Eastern Michigan Financial Corporation®

2019 ANNUAL REPORT

MISSION STATEMENT

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

CORE VALUES

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

OUR PROMISE

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

GENERAL INFORMATION

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

INVESTOR RELATIONS CONTACT

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

INDEPENDENT AUDITORS

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

CORPORATE HEADQUARTERS

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

TRANSFER AGENT AND REGISTRAR

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

STOCK SYMBOL

Over-The-Counter Bulletin Board: EFIN

ANNUAL MEETING

The Eastern Michigan Financial Corporation annual meeting of company shareholders is scheduled for Tuesday, April 21, 2020 at 5:30 p.m. and will be held at Lakeview Hills Golf Resort, 6560 E. Peck Road, Lexington, Michigan 48450.

2019 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
emb.bank

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

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

Karen S. Flanagan, Director
Farmer
Sandusky

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

Kathlene M. Partaka, Director
Retired Executive Vice President, Operations
Eastern Michigan Bank, Croswell

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

Donna M. Niester, Director
President and Chief Executive Officer
Acheson Ventures, LLC, Port Huron

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

APPOINTMENTS

Donna M. Niester

Donna Niester was appointed to the Board of Directors of Eastern Michigan Financial Corporation and its subsidiary, Eastern Michigan Bank, in April 2019. Niester is the President and Chief Executive Officer of Acheson Ventures, LLC, the trustee of the James C. Acheson Foundation and a certified public accountant. Prior to joining Acheson Ventures in 2000, she was a partner in the Port Huron accounting firm of Austin, Niester, Schweihofer & Finnegan, PC.

Niester has a long and distinguished record of service to the Port Huron community as well as various state-wide organizations. She is both a committee member and past chair of the Community Foundation of St. Clair County; past member of the Michigan Community Service Commission; member of the McLaren Port Huron Corporate Compliance Committee; past trustee of the McLaren Port Huron Board of Directors; past chair of the Port Huron Hospital Foundation; and past president of the Port Huron Golf Club.

Donna was instrumental in the development of Studio 1219 and the Blue Water River Walk and is one of the founding members of the Community Foundation of St. Clair County's Women's Initiative. She also personally organizes a private fundraising event each year to support women with breast cancer. In 2016, she was recognized by Crain's Detroit Business as one of their 100 Most Influential Women, and in 2014, she was named a Northwood University Distinguished Women Honoree.

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. Levitt, Senior Vice President, Chief Financial Officer

EASTERN MICHIGAN BANK SENIOR MANAGEMENT OFFICERS

Timothy M. Ward, Chief Executive Officer
William G. Oldford, Jr., President
Errin M. Levitt, Senior Vice President, Chief Financial Officer

EASTERN MICHIGAN BANK VICE PRESIDENTS

Scott R. Badley, Commercial Loan Officer
Stacie L. Bales, Operations
Joseph L. Brown, Appraiser
Chad W. Deaner, Senior Lender
Christopher M. Flann, Commercial Loan Officer
Gerald D. Hepfer, Commercial Loan Officer
Jessica S. McLarty, Commercial Loan Officer
L. Michael O'Vell, Consumer Loan Manager and Security Officer
Joseph Pink, Information Technology Manager and Chief Information Security Officer
Kathleen M. Wurmlinger, Mortgage Manager

EASTERN MICHIGAN BANK ASSISTANT VICE PRESIDENTS

Stefanie M. Abbott, Deckerville Branch Manager
Christi A. Agostino-Erd, Mortgage Loan Officer
Kimberly C. Bowman, Port Huron Branch Manager
Kathi J. Jahn, Ruth Branch Manager
Audra L. Levitte, Human Resources Director
Kim M. Stencel, Lexington Branch Manager
Tammy J. Williford, Marketing and Compliance Officer

EASTERN MICHIGAN BANK OFFICERS

Julie A. Chapdelaine, Bank Secrecy Act Officer
Trishette L. Davis, Croswell Branch Manager
Emily A. Dehring, Fort Gratiot Branch Manager
Rachel L. Galbraith, Commercial Loan Officer
Tracy L. Jackson-Wedge, Sandusky Branch Manager
Alexander J. Messing, Commercial Loan Officer
Jennifer M. Briolat, Lakeport Branch Manager
Amanda K. Rose, Marysville Branch Manager

RETIREMENTS

Karen Biskey
Operations Administrator and Vendor Management Specialist

Karen Biskey retired from Eastern Michigan Bank in 2019 after 38 years of service. During her career with the Bank, Biskey worked as a loan clerk, accounting clerk, credit analyst and commercial loan officer before moving into the Operations Department in 2010. She retired in January as Operations Administrator and Vendor Management Specialist.

Karen was active in the local community throughout her time with the Bank, serving on the Croswell Swinging Bridge Festival committee and as secretary of the Croswell-Lexington Chamber of Commerce for a number of years.

Clariece Creguer
Assistant Vice President, Deckerville Branch Manager

Clariece Creguer retired from Eastern Michigan Bank in March 2019 after 33 years of service. During her career, Creguer worked as a bookkeeper, teller and assistant branch manager before being promoted to branch manager in Sandusky in 1999 and branch manager in Deckerville in 2004. She was named assistant vice president in 2007.

During her time with the Bank, Clariece was active in community groups in both the Deckerville and Sandusky markets, as a member of the Sandusky Chamber of Commerce, Deckerville Community Development Corporation and the St. Isadore Parish finance committee. She also served as secretary for the Sandusky Lions Club and treasurer of the Deckerville Hospital Auxiliary.

Cindy Mugridge
Lakeport Branch Manager

Cindy Mugridge retired in June 2019 after 31 years of service to Eastern Michigan Bank. Mugridge began her career with the Bank in 1988 as a teller. She also worked as an assistant branch manager before being promoted to branch manager in Lakeport in 2000.

During her time with the Bank, Cindy also served on the board of St. Edward's on the Lake Catholic School and was a member of the Kiwanis Club of the Blue Water Area.

OFFICER PROMOTIONS AND NEW HIRES

OFFICER PROMOTIONS

Jennifer M. Briolat Lakeport Branch Manager

Jennifer Briolat was promoted to Branch Manager of Eastern Michigan Bank's Lakeport office in January 2019. Briolat joined the Bank's staff in April 2017 as Assistant Branch Manager in Fort Gratiot, bringing with her an extensive background in retail customer service. Jennifer also volunteers her time with the local charity, Taking a Shot at Breast Cancer, and is a member of the Kiwanis Club of the Blue Water Area. She is a Marysville native and currently resides in Lakeport with her family.

Chad W. Deaner Vice President, Senior Lender

Chad Deaner was promoted to Vice President, Senior Lender in September 2019. In his new role, Deaner is responsible for developing and directing all lending activities and supervising the business development functions of all loan officers. Chad has been a member of the Bank's staff since 2016. He holds a Bachelor of Science degree in business administration and management from Ferris State University and is active in his local community, currently serving on both the audit committee for the Community Foundation of St. Clair County and the board of the Economic Development Alliance of St. Clair County. Chad lives in Goodells with his family.

Errin M. Levitt Senior Vice President, Chief Financial Officer

Errin Levitt was promoted to Senior Vice President in September 2019. Levitt joined Eastern Michigan Bank's staff in October 2016 as Vice President, Controller. She holds a Bachelor of Business Administration degree with a major in finance from Grand Valley State University and is currently pursuing her Masters in Accountancy degree. Errin is a native of Croswell where she resides with her family. She also serves on the Croswell Board of Review and Planning and Zoning Committee.

NEW HIRES

Joseph Pink Vice President, Information Technology Manager and Chief Information Security Officer

Joseph Pink joined Eastern Michigan Bank in February 2019 as Vice President, Information Technology Manager and Chief Information Security Officer. Pink comes to Eastern with more than 25 years' experience in the local information technology industry, most recently serving as a senior network engineer for Port Huron-based Precison Computer Solutions, Inc. While employed by Precision, Joe worked as the Bank's system administrator on a contractual basis for 17 years. He holds a Bachelor of Science degree in computer science from Central Michigan University and is certified by both Microsoft and Barracuda as a system engineer. Joe lives in Lexington with his family.

Kim Stencel Assistant Vice President, Lexington Branch Manager

Kim Stencel joined Eastern Michigan Bank in August 2019 as Assistant Vice President, Branch Manager of the Lexington office. Stencel comes to Eastern with more than 40 years' experience in the local banking industry. Most recently, she served as the Branch Manager of Security Credit Union's Croswell location. In addition to her banking background, Kim has also served as the Buel Township treasurer for a number of years. She resides in Croswell with her husband.

BRANCH AND ADMINISTRATIVE STAFF

CROSWELL BRANCH
Skye Bolsby, Assistant Branch Manager
Amber Herzog-Solis, Head Teller
Jillian Nichol, Teller
Talysha VanEenoo, Teller

DECKERVILLE BRANCH
Jennifer Sampier, Assistant Branch Manager
Scott Cameron, Teller, Customer Service Representative
Debra Quick, Vault Teller

FORT GRATIOT BRANCH
Diane Johnson, Assistant Branch Manager
Annemarie Prax-Cornelissen, Head Teller
Michelle Bodeis, Teller
Kayla Rademacher, Teller

LAKEPORT BRANCH
Kathleen Saelens, Assistant Branch Manager
Karen Louks, Head Teller
Leslie Snyder, Teller

LEXINGTON BRANCH
Lisa Hatch, Assistant Branch Manager
Christine Raymo, Head Teller
Katie Krause, Float Head Teller
Suzanne Hedges, Teller
Paula Mullen, Teller
Melanie Schoen, Teller

MARYSVILLE BRANCH
Barry Catherines, Assistant Branch Manager
Nancy Kulman, Head Teller
Terri Herman, Teller

PORT HURON BRANCH
Elizabeth Symon, Assistant Branch Manager
Chelsea Grant, Head Teller
Stephanie Blake, Float Head Teller
Jessica Ciaciuch, Teller
Joanne Lamar, Teller

RUTH BRANCH
Anna-Marie Peresta, Assistant Branch Manager
Tamira Alden, Head Teller
Cheryl Becker, Teller
Nicole Wolschleger, Teller

SANDUSKY BRANCH
Rita Berberich, Assistant Branch Manager
Megan Hartwick, Head Teller
Mindy Fetting, Teller
Roxann Green, Teller

LOAN CENTER (CROSWELL)
Kathleen Breckner, Mortgage Loan Clerk
Rebekah Delmedico, Credit Analyst
Ashley Foster, Commercial Loan Clerk
Mary Heiden, Commercial Loan Clerk
Amanda Mosher, Mortgage Specialist, Underwriter
Nicki Parker, Consumer Loan Documentation, Collections Specialist
Marian Romzek, Loan Processing Manager
Jasmine Williams, Senior Credit Analyst

ADMINISTRATIVE STAFF
Nicole Butler, Deposit Operations Manager
Chelsea DuPree, Human Resources Generalist
Melissa Gelinski, Accountant
Jamie Goline, Deposit Operations Specialist
Darlene Innes, Courier
Ashley Lindke, Deposit Operations Specialist
Dru Moran, Deposit Operations Specialist
Brett Nemeckay, Accounting Clerk
Amanda Rennie, Relationship Banker, Public Funds
Mechel Smith, Deposit Operations Specialist

LETTER TO SHAREHOLDERS

As we reflect on Eastern Michigan Financial Corporation's ("EMFC") strong performance throughout 2019, there are a number of reasons to be pleased:

- EMFC produced the highest full-year net income in its 125-year history: $4.0 million.
- Our tangible book value per share, which is an important measure of financial strength, ended 2019 at $32.16, reflecting an increase of $3.22, or 11%, over 2018.
- Compared to 2018, your company experienced organic loan growth of $4.7 million, or 2.68%, and deposit growth of $14.3 million, or 4.47%.
- We are especially proud of our cost of funds at 25 basis points, one of the lowest cost of funds for any Michigan bank.
- With our loan growth and exposure to agricultural borrowers, credit challenges can be a concern. However, your company recorded a very low level of net charge-offs in 2019: 0.11%.
- We achieved these results despite a flat yield curve and historically challenging rate environment, especially the 75 basis point reduction in the federal funds rate.

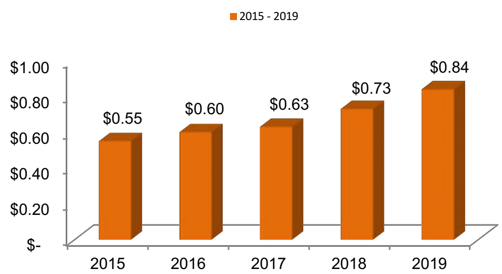
As we celebrate our 125th year of business, we are well-positioned to continue to perform well in 2020 and beyond. Our strong financial performance in 2019 can be largely attributed to the following factors:

First, we set goals with a keen focus on loan production, both as a company and individually. Our entire team understands the importance of loan growth to the sustained strength of our performance as a bank, and we expect to continue as the preferred lender in our markets. We will not, however, compromise our high credit standards. Eastern Michigan Bank ("EMB") has traditionally been known as a conservative lender, a reputation we have earned and will continue to proudly endorse.

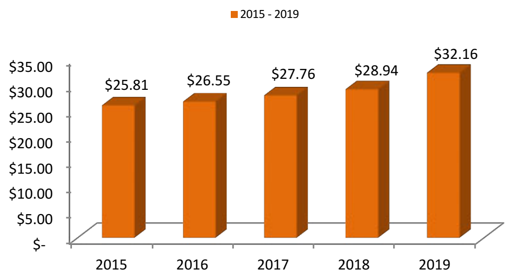
Second, while our loan to deposit ratio would indicate to many that we should not be pursuing deposits, we believe that establishing additional deposit relationships will augment our earnings growth, especially given our low cost of funds.

Third, we continue to enhance our risk management to balance the needs of our customers, the loan growth of the Bank and the regulatory environment we face. As you know, much of our market is heavily based on crop, dairy, and cattle farming, and these customers have faced several challenges in the last several years from poor weather, low prices from supply to trade and higher input costs. We have worked to mitigate risk in this area with strong collateral positions and in many cases, Farm Service Agency guarantees. While undoubtedly some of our customers will experience financial challenges ahead, we will attempt to work with them to find solutions where possible.

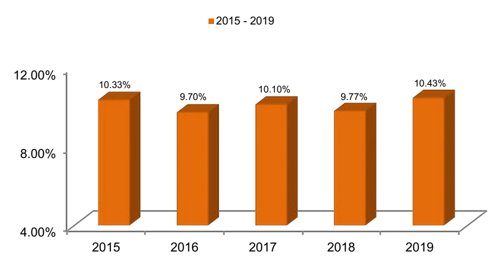
CASH DIVIDENDS PER SHARE



BOOK VALUE PER SHARE



CAPITAL RATIO



LETTER TO SHAREHOLDERS (CON'T)

Eastern Michigan Financial Corporation and Eastern Michigan Bank will experience a number of changes in 2020. As reported at the end of third quarter 2019, Tim Ward has retired as Chief Executive Officer of both EMFC and EMB. Personally, and on behalf of both the Board of Directors and all employees, we would like to thank Tim for his years of service and most importantly, his leadership through the financial crisis of a decade ago. Tim can be proud of the fact he lead the Bank through a financial crisis where several other banks failed and most experienced negative net income. During that crisis, your company experienced positive net income and continued to pay a dividend, albeit reduced to conserve capital. Tim can also be proud of the financial results reflected in this report that both he and the team he developed achieved for our shareholders.

With Tim's retirement, the Board is pleased to have Will Oldford assume the role of CEO of both EMFC and EMB. More importantly, our leadership team going forward will include several very experienced bankers with Errin Levitt as Chief Financial Officer, Chad Deaner as Chief Lending Officer and Stacie Bales as Chief Operating Officer. All members of this team were born and raised in the counties we serve. With the support of our exceptional employees, this leadership will work hard to maintain our commitment to our community, our customers and our shareholders as we celebrate 125 years as a bank.

Let us end by thanking you, our owners. By most accounts, 2019 was an outstanding year for your company. As stated at the beginning of this letter, the platform we have built for 2020 and beyond gives us great cause for optimism. We will continue to work hard to provide sustained growth to improve shareholder value, while managing risks inherent to our business and keeping ethics and our moral obligation as the defining principles of your company.

Sincerely,

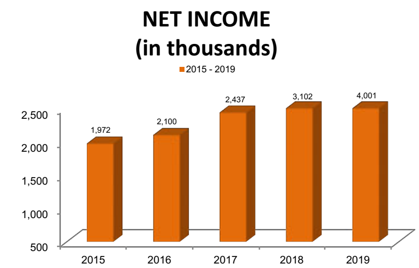
Earl E. DesJardins

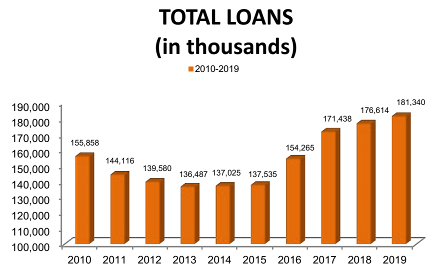
William G. Oldford, Jr.

2019 HIGHLIGHTS AND TEN YEAR FINANCIAL PROFILE

2019 HIGHLIGHTS

FOR THE YEAR (in thousands)	2019	2018	% Change
Net interest income	$ 11,919	$ 10,582	12.6%
Non-interest income	1,765	1,942	-9.1%
Non-interest expense	8,664	8,377	3.4%
Net income	4,001	3,102	29.0%
YEAR END (in thousands)			
Total assets	$ 373,906	$ 355,073	5.3%
Loans, net of unearned interest	181,340	176,614	2.7%
Allowance for loan losses	1,574	1,551	1.5%
Deposits	333,878	319,584	4.5%
Shareholders' equity	38,752	34,477	12.4%
PER SHARE			
Net income	$ 3.33	$ 2.61	29.0%
Book value	32.16	28.94	11.1%
Cash dividends	0.84	0.73	15.1%
Number of shares outstanding	1,204,799	1,191,159	1.1%





TEN YEAR FINANCIAL PROFILE

FOR THE YEAR (in thousands)	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010
Net interest income	$ 11,919	$ 10,582	$ 9,244	$ 9,086	$ 8,306	$ 8,275	$ 8,175	$ 8,500	$ 8,674	$ 8,768
Provision for loan losses	155	363	173	79	(144)	69	283	406	933	1,066
Non-interest income	1,765	1,942	2,095	1,725	1,694	1,530	1,669	1,571	1,278	1,531
Non-interest expense	8,664	8,377	7,637	7,856	7,448	7,291	7,223	7,395	7,132	7,170
Income before income taxes	4,865	3,784	3,529	2,876	2,696	2,445	2,338	2,270	1,887	2,063
Less: income taxes	864	682	1,092	776	724	618	518	497	404	495
Net income	4,001	3,102	2,437	2,100	1,972	1,827	1,820	1,773	1,483	1,568
AT YEAR END (in thousands)										
Total investment securities	$ 103,139	$ 89,065	$ 94,370	$ 106,504	$ 110,344	$ 118,054	$ 113,141	$ 85,452	$ 72,389	$ 64,855
Restricted investments	1,116	1,056	1,056	1,056	980	1,022	916	916	905	952
Federal funds sold	21,128	20,448	176	582	-	-	-	-	-	-
Total loans	181,340	176,614	171,438	154,265	137,535	137,025	136,487	139,580	144,116	155,858
Allowance for loan losses	1,574	1,551	1,330	1,222	1,204	1,688	1,765	2,758	2,796	3,155
Total assets	373,906	355,073	329,426	324,956	293,028	283,251	279,362	270,472	259,757	259,966
Total deposits	333,878	319,584	295,923	293,079	262,124	253,998	252,086	242,897	233,578	234,907
Borrowed funds	-	-	-	-	-	-	-	-	-	-
Shareholders' equity	38,752	34,477	32,649	30,643	29,572	28,394	26,489	26,616	25,103	23,983
PER SHARE										
Net income	$ 3.33	$ 2.61	$ 2.36	$ 1.82	$ 1.73	$ 1.61	$ 1.60	$ 1.57	$ 1.31	$ 1.39
Book value	32.16	28.94	27.76	26.55	25.81	24.97	23.32	23.52	22.24	21.25
Cash dividends	0.84	0.73	0.63	0.60	0.55	0.55	0.55	0.55	0.48	0.48
Number of shares outstanding	1,204,799	1,191,159	1,176,011	1,154,370	1,145,731	1,137,294	1,135,669	1,131,649	1,128,737	1,128,737
Return on average assets	1.08%	0.91%	0.74%	0.67%	0.69%	0.65%	0.67%	0.68%	0.58%	0.61%
Return on average equity	10.97%	9.49%	7.70%	6.90%	6.64%	6.65%	6.83%	6.83%	5.94%	6.48%
Capital ratio	10.43%	9.77%	10.10%	9.70%	10.33%	9.95%	9.75%	9.76%	9.68%	8.98%

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands except per share data)	December 31 2019	December 31 2018
Assets		
Cash and demand deposits due from banks	$ 6,542	$ 7,704
Interest bearing balances due from banks	20,642	37,306
Federal funds sold	21,128	20,448
Cash and cash equivalents	48,312	65,458
Certificates of deposit held in other banks	23,510	6,395
Equity securities	-	798
Debt securities		
Available-for-sale	96,013	79,146
Held-to-maturity	7,126	9,121
Restricted, at cost	1,116	1,056
Net loans	179,766	175,063
Accrued interest receivable	1,336	1,271
Premises and equipment, net	5,456	5,425
Bank-owned life insurance	9,988	9,753
Other assets	1,283	1,587
Total assets	$ 373,906	$ 355,073
Liabilities and Shareholders' Equity		
Deposits		
Noninterest-bearing	$ 79,300	$ 78,221
Interest-bearing	254,578	241,363
Total deposits	333,878	319,584
Accrued interest payable and other liabilities	1,276	1,012
Total liabilities	335,154	320,596
Commitments and contingencies (Notes 12, 14, and 15)		
Shareholders' equity		
Common stock, $5 par value; 3,000,000 shares authorized, 1,204,799 (1,191,159 in 2018) shares issued and outstanding	6,006	5,955
Additional paid-in-capital	2,261	2,214
Retained earnings	30,459	27,497
Deferred compensation	78	2
Accumulated other comprehensive loss	(52)	(1,191)
Total shareholders' equity	38,752	34,477
Total liabilities and shareholders' equity	$ 373,906	$ 355,073

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	
	2019	2018
Interest and dividend income		
Loans (including fees)	$ 8,893	$ 8,398
Securities		
Taxable	2,001	1,441
Nontaxable	337	452
Other	68	104
Federal funds sold and deposits with banks	1,505	665
Total interest and dividend income	12,804	11,060
Interest expense	885	478
Net interest income	11,919	10,582
Provision for loan losses	155	363
Net interest income, after provision for loan losses	11,764	10,219
Noninterest income		
Service charges on deposit accounts	1,086	1,122
Other service charges and fees	258	257
Other	421	563
Total noninterest income	1,765	1,942
Noninterest expenses		
Compensation and benefits	5,128	4,711
Occupancy and equipment	878	854
Other	2,658	2,812
Total noninterest expenses	8,664	8,377
Income before federal income taxes	4,865	3,784
Federal income taxes	864	682
Net income	$ 4,001	$ 3,102
Net income per common share		
Basic	$ 3.33	$ 2.61
Diluted	$ 3.29	$ 2.58

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	
	2019	2018
Other comprehensive income (loss)		
Unrealized holding gains (losses) on available-for-sale securities arising during the year	$ 1,442	$ (647)
Income tax (expense) benefit related to other comprehensive income (loss)	(303)	136
Other comprehensive income (loss)	1,139	(511)
Net income	4,001	3,102
Comprehensive income	$ 5,140	$ 2,591

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	Deferred Compensation	Accumulated Other Comprehensive Loss	Total
	Shares	Amount					
Balances, January 1, 2018	1,176,011	$ 5,880	$ 2,158	$ 25,291	$ -	$ (680)	$ 32,649
Comprehensive income	-	-	-	3,102	-	(511)	2,591
Common stock options recognized	-	-	6	-	-	-	6
Deferred compensation	80	-	-	-	2	-	2
Issuance of restricted stock awards	4,049	21	12	-	-	-	33
Issuance of shares upon exercise of common stock options	12,289	61	38	-	-	-	99
Repurchase of common stock	(1,270)	(7)	-	(27)	-	-	(34)
Cash dividends paid ($0.73 per share)	-	-	-	(869)	-	-	(869)
Balances, December 31, 2018	1,191,159	5,955	2,214	27,497	2	(1,191)	34,477
Comprehensive income	-	-	-	4,001	-	1,139	5,140
Common stock options recognized	-	-	4	-	-	-	4
Deferred compensation	2,912	-	-	-	76	-	76
Issuance of restricted stock awards	3,624	17	33	-	-	-	50
Issuance of shares upon exercise of common stock options	8,404	41	10	-	-	-	51
Repurchase of common stock	(1,300)	(7)	-	(29)	-	-	(36)
Cash dividends paid ($0.84 per share)	-	-	-	(1,010)	-	-	(1,010)
Balances, December 31, 2019	1,204,799	$ 6,006	$ 2,261	$ 30,459	$ 78	$ (52)	$ 38,752

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands except per share data)	Year Ended December 31	
	2019	2018
Cash flows from operating activities		
Net income	$ 4,001	$ 3,102
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	155	363
Depreciation	358	323
Provision for foreclosed assets	-	10
Net amortization of investment securities premiums	315	558
Net unrealized loss on equity security	-	202
Recognized gain on sale of equity security	(22)	-
Loss on available for-sale debt securities	37	-
Share-based compensation	130	41
Net gain on sale of loans	(107)	(116)
Net gain on sale of foreclosed assets	-	(3)
Increase in cash value of bank-owned life insurance	(235)	(230)
Deferred income tax benefit	(27)	(24)
Origination of loans held for sale	(4,099)	(4,013)
Proceeds from loan sales	4,206	4,129
Changes in operating assets and liabilities which (used) provided		
Accrued interest receivable	(65)	11
Other assets	28	88
Accrued interest payable and other liabilities	264	158
Net cash provided by operating activities	4,939	4,599
Cash flows from investing activities		
Net change in certificates of deposit held in other banks	(17,115)	13,605
Activity in held-to-maturity securities		
Maturities, prepayments, and calls	1,927	1,990
Activity in available-for-sale securities		
Purchases	(82,935)	(37,769)
Maturities, prepayments, calls and sales	67,263	39,677
Proceeds from sale of equity security	783	-
Purchase of restricted investments	(60)	-
Loan principal originations, net	(4,858)	(5,486)
Purchases of premises and equipment	(389)	(224)
Proceeds from sale of foreclosed assets	-	252
Net cash (used in) provided by investing activities	(35,384)	12,045
Cash flows from financing activities		
Acceptances and withdrawals of deposits, net	14,294	23,661
Net proceeds from exercise of common stock options	51	99
Repurchase and retirement of common stock	(36)	(34)
Cash dividends paid	(1,010)	(869)
Net cash provided by financing activities	13,299	22,857
Net (decrease) increase in cash and cash equivalents	(17,146)	39,501
Cash and cash equivalents, beginning of year	65,458	25,957
Cash and cash equivalents, end of year	$ 48,312	$ 65,458

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation and Nature of Business

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

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

Concentration Risks

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

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

Use of Estimates

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

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, federal funds sold, and securities purchased under agreements to resell, all of which mature within ninety days. Generally, federal funds are sold for a one-day period. The Company maintains deposit accounts in various financial institutions which generally exceed the FDIC insured limits or are not insured. Management does not believe the Company is exposed to any significant interest, credit or other financial risk as a result of these deposits.

Certificates of Deposit Held in Other Banks

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

Fair Value Measurements

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

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

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

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

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

For a further discussion of Fair Value Measurements, refer to Note 2.

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. Debt securities not classified as held-to-maturity are classified as available-for-sale and are recorded at fair value, with unrealized gains and losses, net of the effect of deferred income taxes, recorded in other comprehensive income (loss). Equity securities are carried at fair value, with changes in fair value reported in net income. Equity securities without readily determinable fair values are carried at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment. 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.

On January 1, 2018, the Company adopted a new accounting principle for Financial Instruments, which requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. The cumulative-effect adjustment to the balance sheet on January 1, 2018 was not considered significant.

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.

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 determined 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. For such loans that are classified as impaired, a specific reserve is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of the loan. 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.

Continued...

(Dollars in thousands except per share data)

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

Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loans obtained market price, or the fair value of the collateral, less costs to sell, if the loan is collateral dependent. A loan is collateral dependent if the repayment is expected to be provided solely by the underlying collateral.

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

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

Loans Held for Sale

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

Transfers of Financial Assets

Transfers of financial assets, including mortgage loans held for sale, are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when 1) the assets have been legally isolated from the Corporation, 2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and 3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Other than servicing, as disclosed in Note 5, the Corporation has no substantive continuing involvement related to these loans. The Corporation sold to an unrelated third party residential mortgage loans with proceeds of $4,206 and $4,129 during 2019 and 2018, respectively, which resulted in a net gain of $107 and $116 for 2019 and 2018, respectively. Servicing fee income earned on such loans was $72 and $74 for 2019 and 2018, 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 in 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, restricted stock awards, and deferred compensation, are measured based on the estimated 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

A past business combination included identified amounts related to the valuation of customer deposit relationships (core deposit intangibles), which are being amortized on the straight line method over ten years, and residual goodwill, which is included in other assets. Such goodwill represents the purchase price in excess of 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.

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.

New Accounting Pronouncement

Accounting Standards Update ("ASU") 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments**,** and all subsequent amendments to the ASU, was issued with the intention of improving financial reporting by requiring timelier recording of credit losses on loans and certain other financial instruments held by financial institutions.

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

The ASU requires enhanced disclosures to assist investors and other financial statement users better understand significant estimates and judgements 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, 2022. Management is currently evaluating the provisions of the standard to determine the potential impact on the Corporation's consolidated financial statements.

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, 2019, the most recent balance sheet presented herein, through February 26, 2020, the date these consolidated financial statements were available to be issued. No such events or transactions were identified.

2. FAIR VALUE MEASUREMENTS

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Equity securities and available-for-sale debt securities 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 debt 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, which includes an indication of the level of the fair value hierarchy in which the assets or liabilities are classified.

Investment Securities

Equity securities and available-for-sale debt securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions.

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

Impaired Loans

The fair value of impaired loans is measured 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.

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.

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(Dollars in thousands except per share data)

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			
2019	**Level 1**	**Level 2**	**Level 3**	**Total**
Debt securities available-for-sale:				
U.S. treasury notes	$ 504	$ -	$ -	$ 504
U.S. government and federal agencies	-	25,358	-	25,358
Corporate bonds	-	15,112	-	15,112
Agency issued mortgage-backed securities	-	34,833	-	34,833
States and municipals	-	16,079	553	16,632
Other asset-backed securities	-	3,574	-	3,574
Total assets at fair value	$ 504	$ 94,956	$ 553	$ 96,013

	Assets at Fair Value			
2018	**Level 1**	**Level 2**	**Level 3**	**Total**
Debt securities available-for-sale:				
U.S. treasury notes	$ 493	$ -	$ -	$ 493
U.S. government and federal agencies	-	19,356	-	19,356
Corporate bonds	-	7,215	-	7,215
Agency issued mortgage-backed securities	-	25,475	-	25,475
States and municipals	-	23,280	606	23,886
Other asset-backed securities	-	2,721	-	2,721
Equity securities	-	798	-	798
Total assets at fair value	$ 493	$ 78,845	$ 606	$ 79,944

The following table sets forth a summary of changes in fair value of the Company's Level 3 assets measured at fair value on a recurring basis:

2019	**Municipal Securities**
Balance of recurring Level 3 assets at January 1, 2019	$ 606
Total gains or losses (realized/unrealized):	
Realized	-
Unrealized	(53)
Balance of recurring Level 3 assets at December 31, 2019	$ 553

Unrealized losses on available-for-sale debt securities, net of deferred taxes, are included in accumulated other comprehensive loss on the consolidated balance sheets.

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			
2019	**Level 1**	**Level 2**	**Level 3**	**Total**
Impaired Loans (1)	$ -	$ -	$ 2,854	$ 2,854

	Assets of Carrying Value			
2018	**Level 1**	**Level 2**	**Level 3**	**Total**
Impaired Loans (1)	`	$ -	$ 1,857	$ 1,857

(1) Certain impaired loans were remeasured and reported at fair value through a specific valuation allowance. Impaired loans of $2,854 and $1,857 as of December 31, 2019 and 2018, respectively, were reduced by a specific valuation allowance totaling $145 and $290 as of those dates.

Quantitative information about Level 3 fair value measurements is as follows as of December 31, 2019:

	Level 3 Instruments			
Instrument	**Fair Value**	**Valuation Technique**	**Unobservable Input**	**Weighted Average and/or Range**
Impaired Loans	$ 2,854	Discounted Appraisal Value	Applied to Collateral Appraisal	1-32%

Quantitative information about Level 3 fair value measurements is as follows as of December 31, 2018:

	Level 3 Instruments			
Instrument	**Fair Value**	**Valuation Technique**	**Unobservable Input**	**Weighted Average and/or Range**
Impaired Loans	$ 1,857	Discounted Appraisal Value	Discount Applied to Collateral Appraisal	2-95%

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:

	2019		2018	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets				
Cash and cash equivalents	$ 48,312	$ 48,312	$ 65,458	$ 65,458
Certificates of deposit held in other banks	23,510	23,721	6,395	6,468
Investment securities held-to-maturity	7,126	7,080	9,121	8,808
Restricted investments	1,116	1,116	1,056	1,056
Net loans	179,766	178,646	175,063	172,982
Mortgage servicing rights	253	266	297	318
Accrued interest receivable	1,336	1,336	1,271	1,271
Liabilities				
Noninterest-bearing deposits	$ 79,300	$ 79,300	$ 78,221	$ 78,221
Interest-bearing deposits	254,578	254,032	241,363	241,512
Accrued interest payable	8	8	9	9

3. INVESTMENT SECURITIES

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

2019	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Held-to-maturity				
Agency issued mortgage-backed securities	$ 5,355	$ 1	$ 53	$ 5,303
States and municipals	1,771	6	-	1,777
Total held-to-maturity	7,126	7	53	7,080
Available-for-sale				
U.S. treasury notes	506	-	2	504
U.S. government and federal agencies	25,304	62	8	25,358
Corporate bonds	15,221	27	136	15,112
Agency issued mortgage-backed securities	34,944	132	243	34,833
States and municipals	16,547	87	2	16,632
Other asset-backed securities	3,558	16	-	3,574
Total available-for-sale	96,080	324	391	96,013
Total securities	$ 103,206	$ 331	$ 444	$ 103,093

2018	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Held-to-maturity				
Agency issued mortgage-backed securities	$ 6,752	$ -	$ 297	$ 6,455
States and municipals	2,369	-	16	2,353
Total held-to-maturity	9,121	-	313	8,808
Available-for-sale				
U.S. treasury notes	509	-	16	493
U.S. government and federal agencies	19,410	-	54	19,356
Corporate bonds	7,441	-	226	7,215
Agency issued mortgage-backed securities	26,497	7	1,029	25,475
States and municipals	24,075	6	195	23,886
Other asset-backed securities	2,723	-	2	2,721
Total available-for-sale	80,655	13	1,522	79,146
Total securities	$ 89,776	$ 13	$ 1,835	$ 87,954

Continued...

(Dollars in thousands except per share data)

Investment securities with carrying values of $4,011 and $3,988 at December 31, 2019 and 2018, 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 and available-for-sale debt securities grouped by contractual maturity at December 31, 2019, 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	$ -	$ -	$ -	$ -	$ 5,355	$ 5,355
States and municipals	1,271	500	-	-	-	1,771
Total held-to-maturity	1,271	500	-	-	5,355	7,126
Available-for-sale						
U.S. treasury notes	-	506	-	-	-	506
U.S. government and federal agencies	8,997	12,033	4,274	-	-	25,304
Corporate bonds	500	11,775	2,946	-	-	15,221
Agency issued mortgage-backed securities	-	-	-	-	34,944	34,944
State and municipals	7,510	6,563	1,223	1,251	-	16,547
Other asset-backed securities	-	-	-	-	3,558	3,558
Total available-for-sale	$ 17,007	$ 30,877	$ 8,443	$ 1,251	$ 38,502	$ 96,080
Total amortized cost	$ 18,278	$ 31,377	$ 8,443	$ 1,251	$ 43,857	$ 103,206
Fair value	$ 18,326	$ 31,451	$ 8,348	$ 1,258	$ 43,710	$ 103,093

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

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

During 2019, proceeds from sales of available-for-sale securities amounted to approximately $3,711 and realized losses amounted to approximately $37. There were no sales of available-for-sale securities during 2018. There were no gross realized gains or losses in 2018.

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			
2019	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Total Gross Unrealized Losses
Securities held-to-maturity						
Agency issued mortgage-backed securities	$ -	$ -	$ 4,755	$ 53	$ 4,755	$ 53
Securities available-for-sale						
U.S. treasury notes	$ -	$ -	$ 504	$ 2	$ 504	$ 2
U.S. government and federal agencies	7,059	6	1,011	2	8,070	8
Corporate bonds	7,959	41	3,853	95	11,812	136
Agency issued mortgage-backed securities	16,889	92	11,260	151	28,149	243
States and municipals	1,083	1	202	1	1,285	2
Total securities available-for-sale	$ 32,990	$ 140	$ 16,830	$ 251	$ 49,820	$ 391

	Less Than 12 Months		Over 12 Months			
2018	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Total Gross Unrealized Losses
Securities held-to-maturity						
Agency issued mortgage-backed securities	$ -	$ -	$ 6,454	$ 297	$ 6,454	$ 297
States and municipals	-	-	2,354	16	2,354	16
Total securities held-to-maturity	$ -	$ -	$ 8,808	$ 313	$ 8,808	$ 313
Securities available-for-sale						
U.S. treasury notes	$ -	$ -	$ 493	$ 16	$ 493	$ 16
U.S. government and federal agencies	12,688	5	6,668	49	19,356	54
Corporate bonds	6,722	220	493	6	7,215	226
Agency issued mortgage-backed securities	-	-	25,305	1,029	25,305	1,029
States and municipals	5,578	21	15,127	174	20,705	195
Other asset-backed securities	2,721	2	-	-	2,721	2
Total securities available-for-sale	$ 27,709	$ 248	$ 48,086	$ 1,274	$ 75,795	$ 1,522

As of December 31, 2019, the Corporation's investment security portfolio consisted of 172 securities, 73 of which were in an unrealized loss position.

As of December 31, 2019 and 2018, management conducted an analysis to determine whether all securities currently in an unrealized loss position 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, 2019 or 2018.

4. 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:

	2019	2018
Commercial and industrial	$ 32,279	$ 31,042
Agricultural	41,658	40,944
Real estate related industries	29,626	30,560
Other commercial	32,128	33,771
Residential real estate	24,052	22,540
Consumer and other	13,993	10,538
Home equity	7,604	7,219
Total loans	181,340	176,614
Allowance for loan losses	1,574	1,551
Loans, net	$ 179,766	$ 175,063

The allowance for loan losses and loans are as follows for the year ended December 31, 2019:

	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	$ 262	$ 426	$ 220	$ 475	$ 77	$ 54	$ 37	$ 1,551
Provision for loan losses	138	155	45	(175)	(3)	(1)	(4)	155
Loans charged off	(147)	(23)	-	(10)	-	(11)	-	(191)
Recoveries of loans previously charged off	13	23	12	-	-	11	-	59
Balance at end of year	$ 266	$ 581	$ 277	$ 290	$ 74	$ 53	$ 33	$ 1,574
Allowance for loan losses attributable to loans								
Individually evaluated for impairment	$ -	$ 65	$ 56	$ 17	$ 1	$ 4	$ 2	$ 145
Collectively evaluated for impairment	266	516	221	273	73	49	31	1,429
Total allowance for loan losses	$ 266	$ 581	$ 277	$ 290	$ 74	$ 53	$ 33	$ 1,574
Loans								
Individually evaluated for impairment	$ 428	$ 3,385	$ 235	$ 278	$ 181	$ 22	$ 58	$ 4,587
Collectively evaluated for impairment	31,851	38,273	29,391	31,850	23,871	13,971	7,546	176,753
Total loans	$ 32,279	$ 41,658	$ 29,626	$ 32,128	$ 24,052	$ 13,993	$ 7,604	$ 181,340

Continued...

(Dollars in thousands except per share data)

The allowance for loan losses and loans are as follows for the year ended December 31, 2018:

	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	$ 196	$ 441	$ 257	$ 251	$ 113	$ 48	$ 24	$ 1,330
Provision for loan losses	130	(25)	(57)	291	(36)	47	13	363
Loans charged off	(121)	-	(153)	(68)	-	(59)	-	(401)
Recoveries of loans previously charged off	57	10	173	1	-	18	-	259
Balance at end of year	$ 262	$ 426	$ 220	$ 475	$ 77	$ 54	$ 37	$ 1,551
Allowance for loan losses attributable to loans								
Individually evaluated for impairment	$ -	$ 35	$ 59	$ 185	$ 4	$ 4	$ 3	$ 290
Collectively evaluated for impairment	262	391	161	290	73	50	34	1,261
Total allowance for loan losses	$ 262	$ 426	$ 220	$ 475	$ 77	$ 54	$ 37	$ 1,551
Loans								
Individually evaluated for impairment	$ 8	$ 1,481	$ 259	$ 1,129	$ 323	$ 28	$ 73	$ 3,301
Collectively evaluated for impairment	31,034	39,463	30,301	32,642	22,217	10,510	7,146	173,313
Total loans	$ 31,042	$ 40,944	$ 30,560	$ 33,771	$ 22,540	$ 10,538	$ 7,219	$ 176,614

The following table shows the loans allocated by management's internal risk ratings at December 31, 2019:

	Commercial Credit Risk Profile by Risk Rating				
	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Total
Risk Rating					
Pass	$ 31,851	$ 29,141	$ 28,335	$ 29,241	$ 118,568
Watch	-	11,377	-	2,604	13,981
Special mention	428	-	1,056	-	1,484
Substandard	-	1,140	235	283	1,658
Total	$ 32,279	$ 41,658	$ 29,626	$ 32,128	$ 135,691

The following table shows the homogeneous loans allocated by payment activity as of December 31, 2019:

	Consumer Credit Risk Profile by Risk Rating			
	Residential Real Estate	Consumer and Other	Home Equity	Total
Payment Activity				
Performing	$ 23,871	$ 13,971	$ 7,599	$ 45,441
Non-Performing	181	22	5	208
Total	$ 24,052	$ 13,993	$ 7,604	$ 45,649

The following table shows the loans allocated by management's internal risk ratings at December 31, 2018:

	Commercial Credit Risk Profile by Risk Rating				
	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Total
Risk Rating					
Pass	$ 31,034	$ 35,527	$ 29,126	$ 29,735	$ 125,422
Watch	8	3,414	-	3,218	6,640
Special mention	-	961	1,175	-	2,136
Substandard	-	1,042	259	818	2,119
Total	$ 31,042	$ 40,944	$ 30,560	$ 33,771	$ 136,317

The following table shows the homogeneous loans allocated by payment activity as of December 31, 2018:

	Consumer Credit Risk Profile by Risk Rating			
	Residential Real Estate	Consumer and Other	Home Equity	Total
Payment Activity				
Performing	$ 22,337	$ 10,510	$ 7,209	$ 40,056
Non-Performing	203	28	10	241
Total	$ 22,540	$ 10,538	$ 7,219	$ 40,297

The following table shows an aging analysis of the loan portfolio by time past due as of December 31, 2019:

	Accruing Interest				
	Current	30 - 89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
Commercial and industrial	$ 31,739	$ 112	$ -	$ 428	$ 32,279
Agricultural	40,118	495	-	1,045	41,658
Real estate related industries	29,605	-	-	21	29,626
Other commercial	32,103	-	-	25	32,128
Residential real estate	23,871	-	-	181	24,052
Consumer and other	13,947	24	-	22	13,993
Home equity	7,577	22	-	5	7,604
Total	$ 178,960	$ 653	$ -	$ 1,727	$ 181,340

The following table shows an aging analysis of the loan portfolio by time past due as of December 31, 2018:

	Accruing Interest				
	Current	30 - 89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
Commercial and industrial	$ 30,063	$ 706	$ -	$ 273	$ 31,042
Agricultural	39,902	-	-	1,042	40,944
Real estate related industries	30,527	-	-	33	30,560
Other commercial	33,735	-	-	36	33,771
Residential real estate	22,258	79	-	203	22,540
Consumer and other	10,451	59	-	28	10,538
Home equity	7,152	57	-	10	7,219
Total	$ 174,088	$ 901	$ -	$ 1,625	$ 176,614

The following table presents information related to impaired loans as of December 31, 2019:

	Recorded Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial and industrial	$ 428	$ 443	$ -	$ 218	$ -
Agricultural	1,057	1,602	-	1,099	5
Real estate related industries	21	613	-	27	-
Other commercial	25	80	-	59	-
Residential real estate	176	436	-	161	-
Consumer and other	10	19	-	11	-
Home equity	16	47	-	21	1
Loans with an allowance recorded					
Commercial and industrial	-	-	-	-	-
Agricultural	2,328	2,328	65	1,334	128
Real estate related industries	214	214	56	220	13
Other commercial	252	252	17	644	14
Residential real estate	5	5	1	91	-
Consumer and other	13	13	4	14	-
Home equity	42	42	2	45	2
Total impaired loans					
Commercial and industrial	$ 428	$ 443	$ -	$ 218	$ -
Agricultural	3,385	3,930	65	2,433	133
Real estate related industries	235	827	56	247	13
Other commercial	278	332	17	703	14
Residential real estate	181	441	1	252	-
Consumer and other	22	32	4	25	-
Home equity	58	89	2	66	3
Total	$ 4,587	$ 6,094	$ 145	$ 3,944	$ 163

Continued...

(Dollars in thousands except per share data)

The following table presents information related to impaired loans as of December 31, 2018:

	Recorded Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial and industrial	$ 8	$ 8	$ -	$ 4	$ -
Agricultural	1,140	1,424	-	961	27
Real estate related industries	33	621	-	59	-
Other commercial	93	180	-	102	-
Residential real estate	146	351	-	150	-
Consumer and other	13	22	-	15	-
Home equity	26	55	-	21	1
Loans with an allowance recorded					
Commercial and industrial	-	-	-	386	-
Agricultural	341	565	35	439	12
Real estate related industries	226	226	59	307	3
Other commercial	1,036	1,036	185	642	70
Residential real estate	177	177	4	151	-
Consumer and other	15	15	4	8	1
Home equity	47	47	3	62	2
Total impaired loans					
Commercial and industrial	$ 8	$ 8	$ -	$ 390	$ -
Agricultural	1,481	1,989	35	1,400	39
Real estate related industries	259	847	59	366	3
Other commercial	1,129	1,216	185	744	70
Residential real estate	323	528	4	301	-
Consumer and other	28	37	4	23	1
Home equity	73	102	3	83	3
Total	$ 3,301	$ 4,727	$ 290	$ 3,307	$ 116

A summary of loans that were modified in troubled debt restructurings during 2019 is as follows:

	Troubled Debt Restructurings		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Agricultural	6	$ 2,373	$ 2,229

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 2019:

	Total Modifications				
	Principal Deferrals		Interest Rate Reductions		
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	Total Modifications
Agricultural	6	$ 2,373	-	$ -	$ 2,373

A summary of loans that were modified in troubled debt restructurings during 2018 is as follows:

	Troubled Debt Restructurings		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Agricultural	1	$ 304	$ 300
Real estate related industries	2	382	226
	3	**$ 686**	**$ 526**

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 2018:

	Total Modifications				
	Principal Deferrals		Interest Rate Reductions		
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	Total Modifications
Agricultural	1	$ 304	-	$ -	$ 304
Real estate related industries	1	153	1	229	382
	2	$ 457	1	$ 229	$ 686

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, 2019 and 2018, that had been modified during the 12-month period prior to default.

5. SERVICING

The Bank services loans for others which generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and taxing authorities, and processing foreclosures. Loans serviced as of December 31, 2019 and 2018, were $28,790 and $29,259, respectively; such loans are not included on the consolidated balance sheets.

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

	2019	2018
Mortgage servicing rights		
Balance at beginning of year	$ 297	$ 276
Mortgage servicing rights capitalized	55	53
Mortgage servicing rights amortized	(99)	(32)
Balance at end of year	$ 253	$ 297

6. FORECLOSED ASSETS

Real estate owned activity was as follows for the year ended December 31, 2018:

Beginning balance	$ 91
Loans reclassified to real estate owned	168
Direct write-downs	(10)
Sales of real estate owned	(249)
End of year	$ -

There was no real estate owned activity during 2019.

At December 31, 2019 and 2018, there were no 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, 2019 or 2018.

Activity in the valuation allowance was as follows for the year ended December 31, 2018:

Beginning balance	$ -
Reductions from sales of real estate owned	(10)
Direct write-downs	10
End of year	$ -

There was no activity during 2019.

(Income) expenses related to foreclosed assets during 2018 include:

Net gain on sales	$ (3)
Provision for unrealized losses	10
Operating expenses, net of rental income	(1)
Net expenses	$ 6

There was no activity during 2019.

7. PREMISES AND EQUIPMENT

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

	2019	2018
Bank premises and land	$ 8,715	$ 8,624
Furniture and equipment	4,542	4,359
Total	13,257	12,983
Less accumulated depreciation	7,801	7,558
Premises and equipment, net	$ 5,456	$ 5,425

Depreciation expense was $358 and $323 for 2019 and 2018, respectively.

8. DEPOSITS

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

	2019	2018
Interest-bearing		
NOW accounts	$ 106,003	$ 91,834
Savings	66,844	67,076
Money market demand	50,364	47,984
Time, $250,000 and over	2,182	1,927
Other time	29,185	32,542
Total interest-bearing	254,578	241,363
Noninterest-bearing demand	79,300	78,221
Total deposits	$ 333,878	$ 319,584

Scheduled maturities of time deposits for each of the five years succeeding December 31, 2019 and thereafter, are summarized as follows:

Year	Amount
2020	$ 18,827
2021	6,461
2022	1,944
2023	1,694
2014	2,437
After	4
Total	$ 31,367

Continued...

(Dollars in thousands except per share data)

9. FEDERAL INCOME TAXES

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

	2019	2018
Currently payable	$ 891	$ 706
Deferred benefit	(27)	(24)
Income taxes	$ 864	$ 682

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

	2019	2018
Income tax provision at statutory rate	$ 1,022	$ 795
Effect of tax-exempt interest income	(108)	(118)
Other, net	(50)	5
Income taxes	$ 864	$ 682

The components of the net deferred income tax asset included within other assets in the accompanying consolidated balance sheets (measured at a 21% tax rate) 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:

	2019	2018
Deferred tax assets		
Allowance for loan losses	$ 199	$ 194
Unrealized loss on available-for-sale securities	14	317
Nonaccrual loan interest	14	12
Deferred loan fees/costs	12	25
Market adjustment on equity securities	38	-
Other	60	51
Total deferred tax assets	337	599
Deferred tax liabilities		
Depreciation	137	99
Mortgage servicing rights	53	63
Other	26	40
Total deferred tax liabilities	216	202
Net deferred tax asset	$ 121	$ 397

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 2016 through 2019, the years which remain subject to examination by major tax jurisdictions as of December 31, 2019. 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, 2019 or 2018 and it is not aware of any claims for such amounts by federal or state income tax authorities.

10. RELATED PARTY TRANSACTIONS

Loans

In the ordinary course of business, the Bank grants loans to certain directors, executive officers and their affiliates. Such loans aggregated to $3,014 and $1,489 at December 31, 2019 and 2018, respectively.

Deposits

Deposits of Corporate directors, executive officers and their affiliates were $690 and $1,219 at December 31, 2019 and 2018, respectively.

11. OFF-BALANCE SHEET ACTIVITIES

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

At December 31, 2019 and 2018, the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount	
	2019	2018
Unfunded commitments under lines of credit	$ 44,939	$ 40,478
Commitments to grant loans	4,607	3,056
Commercial and standby letters of credit	759	590

Unfunded commitments under commercial lines of credit, revolving home equity lines of credit and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. The commitments for equity lines of credit may expire without being drawn upon. These lines of credit are uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed. A majority of such commitments are at fixed rates of interest; a portion is unsecured.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments, if deemed necessary. Guarantees that are not derivative contracts have been recorded on the Corporation's consolidated balance sheets at their fair value at inception. The Bank considers standby letters of credit to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is not significant, a liability related to such guarantees is not recorded at December 31, 2019 or 2018.

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

Common Stock Repurchases

During 2019 and 2018, the Corporation repurchased 1,300 and 1,270 shares of its common stock (see Note 16). The repurchase price in excess of the amounts identified with the original issuance of the common stock was charged entirely to retained earnings.

Share-Based Compensation

Common Stock Options

The fair value of each option award 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, 2019:

Risk-free interest rate	1.88%
Expected term	10 years
Expected stock price volatility	26.30%
Dividend yield or expected	2.77%

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. For the years ended December 31, 2019 and 2018, the Corporation recognized $4 and $6 in compensation expense for stock options. As of December 31, 2019, unrecognized compensation costs related to nonvested awards amounted to $12 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, 2018	124,042	$ 17.05	5.46
Granted	34,234	22.92	
Exercised	(23,008)	15.36	
Forfeited	(12,330)	18.05	
Outstanding at December 31, 2018	122,938	$ 18.90	5.29
Granted	39,346	24.76	
Exercised	(25,122)	18.98	
Forfeited	(10,947)	16.96	
Outstanding at December 31, 2019	126,215	$ 20.88	5.00

The fair value of options granted during 2019 and 2018 was $5.

As of December 31, 2019, 126,215 options under the 2012 plan were outstanding at an average exercise price of $20.88 (range of $12.75 - $27.75) of which 64,593 are exercisable.

Shares granted in 2019 and 2018, include 16,726 and 10,719 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 estimated fair 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.

(Dollars in thousands except per share data)

Restricted Stock Awards

The Plan also authorizes the use of restricted stock awards, which were granted in 2019 and 2018. 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 ceases. Restricted stock activity during 2019 and 2018, is summarized as follows:

	Number of Shares	Weighted-Average Grant - Date Fair Value per Share
Non-vested, January 1, 2018	4,876	$ 21.30
Granted	4,700	22.55
Vested	(934)	21.30
Cancelled and forfeited	(516)	21.79
Non-vested, December 31, 2018	8,126	21.99
Granted	4,524	24.25
Vested	(1,733)	21.93
Cancelled and forfeited	(605)	22.55
Non-vested, December 31, 2019	10,312	$ 22.96

Awards are being amortized to expense over the 5-year vesting period. Compensation cost related to restricted stock awards was $50 and $33 for 2019 and 2018, respectively. As of December 31, 2019, there was $187 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 $.04 and $.03 to diluted earnings per share resulting from such common stock equivalents in 2019 and 2018, respectively.

13. REGULATORY REQUIREMENTS

Capital Requirements

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

Failure to meet capital requirements can initiate regulatory action. The final rules related to the implementation of the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III Rules) became effective for the Corporation on January 1, 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, 2019 and 2018 is 2.5% and 1.875%, 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, 2019 and 2018, that the Corporation and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2019 and 2018, 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, 2019 and 2018 are also presented in the table.

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
December 31, 2019	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total Capital to Risk Weighted Assets						
Consolidated	$ 40,378	18.82 %	$ 22,532	10.50 %	N/A	N/A
Bank	39,394	18.36	22,532	10.50	$ 21,459	10.00 %
Tier 1 (Core) Capital To Risk Weighted Assets						
Consolidated	38,804	18.08	18,240	8.50	N/A	N/A
Bank	37,821	17.62	18,420	8.50	17,167	8.00
Common Tier 1 (CET1)						
Consolidated	38,804	18.08	15,021	7.00	N/A	N/A
Bank	37,821	17.62	15,021	7.00	13,948	6.50
Tier 1 (Core) Capital To Average Assets						
Consolidated	38,804	10.43	14,876	4.00	N/A	N/A
Bank	37,821	10.18	14,876	4.00	18,572	5.00

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
December 31, 2018	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total Capital to Risk Weighted Assets						
Consolidated	$ 37,219	18.59 %	$ 19,775	9.875 %	N/A	N/A
Bank	36,233	18.09	19,775	9.875	$ 20,025	10.00 %
Tier 1 (Core) Capital To Risk Weighted Assets						
Consolidated	35,668	17.81	15,770	7.875	N/A	N/A
Bank	34,681	17.32	15,770	7.875	16,020	8.00
Common Tier 1 (CET1)						
Consolidated	35,668	17.81	12,766	6.375	N/A	N/A
Bank	34,681	17.32	12,766	6.375	13,016	6.50
Tier 1 (Core) Capital To Average Assets						
Consolidated	35,668	9.77	13,448	4.00	N/A	N/A
Bank	34,681	9.78	13,448	4.00	16,810	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, 2019 or 2018.

Restrictions on Dividends, Loans and Advances

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

14. CONTINGENCIES

Litigation

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

Environmental Issues

As a result of acquiring real estate from foreclosure proceedings, the Corporation is subject to potential claims and possible legal proceedings involving environmental matters. No such claims have been asserted as of December 31, 2019.

15. OTHER EMPLOYEE BENEFIT PLANS

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 $81 and $76 in 2019 and 2018, 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 $268 and $219 in 2019 and 2018, respectively.

Continued...

(Dollars in thousands except per share data)

Deferred Compensation Plan

In 2018, the Corporation adopted a deferred compensation plan. Pursuant to the terms of the Deferred Compensation Plan, Bank Officers are permitted to defer all or a portion of any annual bonus and receive shares of the Corporation equal to the stock value based on the closing price on the day the bonus is issued. In addition, the participant's account will be credited with additional shares representing 25% bonus shares based on the number of shares credited from the deferral. Board members may also elect to defer any or all of their board fees and receive the same 25% bonus shares, subject to a 3-year vesting. The bonus shares for both deferred annual bonus amounts and deferred directors fees vest after three years of service, death, disability, or upon mandatory retirement from the board. The Deferred Compensation Plan does not allow for cash settlement.

The amounts deferred under the arrangements and invested in Corporation common stock are maintained in a grantor ("rabbi") trust. Assets of the rabbi trust are consolidated with the Corporation, and the value of the Corporation's common shares held in the rabbi trust is classified in shareholders' equity. The Corporation recognizes the original amount of deferred compensation as the basis for recognition in the rabbi trust. Changes in the fair value owed to employees are not recognized as the Deferred Compensation Plan does not permit diversification and must be settled only by the delivery of a fixed number of shares of the Corporation's common stock.

The Corporation recognized $76 and $2 of compensation expense related to this plan in 2019 and 2018, respectively, and has recorded a related obligation totaling $78 within shareholders' equity at December 31, 2019. As of December 31, 2019, a total of 2,992 shares are held in the rabbi trust of which 394 remain unvested. The weighted average share price of shares held in the rabbi trust at December 31, 2019, is $26.92.

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 $235 and $230 in 2019 and 2018, respectively, is included in noninterest income in the 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.

16. 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:

	2019	2018
Interest	$ 885	$ 479
Income taxes	$ 816	$ 714

Non-Cash Investing Activities

Collateral repossessed on real estate loans having carrying values in the amount of $168 on the date of transfer was reclassified to foreclosed assets in 2018. No such transactions occurred in 2019.

Non-Cash Financing Activities

During 2019 and 2018, options for the purchase of 2,983 and 6,176, respectively, common shares were exercised.

Additionally, during 2019 and 2018, 22,147 and 16,832 common shares were exercised through a reload option whereby 16,726 and 10,719 common shares were tendered to pay the exercise price ("cashless exercise"). The issuance of shares upon exercise of common stock options has been recorded net of the tendered shares in the statements of shareholders' equity.

17. REVENUE FROM CONTRACTS WITH CUSTOMERS

The Corporation's primary revenue stream accounted for under ASC 606 relates to service charges on deposit accounts.

The Corporation earns fees from its deposit customers for transaction-based fees, account maintenance, and overdraft services. Transaction-based fees, including these for services such as ATM fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Corporation fulfills the customer's request. Account maintenance fees, which primarily relate to monthly account maintenance, are earned over the course of the month, which represents the period over which the Corporation satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are deducted from the customer's account balance.

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End of Notes

Continued...

AUDITORS' REPORT

Rehmann

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INDEPENDENT AUDITORS' REPORT

February 26, 2020

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, 2019 and 2018, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Independent Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of ***Eastern Michigan Financial Corporation*** as of December 31, 2019 and 2018, 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

MILESTONES

Eastern Michigan Bank is proud to honor our staff members that celebrated milestone anniversaries with us throughout 2019. They are a valuable part of our team and banking family, and their commitment and contributions are greatly appreciated.

40 YEAR AWARD

Kathi Jahn
Assistant Vice President,
Branch Manager,
Ruth

30 YEAR AWARD

Roxann Green
Teller, Sandusky

20 YEAR AWARD

Mindy Fetting
Teller, Sandusky

Nancy Kulman
Head Teller, Marysville

L. Michael O'Vell
Vice President,
Consumer Loan Manager
and Security Officer

Debbie Quick
Vault Teller, Deckerville

15 YEAR AWARD

Mechel Smith
Deposit Operations Specialist,
Administrative Offices

5 YEAR AWARD

Stephanie Blake
Float Head Teller, Port Huron

Sue Hedges
Teller, Lexington

Paula Mullen
Teller, Lexington

Jasmine Williams
Senior Credit Analyst,
Loan Center

2019 ANNUAL REPORT

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