-	757
Substandard	-	960	447	367	1,774
Total	$ 35,401	$ 46,397	$ 27,944	$ 25,984	$ 135,726

Continued...

(Dollars in thousands except per share data)

The following table shows the homogeneous loans allocated by payment activity as of December 31, 2017:

	Consumer Credit Risk Profile by Risk Rating			
	Residential Real Estate	Consumer and Other	Home Equity	Total
Payment Activity				
Performing	$ 23,212	$ 7,580	$ 4,526	$ 35,318
Non-Performing	356	17	21	394
Total	$ 23,568	$ 7,597	$ 4,547	$ 35,712

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 an aging analysis of the loan portfolio by time past due as of December 31, 2017:

	Accruing Interest				
	Current	30 - 89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
Commercial and industrial	$ 35,401	$ -	$ -	$ -	$ 35,401
Agricultural	45,218	-	-	1,179	46,397
Real estate related industries	27,563	336	-	45	27,944
Other commercial	25,937	-	-	47	25,984
Residential real estate	23,102	111	-	355	23,568
Consumer and Home	7,531	49	-	17	7,597
equity	4,504	22	-	21	4,547
Total	$ 169,256	$ 518	$ -	$ 1,664	$ 171,438

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	5,860	25	-	-	5,885
Home equity	3,710	-	-	35	3,745
Total	$ 151,035	$ 1,065	$ -	$ 2,165	$ 154,265

The following table presents information related to impaired loans as of December 31, 2017:

	Recorded Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial and industrial	$ -	$ -	$ -	$ 14	$ -
Agricultural	783	1,285	-	963	-
Real estate related industries	85	346	-	637	2
Other commercial	111	188	-	94	-
Residential real estate	153	633	-	203	-
Consumer and Home	17	25	-	8	1
equity	16	42	-	19	-
Loans with an allowance recorded					
Commercial and industrial	$ 772	$ 772	$ 41	$ 386	$ 45
Agricultural	538	538	19	280	36
Real estate related industries	388	388	155	393	24
Other commercial	249	249	17	279	16
Residential real estate	125	129	27	62	4
Consumer and Home	-	-	-	-	-
equity	77	86	5	87	4
Total impaired loans					
Commercial and industrial	$ 772	$ 772	$ 41	$ 400	$ 45
Agricultural	1,321	1,823	19	1,243	36
Real estate related industries	473	734	155	1,030	26
Other commercial	360	437	17	373	16
Residential real estate	278	762	27	265	4
Consumer and Home	17	25	-	8	1
equity	93	128	5	106	4
Total	$ 3,314	$ 4,681	$ 264	$ 3,425	$ 132

Continued...

(Dollars in thousands except per share data)

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
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	-
Agriculture	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

A summary of loans that were modified in troubled debt restructurings during 2017 is as follows:

	Troubled Debt Restructurings		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Agricultural	1	$ 538	$ 538
Commercial and industrial	1	737	728
	2	$ 1,275	$ 1,266

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 2017:

	Total Modifications				
	Principal Deferrals		Interest Rate Reductions		
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	Total Modifications
Agricultural	-	$ -	1	$ 538	$ 538
Commercial and industrial	1	737	-	-	737
Residential real estate	-	-	-	-	-
	1	$ 737	1	$ 538	$ 1,275

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
	1	$ 644	3	$ 349	$ 993

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, 2017 and 2016, 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, 2017 and 2016, were $30,153 and $31,665, 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:

	2017	2016
Mortgage servicing rights		
Balance at beginning of year	$ 295	$ 261
Mortgage servicing rights capitalized	44	58
Mortgage servicing rights amortized	(63)	(24)
Balance at end of year	$ 276	$ 295

7. FORECLOSED ASSETS

Real estate owned activity was as follows for the years ended December 31:

	2017	2016
Beginning balance	$ 923	$ 1,191
Loans transferred to real estate owned	561	223
Direct write-downs	(47)	(57)
Sales of real estate owned	(1,346)	(434)
End of year	$ 91	$ 923

Continued...

(Dollars in thousands except per share data)

At December 31, 2017 and 2016, 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. There were no loans secured by residential real estate properties for which formal foreclosure proceeds were in process at December 31, 2017. At December 31, 2016, the recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceeds are in process was $31.

Activity in the valuation allowance was as follows for the year ended December 31:

	2017	2016
Beginning balance	$ 209	$ 209
Reductions from sales of real estate owned	(256)	(57)
Direct write-downs	47	57
End of year	$ -	$ 209

(Income) expenses related to foreclosed assets include:

	2017	2016
Net gain on sales	$ (338)	$ (41)
Provision for unrealized losses	47	57
Operating expenses, net of rental income	(4)	44
Total (income) expenses	$ (295)	$ 60

8. PREMISES AND EQUIPMENT

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

	2017	2016
Bank premises and land	$ 8,557	$ 8,557
Furniture and equipment	4,304	4,244
Total	12,861	12,801
Less accumulated depreciation	7,337	7,112
Premises and equipment, net	$ 5,524	$ 5,689

Depreciation expense was $304 and $358 for 2017 and 2016, respectively.

9. DEPOSITS

The composition of deposits are summarized as follows as of December 31:

	2017	2016
Interest-bearing		
NOW accounts	$ 52,729	$ 52,864
Savings	67,007	66,025
Money market demand	56,806	53,011
Time, $250,000 and over	2,192	3,581
Other time	36,492	41,770
Total interest-bearing	215,226	217,251
Noninterest-bearing demand	80,697	75,828
Total deposits	$ 295,923	$ 293,079

Scheduled maturities of time deposits for each of the five years succeeding December 31, 2017, are summarized as follows:

are summarized as follows:

Year	Amount
2018	$ 19,667
2019	5,758
2020	7,910
2021	3,917
2022	1,432
Total	$ 38,684

10. FEDERAL INCOME TAXES

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

	2017	2016
Currently payable	$ 840	$ 836
Deferred expense (benefit)	252	(60)
Income taxes	$ 1,092	$ 776

The Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. The Act reduces the U.S. federal corporate tax rate from 35% to 21%, among other provisions. The Corporation remeasured certain deferred tax assets and liabilities based on the rates at which such amounts are expected to impact taxable income in the future, which is generally 21%, resulting in an immediate charge of approximately $147 in 2017.

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:

	2017	2016
Income tax provision at statutory rate	$ 1,200	$ 978
Effect of tax-exempt interest income	(154)	(131)
Remeasurement of deferred taxes due to changes in federal tax law	147	-
Other, net	(101)	(71)
Income taxes	$ 1,092	$ 776

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:

	2017 (Remeasured at 21% tax rate)	2016
Deferred tax assets		
Allowance for loan losses	$ 135	$ 160
Unrealized loss on available-for-sale securities	181	344
Nonaccrual loan interest	18	28
Deferred loan fees/costs	30	50
Other real estate	-	22
Other	48	213
Total deferred tax assets	412	817
Deferred tax liabilities		
Depreciation	90	119
Mortgage servicing rights	58	100
Other	28	59
Total deferred tax liabilities	176	278
Net deferred tax asset	$ 236	$ 539

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 2014 through 2017, the years which remain subject to examination by major tax jurisdictions as of December 31, 2017. 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, 2017 or 2016 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 $1,939 and $2,758 at December 31, 2017 and 2016, respectively.

Deposits

Deposits of Corporate directors, executive officers and their affiliates were $1,158 and $402 at December 31, 2017 and 2016, 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, 2017 and 2016, the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount	
	2017	2016
Unfunded commitments under lines of credit	$ 35,088	$ 31,841
Commitments to grant loans	5,271	3,080
Commercial and standby letters of credit	964	1,163

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.

Continued...

(Dollars in thousands except per share data)

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, 2017 or 2016.

13. COMMON STOCK ACTIVITY, INCLUDING SHARE-BASED INCENTIVE PLANS

Common Stock Repurchase

During 2017 and 2016, the Corporation repurchased 3,353 and 6,001 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.

Share-Based Compensation

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, 2017:

Risk-free interest rate	2.41%
Expected term	10 years
Expected stock price volatility	16.80%
Dividend yield or expected	2.79%

Under the Corporation's 2012 Employee Stock Option Plan (the "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, 2017 and 2016, the Corporation recognized $4 and $2, respectively in compensation expense for stock options. As of December 31, 2017, unrecognized compensation costs related to nonvested awards amounted to $9 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. 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 Terms (Years)
Outstanding at January 1, 2016	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
Granted	31,218	21.33	
Exercised	(26,948)	15.04	
Forfeited	(17,439)	18.80	
Outstanding at December 31, 2017	124,042	$ 17.05	5.46

The fair value of options granted during 2017 and 2016 was $9 and $4, respectively.

As of December 31, 2017, 4,455 options under the 2009 plan are outstanding at an average exercise price of $14.80 (range of $10.10 – $19.50), all of which are exercisable. As of December 31, 2017, 119,587 options under the 2012 plan were outstanding at an average exercise price of $18.47 (range of $12.75 - $21.90) of which 53,265 are exercisable.

Shares granted in 2017 include 6,830 shares received in connection with the exercise of a reload option whereby the grantee tendered shares to pay the exercise price of an option and received a new option to purchase the number of shares of common stock equal to the number of shares tendered to pay the exercise price.

Reload options have an exercise price equal to the fair market value as of the date of exercise of the underlying option. The date of grant of the reload option is the date of exercise of the underlying option. The reload option may be exercised one year after it is granted and expires on the date of expiration of the underlying option to which the reload options related.

The Plan also authorizes the use of restricted stock awards, which were granted in 2017. The fair value of restricted stock awards is estimated by the market price of the Corporation's common stock at the date of grant. Under the provisions of the plan, the Corporation cannot be obligated to "cash-settle" any of the restricted stock awards through redemption. The shares become vested over a 5-year service period. During the period the shares are not vested, the grantee may not sell, assign, transfer or pledge the shares but has all other rights of a shareholder, including the right to receive dividends and the right to vote such shares. Restricted stock is immediately forfeited when the employment of a grantee is terminated. Restricted stock activity during 2017, is as follows:

	Number of Shares	Weighted-Average Grant - Date Fair Value per Share
Non-vested, January 1, 2017	-	$ -
Granted	4,876	21.30
Vested	-	-
Cancelled and forfeited	-	-
Non-vested, December 31, 2017	4,876	$ 21.30

Awards are being amortized to expense over the 5-year vesting period. Compensation cost related to restricted stock awards was $19 for 2017. As of December 31, 2017, there was $85 of total remaining unrecognized compensation cost related to nonvested restricted stock awards granted under the Plan. The cost is expected to be recognized over the next 4 years.

There was an impact of $.05 and $.01 to diluted earnings per share resulting from such common stock equivalents in 2017 and 2016, respectively.

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, 2017 and 2016 is 1.25% and 0.625%, respectively. 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, 2017 and 2016, that the Corporation and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2017 and 2016, 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, 2017 and 2016 are also presented in the table.

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
December 31, 2017	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk Weighted Assets						
Consolidated	$ 34,657	18.53%	$ 17,303	9.25%	N/A	N/A
Bank	33,645	17.99	17,303	9.25	$ 18,706	10.00%
Tier 1 (Core) Capital To Risk Weighted Assets						
Consolidated	33,327	17.82	13,562	7.25	N/A	N/A
Bank	32,315	17.28	13,562	7.25	14,964	8.00
Common Tier 1 (CET1)						
Consolidated	33,327	17.82	10,756	5.75	N/A	N/A
Bank	32,315	17.28	10,756	5.75	10,564	6.50
Tier 1 (Core) Capital To Average Assets						
Consolidated	33,327	10.10	13,194	4.00	N/A	N/A
Bank	32,315	9.81	13,175	4.00	16,469	5.00

Continued...

(Dollars in thousands except per share data)

December 31, 2016	Actual Amount	Actual Ratio	Minimum Capital Requirements Amount	Minimum Capital Requirements Ratio	Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions Amount	Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions 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

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, 2017 or 2016.

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, 2017.

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 $74 and $73 in 2017 and 2016, 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 $200 and $164 in 2017 and 2016, 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 $240 and $221 in 2017 and 2016, 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 recognized compensation expense for such benefits.

17. SUPPLEMENTAL CASH FLOWS INFORMATION

Other Cash Flows Information

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

	2017	2016
Interest	$ 370	$ 379
Income taxes	$ 1,111	$ 731

Non-Cash Investing Activities

Collateral repossessed on real estate loans having carrying values in the amount of $561 and $223 on the date of transfer was reclassified to foreclosed assets in 2017 and 2016, respectively.

Non-Cash Financing Activities

During 2017 and 2016, options for the purchase of 20,118 and 14,640, respectively, common shares were exercised. In accordance with the Plan document, 3,353 and 6,001 outstanding shares of common stock were repurchased by the Corporation to facilitate the exercise of 3,954 and 8,839 options. Total value assigned to the repurchased shares was $78 and $103, respectively.

Additionally, during 2017, 9,866 common shares were exercised through a reload option whereby 6,830 common shares were tendered to pay the exercise price. The issuance of shares upon exercise of common stock options has been recorded net of the tendered shares in the statement of shareholders' equity.

■■■■■

End of Notes

Rehmann

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INDEPENDENT AUDITORS' REPORT

February 21, 2018

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, 2017 and 2016, 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 Accountants' 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.

Independent Accountants' Conclusion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of ***Eastern Michigan Financial Corporation*** as of December 31, 2017 and 2016, and the consolidated 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

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Eastern Michigan Financial Corporation

Annual Report 2017

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