DART FINANCIAL CORPORATION

MASON • HOLT/S. LANSING • GRAND LEDGE

DART FINANCIAL CORPORATION

INDEPENDENT AUDITORS' REPORT

2012

Rehmann

Rehmann Robson
675 Robinson Rd.
Jackson, MI 49203
Ph: 517.787.6503
Fx: 517.788.8111
www.rehmann.com

INDEPENDENT AUDITORS' REPORT

February 15, 2013

Shareholders and Board of Directors
Dart Financial Corporation
Mason, Michigan

We have audited the accompanying consolidated financial statements of ***Dart Financial Corporation*** (the "Corporation"), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, 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 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 ***Dart Financial Corporation*** as of December 31, 2012 and 2011, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

DART FINANCIAL CORPORATION

CONSOLIDATED BALANCE SHEETS

ASSETS	December 31, 2012	December 31, 2011
Cash and due from banks	$ 19,599,228	$ 12,714,501
Federal funds sold	8,902,407	8,569,024
Cash and cash equivalents	**28,501,635**	**21,283,525**
Interest-bearing deposits	3,937,053	1,531,535
Investment securities:		
Available-for-sale, at estimated fair value	84,980,261	74,763,068
Held-to-maturity, at amortized cost	683,521	793,346
Federal Home Loan Bank stock, at cost	1,355,000	1,355,000
Net loans	144,056,999	157,478,236
Premises and equipment, net	4,239,776	4,463,946
Accrued interest receivable	1,085,850	1,233,982
Foreclosed and repossessed assets	775,304	968,638
Bank-owned life insurance	6,317,804	5,885,609
Prepaid FDIC insurance premium	348,490	693,095
Other assets	2,606,092	2,788,495
Total assets	**$ 278,887,785**	**$ 273,238,475**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Interest-bearing	$ 168,369,764	$ 173,508,754
Noninterest-bearing	54,934,016	46,322,657
Total deposits	**223,303,780**	**219,831,411**
FHLB advances	25,100,000	24,100,000
Accrued interest payable	198,251	265,908
Deferred compensation	175,820	197,268
Other liabilities	1,022,714	1,270,251
Total liabilities	**249,800,565**	**245,664,838**
Commitments and contingencies (Notes 12, 13, 14, and 15)		
Shareholders' equity		
Common stock, no par; 1,000,000 shares authorized, 600,000 shares issued and outstanding	17,000,000	17,000,000
Retained earnings	10,287,682	8,901,475
Accumulated other comprehensive income	1,799,538	1,672,162
Total shareholders' equity	**29,087,220**	**27,573,637**
Total liabilities and shareholders' equity	**$ 278,887,785**	**$ 273,238,475**

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

DART FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31,	
	2012	**2011**
Interest income		
Loans, including fees	$ 9,199,273	$ 10,260,476
Investment securities	2,411,318	2,609,253
Federal funds sold and other	46,753	57,436
Total interest income	**11,657,344**	**12,927,165**
Interest expense		
Interest expense on deposits	1,768,698	2,287,692
Interest expense on FHLB advances and other	600,580	719,190
Total interest expense	**2,369,278**	**3,006,882**
Net interest income	**9,288,066**	**9,920,283**
Provision for loan losses	1,116,138	1,019,314
Net interest income, after provision for loan losses	**8,171,928**	**8,900,969**
Noninterest income	**2,124,858**	**1,760,403**
Noninterest expenses		
Compensation and benefits	4,233,348	4,240,379
Occupancy and equipment	1,214,261	1,168,936
Office supplies	117,542	110,353
Charitable contributions	94,353	71,953
Other	2,756,075	2,299,425
Total noninterest expenses	**8,415,579**	**7,891,046**
Income before federal income taxes	**1,881,207**	**2,770,326**
Federal income taxes	195,000	477,000
Net income	**$ 1,686,207**	**$ 2,293,326**
Net income per basic share of common stock	**$ 2.81**	**$ 3.82**

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

DART FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year Ended December 31,	
	2012	2011
Unrealized holding gains on available-for-sale securities arising during the year	$ 415,876	$ 2,261,309
Reclassification adjustment for realized gains included in net income	(222,880)	-
Other comprehensive income before related defered federal income taxes	192,996	2,261,309
Deferred federal income taxes	(65,620)	(768,848)
Other comprehensive income	127,376	1,492,461
Net income	1,686,207	2,293,326
Comprehensive income	**$ 1,813,583**	**$ 3,785,787**

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

DART FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balances, January 1, 2011	**$ 17,000,000**	**$ 6,608,149**	**$ 179,701**	**$ 23,787,850**
Comprehensive income	-	2,293,326	1,492,461	3,785,787
Balances, December 31, 2011	**17,000,000**	**8,901,475**	**1,672,162**	**27,573,637**
Comprehensive income	-	1,686,207	127,376	1,813,583
Cash dividends paid ($0.50 per share)	-	(300,000)	-	(300,000)
Balances, December 31, 2012	**$ 17,000,000**	**$ 10,287,682**	**$ 1,799,538**	**$ 29,087,220**

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

DART FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,	
	2012	2011
Cash flows from operating activities		
Net income	$ 1,686,207	$ 2,293,326
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	469,264	466,962
Provision for loan losses	1,116,138	1,019,314
Increase in cash surrender value of BOLI	(172,195)	(204,425)
Deferred federal income tax expense	187,000	80,000
Net amortization of premiums on investment securities	615,885	286,256
Gain on sales of investments	(222,880)	-
Gain on sales of loans	(194,865)	(114,990)
Origination of held-for-sale loans	(10,498,531)	(7,634,361)
Proceeds from sales of held-for-sale loans	10,693,456	7,778,485
Gain on disposals of premises and equipment	(111,511)	-
Impairment loss on premises and equipment	250,000	-
Loss on sale of foreclosed assets	196,078	167,947
Changes in operating assets and liabilities which provided (used) cash		
Accrued interest receivable and other assets	133,677	(722,473)
Prepaid FDIC insurance premium	344,605	445,355
Accrued interest payable and other liabilities	(523,642)	761,910
Net cash provided by operating activities	**3,968,686**	**4,623,306**
Cash flows from investing activities		
Activity in available-for-sale securities		
Purchases	(55,934,851)	(33,225,658)
Sales, maturities, calls, and prepayments	45,529,211	22,087,579
Maturities, calls, and prepayments of held-to-maturity securities	98,260	99,746
Net change in interest-bearing deposits	(2,405,518)	896,498
Loan principal collections, net	10,604,805	5,123,898
Purchases and construction of premises and equipment	(672,597)	(183,064)
Proceeds from sale of premises and equipment	420,255	-
Proceeds from sales of foreclosed assets	1,697,490	2,179,185
Purchase of bank-owned life insurance	(260,000)	-
Proceeds from redemption of FHLB stock	-	77,400
Net cash used in investing activities	**(922,945)**	**(2,944,416)**
Cash flows from financing activities		
Acceptances and withdrawals of deposits, net	3,472,369	6,677,625
Proceeds from FHLB advances	10,000,000	10,000,000
Repayments of FHLB advances	(9,000,000)	(8,000,000)
Dividends paid	(300,000)	-
Net cash provided by financing activities	**4,172,369**	**8,677,625**
Net increase in cash and cash equivalents	**7,218,110**	**10,356,515**
Cash and cash equivalents, beginning of year	21,283,525	10,927,010
Cash and cash equivalents, end of year	**$ 28,501,635**	**$ 21,283,525**

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation and Nature of Business

The accompanying consolidated financial statements include the accounts of Dart Financial Corporation, a registered bank holding company (the “Corporation”), and its wholly-owned subsidiary The Dart Bank (the “Bank”) and the Bank’s subsidiary TDB Services, Inc. d/b/a The Dart Mortgage Company for branding purposes. TDB Services, Inc. is owned 100% by the Bank and no longer has any assets or operations. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Bank is an independently-owned community bank engaged in the business of retail and commercial banking services through its three full-service offices located in Mason, Holt, and Grand Ledge, 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, agricultural, or higher education industries or state government which comprise a significant portion of the local economic environment.

Concentrations of Risk

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 and commercial and consumer loans. While the Bank does not have significant business concentrations with or in any one customer or depositor, the Bank has a concentration of loans whereby loans outstanding at December 31, 2012 to religious organizations comprised 25% of the Bank’s shareholders’ equity, and a substantial portion of commercial loans are collateralized by real estate.

The Bank is a state chartered bank and is a member of the Federal Deposit Insurance Corporation (“FDIC”) Bank Insurance Fund. The Bank is subject to the regulations and supervision of the FDIC and state regulators and undergoes periodic examinations by these regulatory authorities (see Note 14). The Corporation is further subject to regulations of the Federal Reserve Board governing bank holding companies.

Use of Estimates

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

Summary of Significant Accounting Policies

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

Cash and Cash Equivalents

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

Interest-Bearing Deposits in Banks
Interest-bearing deposits in banks represent certificates of deposit that mature within 5 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 on prioritizing information within a fair value hierarchy that gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable data, such as the reporting entity's own data (Level 3).

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

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

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

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

For a further discussion of fair value measurements, refer to Note 2 to the consolidated financial statements.

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

Investment securities are reviewed at each reporting period for possible other-than-temporary impairment (“OTTI”). In determining whether an other-than-temporary impairment exists for debt securities, management must assert that: 1) it does not have the intent to sell the security, and 2) it is more likely than not that the Bank will not have to sell the security before recovery of its cost basis. If these conditions are not met, the Bank 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 Bank 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 (loss). 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 balance of the Bank's outstanding home mortgage loans or advances from the Federal Home Loan Bank and is carried at cost plus the value assigned to stock dividends.

Loans

Loans that the Bank 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. Personal loans are typically charged off no later than 120 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 or cost-recovery method, 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 comprise 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 for loan losses is evaluated on a regular basis by management and is based upon management's periodic assessment of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

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

The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan’s effective interest rate or the fair value of the collateral, less costs to sell, if the loan is collateral dependent. A loan is collateral dependent if its repayment is expected to be provided solely by the underlying collateral.

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

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

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

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

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

Special Mention: Loans classified as special mention have a potential weakness that deserves management's close attention, but does not warrant substandard classification. 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 portfolio comprises secured loans that are evaluated at origination on a centralized basis against standardized underwriting criteria. The ongoing measurement of credit quality of the consumer and residential loan portfolios is largely done on an exception basis. If payments are made on schedule, as agreed, then no further monitoring is performed. However, if delinquency occurs, the delinquent loans are turned over to the Bank's special assets department for resolution, which generally occurs fairly rapidly and often through repossession and foreclosure. Credit quality for the entire consumer and residential loan portfolio is measured by the periodic delinquency rate, nonaccrual amounts, and actual losses incurred.

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

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

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

Agricultural: Agricultural loans other than real estate generally possess a lower inherent risk of loss as compared to commercial loans. Most of these loans are secured by agricultural equipment and some are secured by a UCC filing against crops and other agricultural products. Furthermore, the Bank attempts to mitigate this risk by obtaining an interest in crop insurance, dairy assignments, etc. The risk associated with agricultural loans depends on current market prices, weather conditions and other outside factors that are distinct to this segment.

Agricultural Real Estate: Agricultural real estate loans generally possess a lower inherent risk of loss than other commercial real estate loans. There is generally a stable market for the lease and purchase of agricultural land.

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.

Home Equity Lines-of-Credit: Home equity lines-of-credit possess a higher inherent risk than other types of loans secured by real estate, particularly in this depressed housing market, due to the Bank holding a second lien position, likely with the first lien position held by another financial institution. In the event of default, the Bank is faced with the decision of foreclosing, which would require the payoff of the first lien holder, or charging off the loan balance. Additionally, there is no requirement for the pay down of the principal balance during the draw period of five years or greater.

Home Equity Term Loans: Home equity term loans possess a higher inherent risk than other types of loans secured by real estate; however, they are slightly less risky than home equity lines-of-credit since monthly payments are applied to the principal balance.

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

Although management believes the allowance to be appropriate, ultimate losses may vary from its estimates. At least quarterly, the Bank’s Board of Directors reviews the appropriateness of the allowance, including consideration of the relevant risks in the portfolio, current economic conditions, and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bank’s primary regulators may periodically 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.

Off-Balance-Sheet Credit-Related Financial Instruments
In the ordinary course of business, the Bank enters into commitments to extend credit, including commitments under 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, these commitments are generally recorded only when they are funded.

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 determined to be surrendered when 1) the assets have been legally isolated from the Bank, 2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and 3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. Other than servicing, as disclosed in Note 5, the Bank has no substantive continuing involvement related to these loans. The Bank sold to an unrelated third party residential mortgage loans with proceeds of $10,693,456 and $7,778,485 in 2012 and 2011, respectively, which resulted in a net gain of $194,865 and $114,990 for 2012 and 2011, respectively. Servicing fee income earned on such loans was $103,845 and $84,927 for 2012 and 2011, respectively, and is included in other noninterest income.

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

Servicing assets 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 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. Capitalized servicing rights are reported in other assets on the consolidated balance sheets.

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

Foreclosed and Repossessed Assets
Assets acquired through, or in lieu of, loan foreclosure or repossession are held for sale and are initially recorded at estimated fair value, less costs to sell, at the date of transfer, establishing a new cost basis. Subsequent to foreclosure or repossession, valuations are periodically performed by management and the assets are carried at the lower of the carrying amount or estimated fair value less costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets (within other noninterest expenses).

Premises and Equipment

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

FDIC Insurance Premium

The Bank was required to prepay quarterly FDIC risk-based assessments for the fourth quarter of 2009 and each of the quarters in the years ending December 31, 2010, 2011, 2012, and 2013. The assessments for subsequent years have been deferred on the accompanying consolidated balance sheets as a prepaid asset, and expensed on a ratable basis quarterly through December 31, 2013.

Bank-Owned Life Insurance

The Bank holds life insurance policies purchased on the lives of key members of management, including certain retired executives. 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 noninterest income (see Notes 9 and 16).

Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the federal income tax effects of the temporary differences between the book and tax bases of various 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 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

Net income per basic share of common stock represents income available to common shareholders divided by the weighted-average number of common shares outstanding, which was 600,000 shares during each year.

Reclassification

Certain amounts as reported in the 2011 consolidated financial statements have been reclassified to conform with the 2012 presentation.

Subsequent Events

In preparing these consolidated financial statements, the Bank has evaluated, for potential recognition or disclosure, significant events or transactions that occurred during the period subsequent to December 31, 2012, the most recent consolidated balance sheet presented herein, through February 15, 2013, the date the accompanying consolidated financial statements were available to be issued. No significant such events or transactions were identified.

2. FAIR VALUE MEASUREMENTS

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Investments in available-for-sale 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 held-to-maturity securities, loans held for sale, investments in foreclosed assets, mortgage servicing rights, and certain other assets and liabilities. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write-downs of individual assets.

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

Cash and Cash Equivalents
The carrying amounts of cash and short-term instruments, including Federal funds sold, approximate fair values.

Interest-Bearing Deposits in Banks
The carrying amounts of interest-bearing deposits maturing within ninety days approximate their fair values. Fair values of other interest-bearing deposits are estimated using discounted cash flow analysis based on current rates for similar types of deposits.

Investment Securities
Held-to-maturity securities are recorded at fair value on a nonrecurring basis, only when an other-than-temporary impairment is recorded. Investment securities classified as available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss and liquidity assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, 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, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions. Level 2 securities include U.S. Treasury securities, mortgage-backed securities issued by government-sponsored entities, municipal bonds, corporate debt securities, and money market preferreds in active markets.

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

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

The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with accounting standards for subsequent measurement of receivables. The fair value of impaired loans is estimated using one of several methods, including collateral value, fair value of similar debt, enterprise value, liquidation value, and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2012, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation classifies 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 classifies the impaired loan as nonrecurring Level 3.

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

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

Mortgage Servicing Rights
Mortgage servicing rights are subject to impairment testing. A valuation model, which utilizes a discounted cash flow analysis using interest rates and prepayment speed assumptions currently quoted for comparable instruments and a discount rate determined by management, is used for impairment testing. If the valuation model reflects a value less than the carrying value, mortgage servicing rights are adjusted to fair value through a valuation allowance as determined by the model. As such, the Corporation classifies mortgage servicing rights subjected to nonrecurring fair value adjustments as Level 3. At December 31, 2012 and 2011, there was no impairment recorded for mortgage servicing rights and, therefore, no mortgage servicing rights assets were recorded at fair value on a nonrecurring basis.

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

FHLB Advances
The fair values of advances from the FHLB are estimated using discounted cash flow analyses based on the Bank's current incremental borrowing rates for similar types of borrowing arrangements.

Accrued Interest Payable
The carrying amounts reported on the consolidated balance sheets approximate fair values.

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

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

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

	Fair Value			
2012	**Level 1**	**Level 2**	**Level 3**	**Total**
Investment securities available-for-sale:				
Government-sponsored enterprises (such as FNMA, FHLB, FHLMC, and FFCB)	$ -	$ 18,729,124	$ -	$ 18,729,124
State and municipal	-	31,333,414	-	31,333,414
Small Business Administration securities	-	9,418,863	-	9,418,863
Corporate bonds	-	246,365	-	246,365
Mortgage-backed securities	-	25,252,495	-	25,252,495
Total assets at fair value	**$ -**	**$ 84,980,261**	**$ -**	**$ 84,980,261**

	Fair Value			
2011	**Level 1**	**Level 2**	**Level 3**	**Total**
Investment securities available-for-sale:				
Government-sponsored enterprises (such as FNMA, FHLB, FHLMC, and FFCB)	$ -	$ 17,051,674	$ -	$ 17,051,674
State and municipal	-	28,880,250	-	28,880,250
Small Business Administration securities	-	5,018,453	-	5,018,453
Mortgage-backed securities	-	23,812,691	-	23,812,691
Total assets at fair value	**$ -**	**$ 74,763,068**	**$ -**	**$ 74,763,068**

Assets Recorded at Fair Value on a Nonrecurring Basis
The following table sets forth by level, within the fair value hierarchy, the recorded amount of assets measured at fair value on a nonrecurring basis as of December 31:

2012	Assets at Carrying Value			
	Level 1	Level 2	Level 3	Total
Impaired loans (1)	$ -	$ -	$ 1,191,232	$ 1,191,232
Foreclosed assets (2)	-	216,000	180,214	396,214

2011	Assets at Carrying Value			
	Level 1	Level 2	Level 3	Total
Impaired loans (1)	$ -	$ -	$ 2,262,979	$ 2,262,979

(1) Impaired loans, which are measured for impairment using the estimated fair value of the collateral for collateral dependent loans, had a carrying amount of $1,191,232 and $2,262,979 at December 31, 2012 and 2011, respectively, resulting in an additional provision for loan losses of $395,216 and $762,779 during 2012 and 2011, respectively.

(2) Foreclosed assets, which are carried at the lower of cost or fair value, were written down from cost of $746,708 resulting in a charge of $350,494 to earnings in 2012.

Quantitative information about Level 3 fair value measurements is as follows as of December 31, 2012:

Instrument	Level 3 Instruments			
	Fair Value	Valuation Technique	Unobservable Input	Weighted Average and/or Range
Impaired Loans	$ 1,191,232	Discounted Appraisal Value	Discount Applied to Collateral Appraisal	10% – 40%
Foreclosed assets	$ 180,214	Discounted Appraisal Value	Discount Applied to Collateral Appraisal	10% - 35%

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

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

	2012		2011	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Assets:				
Cash and due from banks	$ 19,599	$ 19,599	$ 12,715	$ 12,715
Federal funds sold	8,902	8,902	8,569	8,569
Interest-bearing deposits in banks	3,937	4,112	1,532	1,453
Held-to-maturity investment securities	684	777	793	890
Net loans	144,057	145,208	157,478	162,201
FHLB stock	1,355	1,355	1,355	1,355
Mortgage servicing rights	226	226	222	222
Accrued interest receivable	1,086	1,086	1,234	1,234
Liabilities:				
Interest-bearing deposits	168,370	163,709	173,509	173,262
Noninterest-bearing deposits	54,934	54,934	46,323	46,323
FHLB advances	25,100	22,849	24,100	24,452
Accrued interest payable	198	198	266	266

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:

2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale				
Government-sponsored enterprises (such as FNMA, FHLB, FHLMC, and FFCB)	$ 18,681,266	$ 66,316	$ 18,458	$ 18,729,124
State and municipal	29,318,412	2,068,242	53,240	31,333,414
Small Business Administration securities	9,172,441	246,422	-	9,418,863
Corporate bonds	250,000	-	3,635	246,365
Mortgage-backed securities	24,830,560	454,220	32,285	25,252,495
Total available-for-sale	**82,252,679**	**2,835,200**	**107,618**	**84,980,261**
Held-to-Maturity				
State and municipal	668,000	92,535	-	760,535
Mortgage-backed securities	15,521	1,243	-	16,764
Total held-to-maturity	**683,521**	**93,778**	**-**	**777,299**
Total	**$82,936,200**	**$ 2,928,978**	**$ 107,618**	**$85,757,560**

2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale				
Government-sponsored enterprises (such as FNMA, FHLB, FHLMC, and FFCB)	$ 16,946,203	$ 112,945	$ 7,474	$ 17,051,674
State and municipal	27,282,969	1,632,667	35,386	28,880,250
Small Business Administration securities	4,947,449	71,004	-	5,018,453
Mortgage-backed securities	23,051,861	760,830	-	23,812,691
Total available-for-sale	**72,228,482**	**2,577,446**	**42,860**	**74,763,068**
Held-to-Maturity				
State and municipal	757,000	94,117	-	851,117
Mortgage-backed securities	36,346	2,892	-	39,238
Total held-to-maturity	**793,346**	**97,009**	**-**	**890,355**
Total	**$73,021,828**	**$ 2,674,455**	**$ 42,860**	**$75,653,423**

Investment securities with carrying values of approximately $25,580,000 and $14,480,000 at December 31, 2012 and 2011, respectively, were pledged to secure public deposits or for other purposes as permitted or required by law.

The amortized cost and fair values of available-for-sale securities and held-to-maturity securities by contractual maturity at December 31, 2012 is summarized as follows:

	Maturing					
	Due In One Year Or Less	Due After One Year Through Five Years	Due After Five Years Through Ten Years	Due After Ten Years	Securities With Variable Monthly Payments	Total
Available-for-Sale						
Government-sponsored enterprises	$ 136,026	$ -	$ 1,655,319	$ 16,889,921	$ -	$ 18,681,266
State and municipal	-	3,002,232	9,022,926	17,293,254	-	29,318,412
Small Business Administration securities	-	-	-	-	9,172,441	9,172,441
Corporate bonds	-	-	-	250,000	-	250,000
Mortgage-backed securities	-	-	-	-	24,830,560	24,830,560
Total available-for-sale	136,026	3,002,232	10,678,245	34,433,175	34,003,001	82,252,679
Held-to-Maturity						
State and municipal	70,000	338,000	220,000	40,000	-	668,000
Mortgage-backed securities	-	-	-	-	15,521	15,521
Total held-to-maturity	70,000	338,000	220,000	40,000	15,521	683,521
Total amortized cost	$ 206,026	$ 3,340,232	$ 10,898,245	$ 34,473,175	$ 34,018,522	$ 82,936,200
Fair value	$ 207,937	$ 3,488,953	$ 11,471,831	$ 35,900,715	$ 34,688,124	$ 85,757,560

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

Because of their variable payments, Small Business Administration securities and mortgage-backed securities are not reported by a specific maturity period group.

Proceeds from sales of available-for-sale securities amounted to $8,951,206 in 2012. Gross realized gains amounted to $222,880 in 2012. There were no gross realized losses during 2012. There were no sales of available-for-sale securities in 2011.

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 is summarized as follows at December 31:

	Less Than Twelve Months		Over Twelve Months		Total Gross Unrealized Losses
2012	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	
Securities available-for-sale					
Government-sponsored enterprises	$ 18,458	$ 4,971,786	$ -	$ -	$ 18,458
State and municipal	53,240	2,520,310	-	-	53,240
Corporate bonds	3,635	246,365	-	-	3,635
Mortgage-backed securities	32,285	5,217,545	-	-	32,285
Total securities available-for-sale	**$ 107,618**	**$12,956,006**	**$ -**	**$ -**	**$ 107,618**

	Less Than Twelve Months		Over Twelve Months		Total Gross Unrealized Losses
2011	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	
Securities available-for-sale					
Government-sponsored enterprises	$ 7,474	$ 2,492,526	$ -	$ -	$ 7,474
State and municipal	35,386	440,736	-	-	35,386
Total securities available-for-sale	**$ 42,860**	**$ 2,933,262**	**$ -**	**$ -**	**$ 42,860**

4. LOANS AND ALLOWANCE FOR LOAN LOSSES

The Bank grants commercial, agricultural, consumer, and residential mortgage loans to customers primarily in certain South Central Michigan counties, principally Ingham, Eaton, and Clinton. The ability of the Bank's debtors to honor their contracts is generally dependent upon the real estate and general economic conditions in this area. While substantially all of the agricultural, consumer, and residential mortgage loans are secured by various forms of collateral including real estate and consumer property, with a significant portion of commercial loans secured primarily by real estate and personal guarantees, borrower cash flow is the primary source of repayment. A small portion of loans are unsecured.

Loans are summarized as follows at December 31:

	2012	2011
Commercial	$ 16,639,115	$ 16,784,732
Commercial real estate	85,710,779	92,402,820
Agricultural	2,985,605	3,768,641
Agricultural real estate	6,593,593	11,023,452
Residential real estate	28,571,971	29,817,160
Consumer and other	2,951,501	4,106,835
Home equity lines-of-credit	3,361,156	3,526,423
Home equity term	1,905,381	2,287,547
Total loans	**148,719,101**	**163,717,610**
Less		
Allowance for loan losses	4,630,000	6,100,000
Deferred gain on loan repurchase	-	120,929
Net deferred loan origination fees	32,102	18,445
Net loans	**$ 144,056,999**	**$ 157,478,236**

The allowance for loan losses and recorded investment in loans is as follows as of and for the years ended December 31:

2012	Commercial	Commercial Real Estate	Agricultural	Agricultural Real Estate	Residential Real Estate	Consumer and Other	Home Equity Lines-of-Credit	Home Equity Term	Unallocated	Total
Allowance for Loan Losses:										
Balance at beginning of year	$ 230,356	$ 4,352,184	$ 21,447	$ 167,496	$ 911,750	$ 89,008	$ 34,243	$ 25,323	$ 268,193	$ 6,100,000
Provision for (reduction to) loan losses	1,817,034	(519,236)	38,265	31,949	17,516	(19,947)	(51,840)	2,464	(200,067)	1,116,138
Loans charged-off	(1,437,292)	(918,143)	-	-	(258,093)	(82,551)	(13,162)	(7,178)	-	(2,716,419)
Recoveries of loans previously charged-off	31,900	15,420	-	-	1,789	39,772	41,250	150	-	130,281
Balance at end of year	**$ 641,998**	**$ 2,930,225**	**$ 59,712**	**$ 199,445**	**$ 672,962**	**$ 26,282**	**$ 10,491**	**$ 20,759**	**$ 68,126**	**$ 4,630,000**
Ending balance: Individually evaluated for impairment	$ 233,799	$ 905,062	$ -	$ 2,289	$ 401,270	$ 3,940	$ 2,797	$ 7,695	$ -	$ 1,556,852
Ending balance: Collectively evaluated for impairment	408,199	2,025,163	59,712	197,156	271,692	22,342	7,694	13,064	68,126	3,073,148
Total allowance for loan losses	**$ 641,998**	**$ 2,930,225**	**$ 59,712**	**$ 199,445**	**$ 672,962**	**$ 26,282**	**$ 10,491**	**$ 20,759**	**$ 68,126**	**$ 4,630,000**
Recorded investment in loans:										
Ending balance: Individually evaluated for impairment	$ 430,229	$ 10,183,680	$ -	$ 315,867	$ 2,477,805	$ 60,055	$ 21,573	$ 163,291		$ 13,652,500
Ending balance: Collectively evaluated for impairment	16,208,886	75,527,099	2,985,605	6,277,726	26,094,166	2,891,446	3,339,583	1,742,090		135,066,601
Total loans	16,639,115	85,710,779	2,985,605	6,593,593	28,571,971	2,951,501	3,361,156	1,905,381		148,719,101
Accrued interest receivable	68,865	320,591	11,606	26,012	79,496	10,187	8,756	7,644		533,157
Net deferred loan fees	(670)	(27,433)	-	(1,310)	(2,689)	-	-	-		(32,102)
Total recorded investment in loans	**$16,707,310**	**$86,003,937**	**$ 2,997,211**	**$ 6,618,295**	**$28,648,778**	**$ 2,961,688**	**$ 3,369,912**	**$ 1,913,025**		**$ 149,220,156**

2011	Commercial	Commercial Real Estate	Agricultural	Agricultural Real Estate	Residential Real Estate	Consumer and Other	Home Equity Lines-of-Credit	Home Equity Term	Unallocated	Total
Allowance for Loan Losses:										
Balance at beginning of year	$ 199,146	$ 3,762,530	$ 18,541	$ 144,803	$ 1,824,950	$ 109,344	$ 112,108	$ 87,376	$ 171,202	$ 6,430,000
Provision for (reduction to) loan losses	140,158	1,536,799	2,906	134,552	(760,323)	31,874	(111,615)	(52,028)	96,991	1,019,314
Loans charged-off	(130,109)	(1,020,760)	-	(111,859)	(152,877)	(94,927)	-	(17,572)	-	(1,528,104)
Recoveries of loans previously charged-off	21,161	73,615	-	-	-	42,717	33,750	7,547	-	178,790
Balance at end of year	**$ 230,356**	**$ 4,352,184**	**$ 21,477**	**$ 167,496**	**$ 911,750**	**$ 89,008**	**$ 34,243**	**$ 25,323**	**$ 268,193**	**$ 6,100,000**
Ending balance: Individually evaluated for impairment	$ 42,646	$ 1,418,209	$ -	$ 3,684	$ 370,992	$ 19,884	$ 4,375	$ 7,394	$ -	$ 1,867,184
Ending balance: Collectively evaluated for impairment	187,710	2,933,975	21,447	163,812	540,758	69,124	29,868	17,929	268,193	4,232,816
Total allowance for loan losses	**$ 230,356**	**$ 4,352,184**	**$ 21,477**	**$ 167,496**	**$ 911,750**	**$ 89,008**	**$ 34,243**	**25,323**	**$ 268,193**	**$ 6,100,000**
Recorded investment in loans:										
Ending balance: Individually evaluated for impairment	$ 231,527	$ 8,904,656	$ -	$ 813,998	$ 2,277,324	$ 38,981	$ 21,885	$ 95,616		$ 12,383,987
Ending balance: Collectively evaluated for impairment	16,553,205	83,498,164	3,768,641	10,209,454	27,539,836	4,067,854	3,504,538	2,191,931		151,333,623
Total loans	16,784,732	92,402,820	3,768,641	11,023,452	29,817,160	4,106,835	3,526,423	2,287,547		163,717,610
Accrued interest receivable	69,249	358,682	27,688	83,954	89,506	15,891	9,346	9,028		663,344
Net deferred loan fees	(1,076)	(13,583)	-	(2,022)	(1,764)	-	-	-		(18,445)
Deferred gain on loan repurchase	-	(120,929)	-	-	-	-	-	-		(120,929)
Total recorded investment in loans	**$16,852,905**	**$92,626,990**	**$ 3,796,329**	**$11,105,384**	**$29,904,902**	**$ 4,122,726**	**$ 3,535,769**	**$ 2,296,575**		**$ 164,241,580**

The following table shows the loans allocated by management's internal risk ratings as of December 31, 2012:

	Commercial Credit Risk Profile by Risk Rating				
	Commercial	Commercial Real Estate	Agricultural	Agricultural Real Estate	Total
Risk rating					
Pass	$ 15,023,681	$ 61,746,297	$ 2,985,605	$ 5,430,566	$ 85,186,149
Special mention	469,619	9,536,653	-	257,525	10,263,797
Substandard	1,077,045	10,073,811	-	905,502	12,056,358
Doubtful	68,770	4,354,018	-	-	4,422,788
Total	**$ 16,639,115**	**$ 85,710,779**	**$ 2,985,605**	**$ 6,593,593**	**$111,929,092**

The following table shows the homogeneous loans allocated by payment activity as of December 31, 2012:

	Consumer Credit Risk Profile by Payment Activity				
	Residential Real Estate	Consumer and Other	Home Equity Lines-of-Credit	Home Equity Term Loans	Total
Payment activity					
Performing	$ 28,156,296	$ 2,951,501	$ 3,361,156	$ 1,892,807	$ 36,361,760
Non-performing	415,675	-	-	12,574	428,249
Total	**$ 28,571,971**	**$ 2,951,501**	**$ 3,361,156**	**$ 1,905,381**	**$ 36,790,009**

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

	Commercial Credit Risk Profile by Risk Rating				
	Commercial	Commercial Real Estate	Agricultural	Agricultural Real Estate	Total
Risk rating					
Pass	$ 15,250,979	$ 65,921,935	$ 3,768,641	$ 9,523,706	$ 94,465,261
Special mention	1,194,461	9,467,803	-	439,740	11,102,004
Substandard	339,292	16,364,876	-	701,954	17,406,122
Doubtful	-	648,206	-	358,052	1,006,258
Total	**$ 16,784,732**	**$ 92,402,820**	**$ 3,768,641**	**$ 11,023,452**	**$123,979,645**

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

	Consumer Credit Risk Profile by Payment Activity				
	Residential Real Estate	Consumer and Other	Home Equity Lines-of-Credit	Home Equity Term Loans	Total
Payment activity					
Performing	$ 28,851,032	$ 4,083,352	$ 3,526,423	$ 2,219,399	$ 38,680,206
Non-performing	966,128	23,483	-	68,148	1,057,759
Total	**$ 29,817,160**	**$ 4,106,835**	**$ 3,526,423**	**$ 2,287,547**	**$ 39,737,965**

The following tables show an aging analysis of the loan portfolio by the length of time past due as of December 31:

	Accruing Interest				
2012	Current	30-89 Days Due	More Than 90 Days Past Due	Total Nonaccrual	Total
Commercial	$ 16,480,671	$ 43,384	$ -	$ 115,060	$ 16,639,115
Commercial real estate	79,400,223	629,055	343,092	5,338,409	85,710,779
Agricultural	2,985,605	-	-	-	2,985,605
Agricultural real estate	6,408,812	184,781	-	-	6,593,593
Residential real estate	27,900,520	255,776	-	415,675	28,571,971
Consumer and other	2,926,245	25,256	-	-	2,951,501
Home equity lines of credit	3,361,156	-	-	-	3,361,156
Home equity term	1,889,604	3,203	-	12,574	1,905,381
Total	**$141,352,836**	**$ 1,141,455**	**$ 343,092**	**$ 5,881,718**	**$148,719,101**

	Accruing Interest				
2011	Current	30-89 Days Due	More Than 90 Days Past Due	Total Nonaccrual	Total
Commercial	$ 16,569,872	$ 52,975	$ -	$ 161,885	$ 16,784,732
Commercial real estate	86,719,433	2,532,886	-	3,150,501	92,402,820
Agricultural	3,768,641	-	-	-	3,768,641
Agricultural real estate	10,645,795	358,052	-	19,605	11,023,452
Residential real estate	28,687,793	163,239	-	966,128	29,817,160
Consumer and other	4,033,344	48,809	1,199	23,483	4,106,835
Home equity lines of credit	3,513,307	13,116	-	-	3,526,423
Home equity term	2,211,209	8,190	-	68,148	2,287,547
Total	**$156,149,394**	**$ 3,177,267**	**$ 1,199**	**$ 4,389,750**	**$163,717,610**

The following tables present information related to impaired loans as of December 31:

2012	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial	$ 91,703	$ 91,540	$ -	$ 29,858	$ 14,885
Commercial real estate	5,143,889	5,125,283	-	4,251,364	162,365
Agricultural real estate	186,107	184,781	-	184,455	13,352
Residential real estate	727,157	722,094	-	589,643	63,359
Consumer and other	23,912	23,800	-	14,863	1,770
Home equity lines-of-credit	11,999	11,964	-	11,495	452
Home equity term	105,488	105,139	-	75,629	7,566
Total loans with no related allowance recorded	**6,290,255**	**6,264,601**	**-**	**5,157,307**	**263,749**
Loans with an allowance recorded					
Commercial	340,260	338,689	233,799	294,947	24,211
Commercial real estate	5,079,772	5,058,397	905,062	3,917,614	241,067
Agricultural real estate	131,304	131,086	2,289	89,430	12,956
Residential real estate	1,760,687	1,755,711	401,270	1,391,723	60,902
Consumer and other	36,543	36,255	3,940	15,454	3,738
Home equity lines-of-credit	9,629	9,609	2,797	2,422	291
Home equity term	58,384	58,152	7,695	44,115	3,653
Total loans with an allowance recorded	**7,416,579**	**7,387,899**	**1,556,852**	**5,755,705**	**346,818**
Total impaired loans					
Commercial	431,963	430,229	233,799	324,805	39,096
Commercial real estate	10,223,661	10,183,680	905,062	8,168,978	403,432
Agricultural real estate	317,411	315,867	2,289	273,885	26,308
Residential real estate	2,487,844	2,477,805	401,270	1,981,366	124,261
Consumer and other	60,455	60,055	3,940	30,317	5,508
Home equity lines-of-credit	21,628	21,573	2,797	13,917	743
Home equity term	163,872	163,291	7,695	119,744	11,219
Total impaired loans	**$ 13,706,834**	**$ 13,652,500**	**$ 1,556,852**	**$ 10,913,012**	**$ 610,567**

2011	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial	$ 15,129	$ 15,101	$ -	$ 21,055	$ 926
Commercial real estate	2,714,773	2,709,535	-	2,777,722	79,883
Agricultural real estate	687,432	680,966	-	735,412	41,075
Residential real estate	1,074,900	1,070,846	-	1,046,449	33,160
Home equity lines-of-credit	12,134	12,097	-	11,751	458
Home equity term	60,275	60,098	-	60,700	2,857
Total loans with no related allowance recorded	**4,564,642**	**4,548,643**	**-**	**4,653,089**	**158,359**
Loans with an allowance recorded					
Commercial	216,852	216,426	42,646	243,738	11,652
Commercial real estate	6,225,636	6,195,121	1,418,209	5,996,435	173,035
Agricultural real estate	133,697	133,032	3,684	136,069	11,603
Residential real estate	1,208,984	1,206,478	370,992	1,141,154	48,194
Home equity lines-of-credit	9,809	9,788	4,375	9,564	285
Home equity term	35,844	35,518	7,394	37,777	2,857
Consumer and other	39,116	38,981	19,884	43,411	3,495
Total loans with an allowance recorded	**7,869,938**	**7,835,344**	**1,867,184**	**7,608,148**	**251,121**
Total impaired loans					
Commercial	231,981	231,527	42,646	264,793	12,578
Commercial real estate	8,940,409	8,904,656	1,418,209	8,774,157	252,918
Agricultural real estate	821,129	813,998	3,684	871,481	52,678
Residential real estate	2,283,884	2,277,324	370,992	2,187,603	81,354
Home equity lines-of-credit	21,943	21,885	4,375	21,315	3,315
Home equity term	96,119	95,616	7,394	98,477	5,714
Consumer and other	39,116	38,981	19,884	43,411	3,495
Total impaired loans	**$ 12,434,580**	**$ 12,383,987**	**$ 1,867,184**	**$ 12,261,237**	**$ 412,052**

The Bank does not have material commitments to lend additional funds to borrowers with loans whose terms have been modified in troubled debt restructurings or whose loans are on nonaccrual.

A summary of loans that were modified in troubled debt restructurings during 2012 and 2011 is as follows:

2012	Troubled Debt Restructurings		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	2	$ 37,057	$ 30,329
Commercial real estate	14	5,173,906	4,228,751
Residential real estate	2	303,408	299,736
Consumer and other	3	51,092	46,629
Home equity term	1	13,281	12,574
	22	$ 5,578,744	$ 4,618,019

2011	Troubled Debt Restructurings		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	2	$ 81,980	$ 55,447
Commercial real estate	9	996,738	943,219
Residential real estate	3	569,465	511,479
Consumer and other	3	30,254	21,047
Home equity term	2	64,769	52,687
	19	$ 1,743,206	$ 1,583,879

The following tables detail the number of loans and the recorded investment in loans considered to be TDRs by type of modification during the years ended December 31:

2012	Total Modification										
	Principal Deferrals		Interest Rate Reductions		Principal Forgiveness		Consolidation and Extension of Amortization		Modification to Interest Only and Extended Maturity		
	Number Of Loans	Recorded Investment	Number Of Loans	Recorded Investment	Number Of Loans	Recorded Investment	Number Of Loans	Recorded Investment	Number Of Loans	Recorded Investment	Total Modifications
Commercial	-	$ -	-	$ -	-	$ -	1	$ 12,618	1	$ 17,711	$ 30,329
Commercial real estate	-	-	11	3,886,251	-	-	-	-	3	342,500	4,228,751
Residential real estate	-	-	2	299,736	-	-	-	-	-	-	299,736
Consumer and other	-	-	-	-	-	-	-	-	3	46,629	46,629
Home equity term	-	-	1	12,574	-	-	-	-	-	-	12,574
Total	-	$ -	14	$ 4,198,561	-	$ -	1	$ 12,618	7	$ 406,840	$ 4,618,019

2011	Total Modification										
	Principal Deferrals		Interest Rate Reductions		Principal Forgiveness		Consolidation and Extension of Amortization		Modification to Interest Only and Extended Maturity		
	Number Of Loans	Recorded Investment	Number Of Loans	Recorded Investment	Number Of Loans	Recorded Investment	Number Of Loans	Recorded Investment	Number Of Loans	Recorded Investment	Total Modifications
Commercial	-	$ -	-	$ -	-	$ -	2	$ 55,447	-	$ -	$ 55,447
Commercial real estate	1	114,012	1	38,042	2	109,834	3	238,214	2	443,117	943,219
Residential real estate	-	-	2	239,845	-	-	1	271,634	-	-	511,479
Consumer and other	-	-	1	10,330	-	-	2	10,717	-	-	21,047
Home equity term	-	-	-	-	-	-	2	52,687	-	-	52,687
Total	1	$ 114,012	4	$ 288,217	2	$ 109,834	10	$ 628,699	2	$ 443,117	$ 1,583,879

During both 2012 and 2011, there was one consumer TDR in each year that defaulted that had been modified during the previous 12 months. The Bank charged off such loans, resulting in a charge to earnings of $20,282 and $1,389 in 2012 and 2011, respectively.

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, 2012 and 2011, approximated $39,261,000 and $38,481,000, respectively; such loans are not included on the accompanying consolidated balance sheets. The activity pertaining to mortgage servicing rights was not significant during the years then ended.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. PREMISES AND EQUIPMENT

A summary of the cost and accumulated depreciation of premises and equipment consists of the following amounts at December 31:

	2012	2011
Land and improvements	$ 2,119,038	$ 2,029,562
Buildings and improvements	3,730,120	4,067,406
Furniture and equipment	2,808,188	2,746,085
Total premises and equipment	8,657,346	8,843,053
Less accumulated depreciation	4,417,570	4,379,107
Premises and equipment, net	**$ 4,239,776**	**$ 4,463,946**

Depreciation expense amounted to $338,023 and $327,475 in 2012 and 2011, respectively.

7. DEPOSITS

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

	2012	2011
Interest-bearing		
NOW accounts	$ 18,278,865	$ 15,824,514
Savings	80,504,638	77,947,192
Time, $100,000 and over	28,272,259	34,412,014
Other time	41,314,002	45,325,034
Total interest-bearing	168,369,764	173,508,754
Noninterest-bearing demand	54,934,016	46,322,657
Total deposits	**$ 223,303,780**	**$ 219,831,411**

Interest expense on time deposits issued in denominations of $100,000 or more was $733,226 and $970,465 in 2012 and 2011, respectively.

Scheduled maturities of time deposits for each of the five years succeeding December 31, 2012 and thereafter are summarized as follows:

2013	$ 30,004,297
2014	16,299,963
2015	11,235,502
2016	7,056,295
2017	437,865
Thereafter	4,552,339
Total	**$ 69,586,261**

8. BORROWED FUNDS

Federal Home Loan Bank advances are collateralized by a blanket lien on all qualified 1-to-4 family whole mortgage loans and U.S. government-sponsored enterprises securities with combined carrying values of approximately $50,309,000 and $36,414,000 at December 31, 2012 and 2011, respectively. Required principal payments are $7,000,000 in 2013, $2,000,000 in 2014, $6,000,000 in 2016, $10,000,000 in 2019, and $100,000 in 2021. Interest is charged on these advances at fixed annual rates ranging from 0.75% to 4.51%.

At December 31, 2012, the Bank also had $30,900,000 in borrowing availability under short-term lines of credit.

9. NONINTEREST INCOME

Noninterest income consists of the following amounts for the years ended December 31:

	2012	2011
Fees and service charges	$ 1,071,276	$ 1,054,587
Gain on sales of loans	194,865	114,990
Increase in cash surrender value of BOLI	172,194	204,425
Other	686,523	386,401
Total noninterest income	**$ 2,124,858**	**$ 1,760,403**

10. FEDERAL INCOME TAXES

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

	2012	2011
Currently payable	$ 8,000	$ 397,000
Deferred expense	187,000	80,000
Total expense	**$ 195,000**	**$ 477,000**

A reconciliation of the provision for federal income taxes and the amount computed by applying the statutory federal income tax rates to income before federal income taxes is as follows for the years ended December 31:

	2012	2011
Income tax provision at statutory rate	$ 640,000	$ 942,000
Effect of tax-exempt interest income	(399,000)	(403,000)
Effect of nondeductible interest expense	17,000	21,000
Other reconciling amounts	(63,000)	(83,000)
Income tax expense reported	**$ 195,000**	**$ 477,000**

The components of the net deferred tax asset included on the consolidated balance sheets within other assets 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:

	2012	2011
Deferred tax assets:		
Allowance for loan losses	$ 1,074,093	$ 1,709,714
Deferred compensation	59,779	67,071
Non accrued interest	305,784	287,964
Net operating loss carryforward	243,707	-
Other	330,120	238,233
Total deferred tax assets	**2,013,483**	**2,302,982**
Deferred tax liabilities:		
Premises and equipment	136,383	247,701
Mortgage servicing rights	76,846	75,613
Prepaid expenses	73,319	65,733
FHLB stock	23,089	23,089
Unrealized gain on available-for-sale securities	927,379	861,759
Total deferred tax liabilities	**1,237,016**	**1,273,895**
Net deferred tax asset	**$ 776,467**	**$ 1,029,087**

At December 31, 2012, the Corporation has net operating loss carryforwards totaling approximately $717,000 that may be offset against future federal taxable income through 2032.

The Corporation has evaluated the provisions of ASC Topic 740 regarding accounting for uncertainty in income taxes for the years 2009 through 2012, the years which remain subject to examination by major tax jurisdictions as of December 31, 2012. The Corporation concluded that there are no significant uncertain tax positions requiring recognition in the Corporation's consolidated financial statements. The Corporation does not expect the total amount of unrecognized tax benefits (“UTB”) (e.g. tax deductions, exclusions, or credits claimed or expected to be claimed) to significantly change in the next 12 months. The Corporation does not have any amounts accrued for interest and penalties related to UTBs at December 31, 2012 or 2011, and it is not aware of any claims for such amounts by federal or state income tax authorities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. RELATED PARTY TRANSACTIONS

Loans
In the ordinary course of business, the Bank grants loans to certain directors and executive officers and their affiliates. Such loans aggregated approximately $87,000 and $537,000 at December 31, 2012 and 2011, respectively.

Deposits
Deposits of Bank directors and executive officers and their affiliates were approximately $1,652,000 and $1,581,000 at December 31, 2012 and 2011, respectively.

12. OFF-BALANCE SHEET ACTIVITIES

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

At December 31, 2012 and 2011, the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount	
	2012	2011
Unfunded commitments under lines of credit	$ 11,193,881	$ 12,370,139
Commitments to grant loans	4,073,280	5,018,207
Commitments under overdraft protection agreements	3,344,564	3,432,078
Commercial and standby letters of credit	435,322	403,802

Unfunded commitments under commercial lines-of-credit, revolving credit lines, and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines-of-credit are generally uncollateralized and usually contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed.

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. Those 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 and at December 31, 2012 and 2011 such collateral amounted to approximately $4,767,000 and $3,927,000, respectively. Guarantees that are not derivative contracts are recorded on the Bank's consolidated balance sheet at their fair value at inception. The Bank considers standby letters of credit to be guarantees; however, since the amount of the estimated liability related to such guarantees on the commitment date is not significant, a liability related to such guarantees is not recognized at December 31, 2012 or 2011.

13. DERIVATIVE INSTRUMENTS

Interest Rate Risk Management – Derivative Instruments not Designated as Hedging Instruments
Certain derivative instruments do not, or are not designated to, meet the accounting criteria for hedging requirements. Where applicable, these undesignated derivative instruments are recognized on the consolidated balance sheets at fair value, with changes in fair value recorded in other noninterest income.

Derivative Loan Commitments
Mortgage loan commitments are referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. The Bank enters into commitments to fund residential mortgage loans at specified times in the future, with the intention that these loans will subsequently be sold in the secondary market. A mortgage loan commitment binds the Bank to lend funds to a potential borrower at a specified interest rate and within a specified period of time, generally up to 60 days after inception of the rate-lock.

Outstanding derivative loan commitments expose the Bank to the risk that the price of the loans arising from exercise of the loan commitment might decline from inception of the rate lock to funding of the loan due to increases in mortgage interest rates. If interest rates increase, the value of these loan commitments decreases. Conversely, if interest rates decrease, the value of these loan commitments increases. There were no undesignated mortgage loan commitments at December 31, 2012 and 2011.

Forward Loan Sale Commitments
To protect against the price risk inherent in derivative loan commitments, the Bank utilizes both "mandatory delivery" and "best efforts" forward loan sale commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments.

With a "mandatory delivery" contract, the Bank commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. If the Bank fails to deliver the amount of mortgages necessary to fulfill the commitment by the specified date, it is obligated to pay a "pair-off" fee, based on then-current market prices, to the investor to compensate the investor for the shortfall.

With a "best efforts" contract, the Bank commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. Generally, the price the investor will pay the seller for an individual loan is specified prior to the loan being funded (e.g., on the same day the lender commits to lend funds to a potential borrower).

The Bank expects that these forward loan sale commitments will experience changes in fair value opposite to the change in fair value of derivative loan commitments. The notional amount of fixed rate forward loan sale commitments was not significant at December 31, 2012 and 2011.

The fair value of the rate-lock loan commitments related to the origination or acquisition of mortgage loans that will be held for sale and the forward loan sale commitments are deemed insignificant by management and, accordingly, are not recognized in these consolidated financial statements.

Collateral Requirements
To reduce credit risk related to the use of derivative instruments, the Bank might deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on the Bank's credit evaluation of the customer. If the counterparty does not have the right and ability to redeem the collateral or the Bank is permitted to sell or re-pledge the collateral on short notice, the Bank records the collateral on the consolidated balance sheets at fair value with a corresponding obligation to return it.

14. REGULATORY REQUIREMENTS

Capital Requirements
The Corporation (on a consolidated basis) and the Bank are subject to various regulatory capital requirements, including restrictions on dividends, administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible 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.

Quantitative measurements established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and Tier 1 capital to average assets (as defined). Management believes, as of December 31, 2012 and 2011, that the Corporation and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2012, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category. The Corporation's, on a consolidated basis, and the Bank's, actual capital amounts and ratios as of December 31, 2012 and 2011 are also presented in the following table.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
December 31, 2012	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
Total capital to risk weighted assets						
Corporation	$ 29,143	17.77 %	$ 13,121	8.0 %	$ N/A	N/A %
Bank	29,141	17.77	13,121	8.0	16,401	10.0
Tier 1 capital to risk weighted assets						
Corporation	27,061	16.50	6,560	4.0	N/A	N/A
Bank	27,059	16.50	6,560	4.0	9,841	6.0
Tier 1 capital to average assets						
Corporation	27,061	10.02	10,803	4.0	N/A	N/A
Bank	27,059	10.02	10,803	4.0	13,503	5.0

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
December 31, 2011	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
Total capital to risk weighted assets						
Corporation	$ 27,862	16.33 %	$ 13,651	8.0 %	$ N/A	N/A %
Bank	27,860	16.33	13,651	8.0	17,064	10.0
Tier 1 capital to risk weighted assets						
Corporation	25,680	15.05	6,825	4.0	N/A	N/A
Bank	25,678	15.05	6,825	4.0	10,238	6.0
Tier 1 capital to average assets						
Corporation	25,680	9.59	10,716	4.0	N/A	N/A
Bank	25,678	9.59	10,716	4.0	13,395	5.0

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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. Required reserve balances were $1,489,000 and $1,248,000 at December 31, 2012 and 2011, respectively.

Regulatory Capital Transfer
During 2011, the Bank effected a capital transfer of $2,000,000 from retained earnings to common stock in order to increase its legal lending limit.

15. CONTINGENCIES

Litigation
The Corporation is a party to litigation arising during the normal course of business. There were no claims outstanding as of December 31, 2012 that in management's opinion would have a material effect on the consolidated financial statements.

Environmental Issues
As a result of acquiring real estate in foreclosure proceedings, the Bank is subject to potential claims and possible legal proceedings involving environmental matters. No such claims have been asserted at December 31, 2012.

16. EMPLOYEE BENEFIT PLANS

Defined Contribution 401(k) Plan
The Bank sponsors a defined contribution plan qualified under 401(k) of the Internal Revenue Code. Under the terms of the Plan, employees may make contributions to the plan and the Bank matches 50% of the first 6% of employees' salary contributions. The Bank made matching contributions of approximately $61,000 in both 2012 and 2011. Additionally, the Bank made a discretionary profit-sharing contribution of $124,000 in 2012.

Deferred Compensation
The Bank also maintains two executive deferred compensation plans for certain officers and directors. The first plan includes participants that elected to defer compensation over eight years in exchange for a predetermined benefit after retirement. During 2003, a second plan was implemented to fund a defined contribution for selected employees at the discretion of the Board of Directors. Plan expenses are allocated over years of service or based upon the current amount of the defined contributions. Expense for these plans was approximately $11,000 and $13,000 in 2012 and 2011, respectively.

Bank-Owned Life Insurance
The Bank has invested $5,260,000 in single premium, bank-owned, endorsement split-dollar, whole life insurance programs. Bank owned life insurance is an alternative investment vehicle 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 approximately $172,000 and $204,000 2012 and 2011, respectively, is included in noninterest income in the accompanying consolidated statements of income.

The benefit promised by the Bank to the covered officers is a $25,000 death benefit; such benefit expires if the officers' employment is terminated for any reason other than death, including voluntary or involuntary termination or retirement. Based primarily on the ages of the covered officers, the Bank believes that the payment of such benefits is not probable; accordingly, the Bank has not recorded a liability for such benefits.

17. SUPPLEMENTAL CASH FLOWS INFORMATION

Non-Cash Investing Activities

During 2012 and 2011, collateral was foreclosed and repossessed related to outstanding loans of approximately $1,700,000 and $946,000, respectively, which amounts were then transferred to foreclosed and repossessed assets.

Other Cash Flows Information

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

	2012	2011
Interest	$ 2,436,935	$ 3,080,874
Federal income taxes	$ 260,360	$ 402,000

■ ■ ■ ■ ■