

*Our Values Are Our Foundation*

DART FINANCIAL CORPORATION 86<sup>TH</sup> ANNUAL REPORT 2010





### **Delmer Kramer** **1928 – 2010**

Delmer Kramer began his 40-year career at Dart Bank (then Dart National Bank) in 1954. Delmer passed through various jobs before landing in the bank's loan department. The quality of his work shone from the very first day. During his career Delmer attracted a great following of people because of his caring ways, his ability to give the best of counsel to people and his willingness to talk honestly with them — be it day or night. Delmer was a tremendous example of a man with a servant's heart.

It would be difficult to enumerate the man's contributions to our Mason area community. He served long years on the Mason Hospital board, had been a faithful Kiwanian and was one of the very key persons in founding, organizing and bringing into operations the Mason Kiwanis village, making housing available most reasonably for our seniors.

Delmer held various positions in the bank and retired in 1993 as the bank's Senior Vice President.

Delmer will be missed by many, many people who loved him, and we affectionately dedicate this, the *86th Annual Report of The Dart Financial Corporation*, to him. Thank you, Delmer, for all you have done for our bank, and for ALL of the people you served and cared for, while you were with us.

## TABLE OF CONTENTS • MISSION STATEMENT

Letter to Shareholders . . . . .	2
Five-Year Summary . . . . .	4
Independent Auditors' Report . . . . .	6
Consolidated Financial Statements, 2010 and 2009 . . . . .	7
2010 Management Team . . . . .	35
Dart Bankers . . . . .	35
Donations 2010 . . . . .	36
Board of Directors and Dart Bank Values . . . . .	Inside Back Cover

### OUR MISSION

*Our primary purposes are to meet the financial needs of our banking communities, protect and increase the value of stockholders' investments, and serve the community in financial and non-financial ways.*

*Our bank acknowledges the interdependence of all mankind in the world and reaches out beyond local areas in times of need.*

*We are committed to creating a workplace that nurtures the well-being and growth of our employees.*

February 7, 2011

### Dear Friends—Shareholders in Dart Financial Corporation:

Real progress was achieved in earnings during 2010. This is especially pleasing when considering the challenges of the prior year. Our profit was \$480,928 or \$ 0.80 per share and produced a Return on Equity of 2.0%. The prior year was in the black, but only nominally.

Improvement in net profit was driven by several factors but chiefly due to an increase in our net interest margin. Low and relatively stable interest rates allowed an increase in the margin to 3.75% compared to 3.21% the prior year. This was a record in dollar terms. Non-interest income was slightly lower than the prior year but did exceed \$2.0 million for only the second time.

A moderating unemployment rate is a sign of an improving economy, nationally and in Michigan also. Consumers and businesses are reluctant borrow, or invest. Increasing loans to qualified borrowers will be important to the continued recovery of earnings for your company. We are increasing our calling efforts and other marketing initiatives in an effort to increase loans.

We are concerned about regulations that will come from the Dodd-Frank Wall Street Reform and Consumer Protection Act. Actions from community banks like Dart did nothing to cause the recent financial crisis. However, we are sure to bear the cost of complying with provisions of new legislation and will likely see price controls placed on several business segments that generate fee income. Elected officials will be apprised of the importance of healthy community banks, directly, as well as by working with our state banking association.

Total assets declined by 7.1% and this was due, in large part, to the 10.1% reduction in net loans. Loans outstanding decreased for the second consecutive year. Contributing to this was last year's low rates encouraging a number of homeowners to refinance mortgages into the secondary market removing loans once held on our books. Recently we explained to you the features of our Goal Setter mortgage which we hope will help increase our residential mortgage loans.



*Peter Kubacki,  
Rollin Dart, and  
Richard Cheney*

# Teamwork

**TEAMWORK:** *We're different than other Financial Institutions; we work together as a team to accomplish goals established by our bank and the needs of our customers. It's easy for us because we are individuals with a lot of heart who care about making the difference in the lives of others.*

This past year nearly \$3.6 million was set aside from profits and added to our loan loss reserve. Our reserve for losses has reached a record level of 3.76% of outstanding loans. Loan charge-offs were higher this past year and our holdings of real estate taken through foreclosure have increased. Increases in these categories are to be expected as we emerge from this recession. We have been able to assist many borrowers by renegotiating their loan repayment terms. This offer of a second chance is part of what defines our community bank philosophy. We are happy to report that most of these borrowers have been able to honor the new repayment terms. Our willingness to restructure terms requires us to maintain a higher loss reserve.

We advised you in last year's report, as well as recently by letter, that the payment of dividends would not serve the long-term interest of the shareholders. Our Capital Ratio has strengthened, increasing at year-end to 9.15% compared to 8.46% in 2009. Our capital and the increased loan loss reserve should provide the necessary strength as we continue to work to reduce our non-performing assets. Your directors appreciate the importance of dividends and you are assured the board and management are working toward that goal.

Very few shares traded during this past year. Based upon the limited activity, the value of our shares would be in the range of \$37.00 to \$45.00. Please let us know if we should add your name to the list of interested purchasers.

Two years ago nine values appeared for the first time in the annual report under our mission statement. We feel these beliefs have been practiced in our everyday working lives but

had not been recorded in writing. All of us promised we would continue to keep these values alive in all we do, each day. The cover of this year's annual report features the theme "Our Values Are Our Foundation." We have met again this past year to define these values on a more personal level. You will find these interpretations within the pages of this year's report. We do not need a rule book for direction. Our values provide the necessary guidance.

The Annual Meeting of shareholders will begin at 6:30 p.m. on Tuesday, March 22, 2011 at the Delhi-South Lansing bank. As is our tradition refreshments will be served following the meeting. We look forward to seeing you.

With warm wishes we are,

Peter Kubacki, President and CEO

Richard Cheney, Chairman of the Board

Rollin Dart, C.E., Community Relations Officer



## FIVE-YEAR COMPARATIVE BALANCE SHEETS

# Stability

	As of December 31,				
Assets	2010	2009	2008	2007	2006
Cash and due from banks	\$ 8,141,379	\$ 6,543,470	\$ 4,909,218	\$ 4,284,852	\$ 6,298,695
Federal funds sold	<u>2,785,631</u>	<u>8,028,980</u>	<u>7,166,099</u>	<u>867,385</u>	<u>6,236,975</u>
Cash and cash equivalents	10,927,010	14,572,450	12,075,317	5,152,237	12,535,670
Interest-bearing deposits	2,428,033	5,010,232	3,859,549	4,254,749	4,759,890
Investment securities	62,543,028	58,724,963	49,998,254	47,007,182	54,525,455
Federal Home Loan Bank stock	1,432,400	1,505,000	1,305,000	765,900	765,900
Net loans	164,596,340	183,099,902	186,624,645	171,604,594	148,078,954
Premises and equipment, net	4,608,357	4,862,431	4,886,299	4,798,834	4,742,780
Accrued interest receivable	1,129,565	1,200,681	1,204,076	1,214,897	1,133,872
Foreclosed and repossessed assets	2,370,012	1,035,543	89,700	345,226	502,800
Bank-owned life insurance	5,681,184	5,473,497	5,270,881	3,641,400	—
Prepaid FDIC insurance premium	1,138,450	1,533,967	42,118	5,809	5,795
Other assets	<u>3,158,774</u>	<u>2,943,770</u>	<u>1,349,959</u>	<u>1,043,634</u>	<u>975,063</u>
	<u>\$ 260,013,153</u>	<u>\$ 279,962,436</u>	<u>\$ 266,705,798</u>	<u>\$ 239,834,462</u>	<u>\$ 228,026,179</u>
<b>Liabilities and Shareholders' Equity</b>					
Deposits					
Interest bearing	\$ 173,215,288	\$ 193,571,945	\$ 186,377,318	\$ 175,157,715	\$ 173,904,503
Noninterest bearing	<u>39,938,498</u>	<u>34,418,926</u>	<u>29,196,922</u>	<u>29,023,918</u>	<u>28,817,781</u>
	213,153,786	227,990,871	215,574,240	204,181,633	202,722,284
FHLB advances	22,100,000	27,100,000	26,100,000	11,100,000	1,100,000
Accrued interest payable	339,900	496,050	566,422	723,497	713,313
Deferred compensation	244,216	296,893	341,910	384,819	406,691
Other liabilities	<u>387,401</u>	<u>389,686</u>	<u>322,313</u>	<u>333,209</u>	<u>344,769</u>
	<u>236,225,303</u>	<u>256,273,500</u>	<u>242,904,885</u>	<u>216,723,158</u>	<u>205,287,057</u>
Shareholders' equity					
Common stock	17,000,000	17,000,000	17,000,000	17,000,000	17,000,000
Retained earnings	6,608,149	6,127,221	6,423,506	6,138,577	6,017,256
Accumulated other comprehensive income (loss)	<u>179,701</u>	<u>561,715</u>	<u>377,407</u>	<u>(27,273)</u>	<u>(278,134)</u>
	<u>23,787,850</u>	<u>23,688,936</u>	<u>23,800,913</u>	<u>23,111,304</u>	<u>22,739,122</u>
Total liabilities and shareholders' equity	<u>\$ 260,013,153</u>	<u>\$ 279,962,436</u>	<u>\$ 266,705,798</u>	<u>\$ 239,834,462</u>	<u>\$ 228,026,179</u>

## FIVE-YEAR COMPARATIVE STATEMENTS OF INCOME

	<b>Years Ended December 31,</b>				
	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Interest and dividend income					
Loans, including fees	\$ 11,014,466	\$ 11,876,458	\$ 12,121,214	\$ 11,539,619	\$ 10,219,867
Investment securities	2,550,397	2,267,753	2,191,921	2,514,460	2,596,323
Federal funds sold and other	<u>121,751</u>	<u>178,503</u>	<u>241,406</u>	<u>476,864</u>	<u>336,080</u>
	13,686,614	14,322,714	14,554,541	14,530,943	13,152,270
Interest expense					
Deposits	3,591,912	4,769,938	5,858,200	6,834,067	5,669,805
FHLB advances and other	<u>907,366</u>	<u>1,041,602</u>	<u>746,300</u>	<u>299,696</u>	<u>62,373</u>
	<u>4,499,278</u>	<u>5,811,540</u>	<u>6,604,500</u>	<u>7,133,763</u>	<u>5,732,178</u>
<b>Net interest income</b>	9,187,336	8,511,174	7,950,041	7,397,180	7,420,092
Provision for (reduction of provision for) loan losses	<u>3,577,200</u>	<u>4,000,840</u>	<u>1,457,685</u>	<u>595,710</u>	<u>(476,685)</u>
<b>Net interest income after provision for loan losses</b>	5,610,136	4,510,334	6,492,356	6,801,470	7,896,777
Noninterest income	<u>2,070,434</u>	<u>2,129,539</u>	<u>1,694,516</u>	<u>1,384,515</u>	<u>1,183,474</u>
Noninterest expenses					
Compensation and benefits	3,709,545	3,617,933	3,634,680	3,592,009	3,529,286
Occupancy and equipment	1,157,702	1,043,703	891,180	934,693	1,031,648
Office supplies	123,399	130,990	164,230	207,043	147,021
Charitable contributions	65,477	71,108	95,371	85,698	94,095
Other	<u>2,453,519</u>	<u>2,283,424</u>	<u>1,791,482</u>	<u>1,689,221</u>	<u>1,666,917</u>
	<u>7,509,642</u>	<u>7,147,158</u>	<u>6,576,943</u>	<u>6,508,664</u>	<u>6,468,967</u>
<b>Income (loss) before federal income taxes</b>	170,928	(507,285)	1,609,929	1,677,321	2,611,284
Federal income tax (benefit) expense	<u>(310,000)</u>	<u>(511,000)</u>	<u>305,000</u>	<u>356,000</u>	<u>639,000</u>
<b>Net income</b>	<u>\$ 480,928</u>	<u>\$ 3,715</u>	<u>\$ 1,304,929</u>	<u>\$ 1,321,321</u>	<u>\$ 1,972,284</u>

**STABILITY:** *Our history is built on a solid foundation, which will guide us through a strong future, keeping us a dependable bank.*



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## INDEPENDENT AUDITORS' REPORT

Shareholders and Board of Directors  
Dart Financial Corporation  
Mason, Michigan

We have audited the accompanying consolidated balance sheets of **Dart Financial Corporation** as of December 31, 2010 and 2009, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our 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, 2010 and 2009, 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.

February 11, 2011



CPAs • Business Consultants • Financial Advisors

## CONSOLIDATED BALANCE SHEETS

ASSETS	December 31,	
	2010	2009
Cash and due from banks	\$ 8,141,379	\$ 6,543,470
Federal funds sold	2,785,631	8,028,980
<b>Cash and cash equivalents</b>	<b>10,927,010</b>	<b>14,572,450</b>
Interest-bearing deposits	2,428,033	5,010,232
Investment securities:		
Available-for-sale, at estimated fair value	61,649,936	57,691,728
Held-to-maturity, at amortized cost	893,092	1,033,235
Federal Home Loan Bank stock, at cost	1,432,400	1,505,000
Net loans	164,596,340	183,099,902
Premises and equipment, net	4,608,357	4,862,431
Accrued interest receivable	1,129,565	1,200,681
Foreclosed and repossessed assets	2,370,012	1,035,543
Bank-owned life insurance	5,681,184	5,473,497
Prepaid FDIC insurance premium	1,138,450	1,533,967
Other assets	3,158,774	2,943,770
<b>Total assets</b>	<b>\$ 260,013,153</b>	<b>\$ 279,962,436</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Deposits</b>		
Interest-bearing	\$ 173,215,288	\$ 193,571,945
Noninterest-bearing	39,938,498	34,418,926
<b>Total deposits</b>	<b>213,153,786</b>	<b>227,990,871</b>
FHLB advances	22,100,000	27,100,000
Accrued interest payable	339,900	496,050
Deferred compensation	244,216	296,893
Other liabilities	387,401	389,686
<b>Total liabilities</b>	<b>236,225,303</b>	<b>256,273,500</b>
<b>Commitments and contingencies (Notes 13, 14, 15, and 16)</b>		
<b>Shareholders' equity</b>		
Common stock, no par; 1,000,000 shares authorized, 600,000 shares issued and outstanding	17,000,000	17,000,000
Retained earnings	6,608,149	6,127,221
Accumulated other comprehensive income	179,701	561,715
<b>Total shareholders' equity</b>	<b>23,787,850</b>	<b>23,688,936</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 260,013,153</b>	<b>\$ 279,962,436</b>

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

## CONSOLIDATED STATEMENTS OF INCOME

	<b>Year Ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Interest income</b>		
Loans, including fees	\$11,014,466	\$ 11,876,458
Investment securities	2,550,397	2,267,753
Federal funds sold and other	121,751	178,503
<b>Total interest income</b>	<b>13,686,614</b>	<b>14,322,714</b>
<b>Interest expense</b>		
Interest expense on deposits	3,591,912	4,769,938
Interest expense on FHLB advances and other	907,366	1,041,602
<b>Total interest expense</b>	<b>4,499,278</b>	<b>5,811,540</b>
<b>Net interest income</b>	<b>9,187,336</b>	<b>8,511,174</b>
Provision for loan losses	3,577,200	4,000,840
<b>Net interest income, after provision for loan losses</b>	<b>5,610,136</b>	<b>4,510,334</b>
<b>Noninterest income</b>	<b>2,070,434</b>	<b>2,129,539</b>
<b>Noninterest expenses</b>		
Compensation and benefits	3,709,545	3,617,933
Occupancy and equipment	1,157,702	1,043,703
Office supplies	123,399	130,990
Charitable contributions	65,477	71,108
Other	2,453,519	2,283,424
<b>Total noninterest expenses</b>	<b>7,509,642</b>	<b>7,147,158</b>
<b>Income (loss) before federal income tax benefit</b>	<b>170,928</b>	<b>(507,285)</b>
Federal income tax benefit	310,000	511,000
<b>Net income</b>	<b>\$ 480,928</b>	<b>\$ 3,715</b>
<b>Net income per basic share of common stock</b>	<b>\$ 0.80</b>	<b>\$ 0.01</b>

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

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	<b>Year Ended December 31,</b>	<b>2010</b>	<b>2009</b>
	<u>2010</u>	<u>2009</u>	
Unrealized holding (losses) gains on available-for-sale securities arising during the year	\$ (436,842)	\$ 375,606	
Reclassification adjustment for realized gains included in net income	<u>(141,972)</u>	<u>(96,352)</u>	
Other comprehensive (loss) income before federal income (taxes) benefit	(578,814)	279,254	
Deferred federal income (taxes) benefit related to other comprehensive (loss) income	<u>196,800</u>	<u>(94,946)</u>	
Other comprehensive (loss) income	(382,014)	184,308	
Net income	<u>480,928</u>	<u>3,715</u>	
<b>Comprehensive income</b>	<b><u><u>\$ 98,914</u></u></b>	<b><u><u>\$ 188,023</u></u></b>	

# Hard Work

### **HARD WORK:**

Being dedicated to go above and beyond with commitment to consistently provide the Dart Difference.

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

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	<u>Common Stock</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total Shareholders' Equity</u>
<b>Balances, January 1, 2009</b>	<b>\$ 17,000,000</b>	<b>\$ 6,423,506</b>	<b>\$ 377,407</b>	<b>\$ 23,800,913</b>
Comprehensive income	-	3,715	184,308	188,023
Cash dividends (\$.50 per share)	-	(300,000)	-	(300,000)
<b>Balances, December 31, 2009</b>	<b>17,000,000</b>	<b>6,127,221</b>	<b>561,715</b>	<b>23,688,936</b>
Comprehensive income	-	480,928	(382,014)	98,914
<b>Balances, December 31, 2010</b>	<b><u>\$ 17,000,000</u></b>	<b><u>\$ 6,608,149</u></b>	<b><u>\$ 179,701</u></b>	<b><u>\$ 23,787,850</u></b>

# Loyalty

### **LOYALTY:**

*Pride and  
dedication to  
staying together  
through thick  
and thin.*

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	<b>Year Ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 480,928	\$ 3,715
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	559,506	524,350
Provision for loan losses	3,577,200	4,000,840
Increase in cash surrender value of BOLI	(207,687)	(202,616)
Deferred federal income tax benefit	(599,000)	(821,000)
Gain on sales of investments	(141,972)	(96,352)
Gain on sales of loans	(144,124)	(182,303)
Origination of held-for-sale loans	(10,610,561)	(17,340,682)
Proceeds from sales of held-for-sale loans	10,754,685	17,522,985
Loss on sale of foreclosed assets	119,118	31,363
Net amortization of premiums on investment securities	227,451	103,727
Changes in operating assets and liabilities which provided (used) cash		
Accrued interest receivable and other assets	424,066	(1,057,783)
Prepaid FDIC insurance premium	395,517	(1,491,849)
Accrued interest payable and other liabilities	(211,112)	(48,016)
<b>Net cash provided by operating activities</b>	<b>4,624,051</b>	<b>946,379</b>
<b>Cash flows from investing activities</b>		
Activity in available-for-sale securities		
Purchases	(41,164,605)	(28,282,566)
Sales, maturities, calls, and prepayments	36,569,491	19,246,972
Maturities, calls, and prepayments of held-to-maturity securities	112,755	580,765
Net change in interest-bearing deposits	2,582,199	(1,150,683)
Loan principal collections (originations), net	12,578,908	(2,340,405)
Purchases and construction of premises and equipment	(77,621)	(307,062)
Proceeds from sales of foreclosed assets	893,867	887,102
Sales (purchases) of FHLB stock	72,600	(200,000)
<b>Net cash provided by (used in) investing activities</b>	<b>11,567,594</b>	<b>(11,565,877)</b>
<b>Cash flows from financing activities</b>		
Acceptances and withdrawals of deposits, net	(14,837,085)	12,416,631
Proceeds from FHLB advances	3,000,000	5,000,000
Repayments of FHLB advances	(8,000,000)	(4,000,000)
Cash dividends paid	-	(300,000)
<b>Net cash (used in) provided by financing activities</b>	<b>(19,837,085)</b>	<b>13,116,631</b>
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>(3,645,440)</b>	<b>2,497,133</b>
Cash and cash equivalents, beginning of year	14,572,450	12,075,317
<b>Cash and cash equivalents, end of year</b>	<b>\$ 10,927,010</b>	<b>\$ 14,572,450</b>

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, Nature of Business, and Concentrations of Risks

The 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 subsidiaries The Dart Mortgage Company, LLC and TDB Services, Inc. The Dart Mortgage Company, LLC was a mortgage banking company which was 99% owned by the Bank and 1% owned by TDB Services, Inc. TDB Services, Inc. is owned 100% by the Bank and its only business activity was its 1% ownership in The Dart Mortgage Company, LLC. Effective October 31, 2009, the Bank dissolved The Dart Mortgage Company, LLC; this dissolution had no effect on the consolidated financial statements. After the dissolution of The Dart Mortgage Company, LLC, TDB Services, Inc. became TDB Services, Inc. d/b/a The Dart Mortgage Company for branding purposes. TDB Services, Inc. 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.

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 industry, customer, or depositor, 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 15). 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 conform to predominant banking industry practices and are based on generally accepted accounting principles. The principles which materially affect the determination of the financial position or results of operations of the Corporation and its subsidiaries are summarized below.

### ***Cash and Cash Equivalents***

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***

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. All other securities are classified as “available-for-sale” and recorded at fair value, with unrealized gains and losses, net of the effect of deferred income taxes, reported in other comprehensive (loss) income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains or losses on the sale of securities are recorded in investment income on the trade date and are determined using the specific identification method.

Investment securities are reviewed at each reporting period for possible other-than-temporary impairment (“OTTI”). In determining whether an other-than-temporary impairment exists for debt securities, management must assert that: 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 must recognize an other-than-temporary impairment charge through earnings for the difference between the debt security’s amortized cost basis and its fair value, and such amount is included in noninterest income. For debt securities that do not meet the above criteria, and the Bank does not expect to recover a security’s amortized cost basis, the security is considered other-than-temporarily impaired. For these debt securities, 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. 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 and Related Income***

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 unamortized 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 non-accrual 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 non-accrual or charged-off status 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 continues to be accrued over the term of the loan based on the principal amount outstanding.

# Relationships

### ***Allowance for Loan Losses***

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of the loan balance is confirmed. Subsequent recoveries, if any, are generally credited 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 specific component relates to loans that are classified as doubtful, substandard, or special mention. For such loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is generally maintained to cover uncertainties that could affect management's estimate of probable losses. 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.

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.

### ***Transfers of Financial Assets***

Transfers of financial assets 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 6, the Bank has no substantive continuing involvement related to these loans.

**RELATIONSHIPS:** *We seek to establish mutually beneficial, caring relationships based on trust and the desire for mutual success.*

### *Servicing*

Servicing assets are recognized as separate assets when mortgaging 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 estimated based generally on market prices for comparable mortgage servicing contracts, when available. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. 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. 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.

### *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*

In 2009, 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, and 2012. The assessments for 2010 through 2012 have been deferred on the accompanying consolidated balance sheets as a prepaid asset, and are expected to be charged to expense on a ratable basis quarterly through December 31, 2012.

### ***Bank-Owned Life Insurance (BOLI)***

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 10 and 17).

### ***Advertising Costs***

All advertising costs, amounting to \$90,606 and \$115,379 in 2010 and 2009, respectively, are expensed as incurred.

### ***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.

### ***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.

The Corporation analyzes its filing positions in the jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The Corporation also treats interest and penalties attributable to income taxes, and reflects any charges for such, to the extent they arise, as a component of its noninterest expenses.

### ***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.

### ***Subsequent Events***

In preparing the accompanying consolidated financial statements, management has evaluated, for potential recognition or disclosure, significant events or transactions that occurred during the period subsequent to December 31, 2010, the most recent consolidated balance sheet presented herein, through February 11, 2011, 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, held-for-sale loans, 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:** 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, unless 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. Securities classified as Level 3 would include securities, if any, in less liquid markets, including illiquid markets in some instances.

**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 other loans (e.g., real estate mortgage, agricultural, commercial, and installment) 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, market 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, 2010, 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 statements of financial position 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, 2010 and 2009, 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 (i.e., interest- and noninterest-bearing checking, savings, and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Off-Balance Sheet Credit-Related Instruments:** 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 and Liabilities 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 and liabilities measured at fair value on a recurring basis as of December 31:

	<u>Assets at Fair Value</u>			
	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<b>December 31, 2010</b>				
Investment securities available-for-sale:				
Government-sponsored enterprises	\$ 14,084,915	\$ -	\$ 14,084,915	\$ -
State and municipal	24,761,518	-	24,761,518	-
Mortgage-backed securities	<u>22,803,503</u>	<u>-</u>	<u>22,803,503</u>	<u>-</u>
<b>Total assets at fair value</b>	<b><u>\$ 61,649,936</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 61,649,936</u></b>	<b><u>\$ -</u></b>
<b>December 31, 2009</b>				
Investment securities available-for-sale:				
Government-sponsored enterprises	\$ 16,212,673	\$ -	\$ 16,212,673	\$ -
State and municipal	20,131,459	-	20,131,459	-
Mortgage-backed securities	<u>21,347,596</u>	<u>-</u>	<u>21,347,596</u>	<u>-</u>
<b>Total assets at fair value</b>	<b><u>\$ 57,691,728</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 57,691,728</u></b>	<b><u>\$ -</u></b>

### Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

The following table presents the carrying value of those assets measured at fair value on a nonrecurring basis, for which impairment was recognized during the respective year.

	<u>Total Carrying Value</u>	<u>Level</u>		
		<u>1</u>	<u>2</u>	<u>3</u>
<b>December 31, 2010</b>				
Loans (1)	\$ 3,025,509	\$ -	\$ 788,375	\$2,237,134
Foreclosed and repossessed assets (2)	152,000	-	-	152,000
<b>December 31, 2009</b>				
Loans (1)	\$ 5,762,417	\$ -	\$ 3,690,731	\$2,071,686
Foreclosed and repossessed assets (2)	320,000	-	-	320,000

- (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 \$3,025,509 at December 31, 2010, resulting in an additional provision for loan losses of \$1,043,178 during 2010. Impaired loans, which are measured for impairment using the estimated fair value of the collateral for collateral dependent loans, had a carrying amount of \$5,762,417 at December 31, 2009, resulting in an additional provision for loan losses of \$1,897,056 during 2009.
- (2) Foreclosed assets, which are carried at the lower of carrying value or estimated fair value less costs to sell, were written down from cost to \$152,000 at December 31, 2010 resulting in a charge of \$61,000 to earnings during the year then ended. Foreclosed assets, which are carried at the lower of carrying value or estimated fair value less costs to sell, were written down from cost to \$320,000 at December 31, 2009 resulting in a charge of \$32,093 to earnings during the year then ended.

**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 described 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:

	<u>2010</u>		<u>2009</u>	
	<u>Carrying Value</u>	<u>Estimated Fair Value</u>	<u>Carrying Value</u>	<u>Estimated Fair Value</u>
<b>Financial assets</b>				
Cash and due from banks	\$ 8,141	\$ 8,141	\$ 6,543	\$ 6,543
Federal funds sold	2,786	2,786	8,029	8,029
Interest-bearing deposits	2,428	2,474	5,010	5,083
Investment securities	62,543	62,646	58,725	58,809
Loans, net	164,596	166,910	183,100	185,601
FHLB stock	1,432	1,432	1,505	1,505
Mortgage servicing rights	217	217	193	193
Accrued interest receivable	1,130	1,130	1,201	1,201
<b>Financial liabilities</b>				
Interest-bearing deposits	173,215	173,944	193,572	193,921
Noninterest-bearing deposits	39,938	39,938	34,419	34,419
FHLB advances	22,100	22,818	27,100	27,702
Accrued interest payable	340	340	496	496

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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:

<u>2010</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<b>Available-for-Sale</b>				
Government-sponsored enterprises	\$ 14,276,962	\$ 97,729	\$ 289,776	\$ 14,084,915
State and municipal	24,663,509	341,753	243,744	24,761,518
Mortgage-backed securities	<u>22,436,188</u>	<u>460,577</u>	<u>93,262</u>	<u>22,803,503</u>
<b>Total available-for-sale</b>	<b><u>61,376,659</u></b>	<b><u>900,059</u></b>	<b><u>626,782</u></b>	<b><u>61,649,936</u></b>
<b>Held-to-Maturity</b>				
State and municipal	845,000	99,027	-	944,027
Mortgage-backed securities	<u>48,092</u>	<u>4,056</u>	<u>-</u>	<u>52,148</u>
<b>Total held-to-maturity</b>	<b><u>893,092</u></b>	<b><u>103,083</u></b>	<b><u>-</u></b>	<b><u>996,175</u></b>
<b>Total</b>	<b><u>\$ 62,269,751</u></b>	<b><u>\$ 1,003,142</u></b>	<b><u>\$ 626,782</u></b>	<b><u>\$ 62,646,111</u></b>
<u>2009</u>				
<b>Available-for-Sale</b>				
Government-sponsored enterprises	\$ 16,269,561	\$ 125,435	\$ 182,323	\$ 16,212,673
State and municipal	19,705,177	465,233	38,951	20,131,459
Mortgage-backed securities	<u>20,864,899</u>	<u>528,495</u>	<u>45,798</u>	<u>21,347,596</u>
<b>Total available-for-sale</b>	<b><u>56,839,637</u></b>	<b><u>1,119,163</u></b>	<b><u>267,072</u></b>	<b><u>57,691,728</u></b>
<b>Held-to-Maturity</b>				
State and municipal	933,000	80,038	-	1,013,038
Mortgage-backed securities	<u>100,235</u>	<u>4,191</u>	<u>-</u>	<u>104,426</u>
<b>Total held-to-maturity</b>	<b><u>1,033,235</u></b>	<b><u>84,229</u></b>	<b><u>-</u></b>	<b><u>1,117,464</u></b>
<b>Total</b>	<b><u>\$ 57,872,872</u></b>	<b><u>\$ 1,203,392</u></b>	<b><u>\$ 267,072</u></b>	<b><u>\$ 58,809,192</u></b>

Investment securities with carrying values of approximately \$16,365,000 and \$17,660,000 at December 31, 2010 and 2009, 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, 2010 is summarized as follows:

	<u>Amortized Cost</u>	<u>Fair Value</u>
<b>Available-for-Sale</b>		
Due after one year through five years	\$ 2,904,075	\$ 3,001,194
Due after five years through ten years	9,582,423	9,758,772
Due after ten years	<u>26,453,973</u>	<u>26,086,467</u>
Subtotal	38,940,471	38,846,433
Mortgage-backed securities	<u>22,436,188</u>	<u>22,803,503</u>
<b>Total</b>	<b><u>\$ 61,376,659</u></b>	<b><u>\$ 61,649,936</u></b>
<b>Held-to-Maturity</b>		
Due in one year or less	\$ 67,000	\$ 68,354
Due after one year through five years	276,000	301,326
Due after five years through ten years	387,000	442,810
Due after ten years	<u>115,000</u>	<u>131,537</u>
Subtotal	845,000	944,027
Mortgage-backed securities	<u>48,092</u>	<u>52,148</u>
<b>Total</b>	<b><u>\$ 893,092</u></b>	<b><u>\$ 996,175</u></b>

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

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

Proceeds from sales of available-for-sale securities amounted to \$3,203,761 and \$2,981,966 in 2010 and 2009, respectively. Gross realized gains amounted to \$141,972 and \$96,352 in 2010 and 2009, respectively. There were no gross realized losses during either year.

# Integrity

## **INTEGRITY:**

*Our character guides us to do the right things even when no one is watching.*

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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:

	<u>Less Than Twelve Months</u>		<u>Over Twelve Months</u>		<u>Total Gross Unrealized Losses</u>
	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	
<b>2010</b>					
<b>Securities available-for-sale</b>					
Government-sponsored enterprises	\$ 289,776	\$ 9,710,224	\$ -	\$ -	\$ 289,776
State and municipal	243,744	7,794,656	-	-	243,744
Mortgage-backed securities	<u>93,262</u>	<u>6,006,515</u>	<u>-</u>	<u>-</u>	<u>93,262</u>
<b>Total securities available-for-sale</b>	<b><u>\$ 626,782</u></b>	<b><u>\$ 23,511,395</u></b>	<b><u>\$ -</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 626,782</u></b>
<b>2009</b>					
<b>Securities available-for-sale</b>					
Government-sponsored enterprises	\$ 182,323	\$ 9,316,746	\$ -	\$ -	\$ 182,323
State and municipal	38,951	2,637,559	-	-	38,951
Mortgage-backed securities	<u>45,798</u>	<u>4,644,012</u>	<u>-</u>	<u>-</u>	<u>45,798</u>
<b>Total securities available-for-sale</b>	<b><u>\$ 267,072</u></b>	<b><u>\$ 16,598,317</u></b>	<b><u>\$ -</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 267,072</u></b>

Management has asserted that it does not have the intent to sell investment securities in an unrealized loss position and that it is more likely than not that the Bank will not have to sell such securities before recovery of their cost basis; therefore, the Corporation does not consider these investments to be other-than-temporarily impaired at December 31, 2010.

#### 4. LOANS

The Bank grants commercial, 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 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.

Major loan classifications are summarized as follows as of December 31:

	<u>2010</u>	<u>2009</u>
Mortgage loans		
Residential 1-4 family	\$ 50,666,454	\$ 59,712,525
Commercial	88,389,847	92,118,863
Construction	3,903,913	5,541,312
Equity lines of credit	<u>3,604,860</u>	<u>3,815,923</u>
Total mortgage loans	146,565,074	161,188,623
Commercial	18,626,160	19,712,643
Consumer installment loans	<u>6,004,430</u>	<u>7,553,958</u>
Total loans	171,195,664	188,455,224
Less		
Allowance for loan losses	6,430,000	5,340,000
Deferred gain on loan repurchase	160,909	-
Net deferred loan origination fees	<u>8,415</u>	<u>15,322</u>
<b>Net loans</b>	<b><u>\$ 164,596,340</u></b>	<b><u>\$ 183,099,902</u></b>

At December 31, 2010 scheduled maturities of loans with fixed rates of interest are summarized as follows:

One year or less	\$ 14,786,283
One to five years	93,175,557
Over five years	<u>33,958,743</u>
<b>Total</b>	<b><u>\$ 141,920,583</u></b>

Variable rate loans of \$29,295,493 reprice annually or more frequently.

The following is a summary of information pertaining to impaired and non-accrual loans as of and for the year ended December 31:

	<u>2010</u>	<u>2009</u>
<b>Impaired loans:</b>		
Total impaired loans with a valuation allowance	<u>\$ 9,175,951</u>	<u>\$ 8,270,508</u>
Valuation allowance related to impaired loans	<u>\$ 2,513,434</u>	<u>\$ 2,508,091</u>
Average investment in impaired loans	<u>\$ 9,088,963</u>	<u>\$ 6,094,179</u>
Interest income recognized on impaired loans	<u>\$ 260,074</u>	<u>\$ 255,794</u>
Interest income recognized on a cash basis on impaired loans	<u>\$ -</u>	<u>\$ -</u>
<b>Nonperforming loans:</b>		
Loans on nonaccrual status	<u>\$ 5,129,729</u>	<u>\$ 7,294,135</u>
Loans past due over 90 days still on accrual	<u>\$ -</u>	<u>\$ 1,673</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

No additional funds were committed to be advanced in connection with impaired loans.

Impaired loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

### 5. ALLOWANCE FOR LOAN LOSSES

The following is a summary of the changes in the allowance for loan losses during the years ended December 31:

	<u>2010</u>	<u>2009</u>
<b>Balance, beginning of year</b>	<b>\$ 5,340,000</b>	<b>\$ 2,550,000</b>
Loans charged off	(2,568,553)	(1,380,873)
Recoveries	81,353	170,033
Net charge offs	(2,487,200)	(1,210,840)
Provision for loan losses	3,577,200	4,000,840
<b>Balance, end of year</b>	<b><u>\$ 6,430,000</u></b>	<b><u>\$ 5,340,000</u></b>

### 6. SERVICING

The Bank services loans for others which generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and taxing authorities, and processing foreclosures. Loans serviced for others are not included on the accompanying consolidated balance sheets. The unpaid principal balances of mortgages and other loans serviced for others were approximately \$35,793,000 and \$31,757,000 at December 31, 2010 and 2009, respectively. The activity pertaining to mortgage servicing rights was not significant during the years then ended.

### 7. PREMISES AND EQUIPMENT

A summary of the cost and accumulated depreciation of premises and equipment is as follows at December 31:

	<u>2010</u>	<u>2009</u>
Land and improvements	\$ 2,028,585	\$ 2,002,710
Buildings and improvements	4,029,225	4,005,284
Furniture and equipment	<u>2,634,059</u>	<u>3,237,208</u>
Total premises and equipment	8,691,869	9,245,202
Less accumulated depreciation	<u>4,083,512</u>	<u>4,382,771</u>
<b>Premises and equipment, net</b>	<b><u>\$ 4,608,357</u></b>	<b><u>\$ 4,862,431</u></b>

Depreciation expense amounted to \$331,656 and \$330,930 in 2010 and 2009, respectively.

## 8. DEPOSITS

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

	<u>2010</u>	<u>2009</u>
<b>Interest-bearing</b>		
NOW accounts	\$ 13,897,127	\$ 16,654,786
Savings	71,611,253	64,203,319
Time, \$100,000 and over	37,935,172	52,719,698
Other time	<u>49,771,736</u>	<u>59,994,142</u>
<b>Total interest-bearing</b>	173,215,288	193,571,945
Noninterest-bearing demand	<u>39,938,498</u>	<u>34,418,926</u>
<b>Total deposits</b>	<b><u>\$ 213,153,786</u></b>	<b><u>\$ 227,990,871</u></b>

Interest expense on time deposits issued in denominations of \$100,000 or more was \$1,534,163 and \$1,919,769 in 2010 and 2009, respectively.

Scheduled maturities of time deposits for each of the five years succeeding December 31, 2010 and thereafter are summarized as follows:

2011	\$ 30,114,957
2012	26,623,689
2013	13,469,731
2014	10,034,599
2015	7,302,390
Thereafter	<u>161,542</u>
<b>Total</b>	<b><u>\$ 87,706,908</u></b>

## 9. 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 agency securities with combined carrying values of approximately \$35,445,000 and \$42,430,000 at December 31, 2010 and 2009, respectively. During 2008, the Bank increased the amount of collateral pledged to the FHLB to increase the Bank's borrowing limit to create the possibility of additional liquidity. Required principal payments are \$8,000,000 in 2011, \$5,000,000 in 2012, \$9,000,000 in 2013, and \$100,000 in 2021. Interest is charged on these advances at fixed annual rates ranging from 2.74% to 4.5%.

At December 31, 2010, the Bank also had \$33,900,000 in borrowing availability under short-term lines of credit.

# Honesty

### **HONESTY:**

*Committed to the practice  
of choosing to be  
forthright and respectful;  
this is who we are.*

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 10. NONINTEREST INCOME

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

	<u>2010</u>	<u>2009</u>
Fees and service charges	\$ 1,157,532	\$ 1,218,778
Increase in cash surrender value of BOLI	207,686	202,616
Gain on sales of loans	144,124	182,303
Other	<u>561,092</u>	<u>525,842</u>
<b>Total noninterest income</b>	<b><u>\$ 2,070,434</u></b>	<b><u>\$ 2,129,539</u></b>

### 11. FEDERAL INCOME TAXES

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

	<u>2010</u>	<u>2009</u>
Currently payable	\$ (289,000)	\$ (310,000)
Deferred benefit	<u>599,000</u>	<u>821,000</u>
<b>Total benefit</b>	<b><u>\$ 310,000</u></b>	<b><u>\$ 511,000</u></b>

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

	<u>2010</u>	<u>2009</u>
Income (tax) benefit at statutory rate	\$ (58,000)	\$ 172,000
Effect of tax-exempt interest income	352,000	313,000
Effect of nondeductible interest expense	(31,000)	(32,000)
Other reconciling amounts	<u>47,000</u>	<u>58,000</u>
<b>Income tax benefit reported</b>	<b><u>\$ 310,000</u></b>	<b><u>\$ 511,000</u></b>

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:

	<u>2010</u>	<u>2009</u>
<b>Deferred tax assets:</b>		
Allowance for loan losses	\$ 1,905,259	\$ 1,519,290
Deferred compensation	83,033	100,944
Other	<u>431,209</u>	<u>253,669</u>
<b>Total deferred tax assets</b>	<b><u>2,419,501</u></b>	<b><u>1,873,903</u></b>

	<u>2010</u>	<u>2009</u>
<b>Deferred tax liabilities:</b>		
Premises and equipment	\$ 277,229	\$ 355,773
Mortgage servicing rights	73,740	65,744
Prepaid expenses	73,098	54,895
FHLB stock	24,588	25,645
Unrealized gain on available-for-sale securities	<u>92,915</u>	<u>289,711</u>
<b>Total deferred tax liabilities</b>	<b><u>541,570</u></b>	<b><u>791,768</u></b>
<b>Net deferred tax asset</b>	<b><u>\$ 1,877,931</u></b>	<b><u>\$ 1,082,135</u></b>

The Corporation has evaluated the provisions of ASC Topic 740, *Accounting for Uncertainty in Income Taxes*. The evaluation was performed for the years 2007 through 2010, the years which remain subject to examination by major tax jurisdictions as of December 31, 2010. 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, 2010 or 2009, and it is not aware of any claims for such amounts by federal or state income tax authorities.

## 12. 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 \$885,000 and \$1,182,000 at December 31, 2010 and 2009, respectively.

### Deposits

Deposits of Bank directors and executive officers and their affiliates were approximately \$2,163,000 and \$1,471,000 at December 31, 2010 and 2009, respectively.

## 13. OFF-BALANCE SHEET ACTIVITIES

### Credit-Related Financial Instruments

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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

At December 31, 2010 and 2009, the following financial instruments were outstanding whose contract amounts represent credit risk:

	<u>Contract Amount</u>	
	<u>2010</u>	<u>2009</u>
Unfunded commitments under lines of credit	\$ 10,621,677	\$ 11,804,106
Commitments to grant loans	3,116,105	492,990
Commitments under overdraft protection agreements	3,526,198	3,574,426
Commercial and standby letters of credit	375,391	272,984

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, 2010 and 2009 such collateral amounted to approximately \$3,933,000 and \$659,000, 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, 2010 or 2009.

### 14. 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, 2010 and 2009.

### ***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, 2010 and 2009.

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.

## **15. 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2010 and 2009, that the Corporation and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2010, 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, 2010 and 2009 are also presented in the following table.

<u>As of December 31, 2010</u>	<u>Actual</u>		<u>Minimum Capital Requirement</u>		<u>Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
	(Dollars in thousands)					
Total capital to risk weighted assets						
Corporation	\$ 25,061	14.60 %	\$ 14,072	8.0%	\$ N/A	N/A %
Bank	25,058	14.60	14,072	8.0	17,591	10.0
Tier 1 capital to risk weighted assets						
Corporation	22,862	13.32%	7,036	4.0	N/A	N/A
Bank	22,859	13.32	7,036	4.0	10,554	6.0
Tier 1 capital to average assets						
Corporation	22,862	8.67%	10,550	4.0	N/A	N/A
Bank	22,859	8.67	10,550	4.0	13,186	5.0
 <u>As of December 31, 2009</u>						
Total capital to risk weighted assets						
Corporation	\$ 25,347	13.33%	\$ 15,210	8.0 %	\$ N/A	N/A%
Bank	25,341	13.33	15,210	8.0	19,013	10.0
Tier 1 capital to risk weighted assets						
Corporation	22,934	12.06	7,605	4.0	N/A	N/A
Bank	22,928	12.06	7,605	4.0	11,408	6.0
Tier 1 capital to average assets						
Corporation	22,934	8.24	11,132	4.0	N/A	N/A
Bank	22,928	8.24	11,132	4.0	13,914	5.0

### **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 \$1,217,000 and \$911,000 at December 31, 2010 and 2009, respectively.

### **Other Matters**

In November 2009, the Bank's Board of Directors issued a resolution committing the Bank to certain actions intended to improve and increase, among other things, the Bank's capital levels, asset quality, and earnings. Among other actions, such resolution committed the Bank to continue the suspension of shareholder dividends through 2010.

## **16. 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, 2010 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, 2010.

## **17. EMPLOYEE BENEFIT PLANS**

### **401(k) Plan**

The Bank maintains, pursuant to section 401(k) of the Internal Revenue Code, a retirement plan which covers all eligible employees. 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. In 2010 and 2009, the Bank made matching contributions of approximately \$58,000 and \$0, respectively.

### **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 \$16,000 and \$19,000 in 2010 and 2009, respectively.

# Respect

## **RESPECT:**

*Consistently treating others  
as we want to be treated.*

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Bank-Owned Life Insurance

The Bank has invested \$5,000,000 in single premium, bank-owned, endorsement split-dollar, whole life insurance programs. Bank-owned life insurance is an alternative investment vehicle, generally non-liquid, which may produce additional earnings to offset, and later fund, various employee supplemental benefit expenses. The earnings on the policies are not taxed unless withdrawn or surrendered prior to the death of the insured. The increase in cash surrender value of the policies, which was approximately \$207,000 and \$203,000 in 2010 and 2009, 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.

### 18. SUPPLEMENTAL CASH FLOWS INFORMATION

#### Non-Cash Investing Activities

During 2010 and 2009, collateral was foreclosed and repossessed related to outstanding loans of approximately \$2,374,000 and \$1,864,000, 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:

	<u>2010</u>	<u>2009</u>
Interest	<u>\$ 4,655,428</u>	<u>\$ 5,881,912</u>
Federal income taxes	<u>\$ 505,000</u>	<u>\$ 629,000</u>

\* \* \* \* \*

## 2010 MANAGEMENT TEAM

Trina Austin . . . . .	Assistant Manager/Holt	Debra Mack . . . . .	Vice President
Debra Borst . . . . .	Assistant Vice President	Michelle Memenga . . . . .	Assistant Manager/Mason
Colleen Briggs . . . . .	Consumer Loan Officer/CRA	Debra Miles . . . . .	Vice President
Scott Cornell . . . . .	IT Officer	John Morris . . . . .	Assistant Vice President
Melanie Dart . . . . .	Business Development Associate	Charles Parker . . . . .	Special Assets Workout Officer
Rollin Dart . . . . .	Chairman Emeritus/Community Relations Officer	Sally Rae . . . . .	Executive Vice President
Mark Emmert . . . . .	Vice President	Karla Spoor . . . . .	Assistant Vice President
Craig Goble . . . . .	Vice President	Sharon Thompson . . . . .	Vice President
Cindy Hamilton . . . . .	Vice President	Mary Tressel . . . . .	Special Assets Officer
Kimberly Harless . . . . .	Assistant Vice President/Office Manager/Holt	Brian Vicary . . . . .	Office Manager/Mason
Mark Howe . . . . .	Vice President	Timothy Walling . . . . .	Vice President
Tammy Jenks . . . . .	Assistant Manager/Grand Ledge	Jacob Walters . . . . .	Sr. Credit Analyst/Lender
Peter Kubacki . . . . .	President & CEO	John Watson . . . . .	Credit Analyst
Devin Lavengood . . . . .	Office Manager/Grand Ledge	Susan Webster . . . . .	Assistant Vice President
Nanette Listing . . . . .	Assistant Vice President		

## DART BANKERS

	Years of Service		Years of Service		Years of Service		Years of Service
Noreen Akom . . . . .	42	Lindsey Edmiston . . . . .	2	Nanette Listing . . . . .	5	Kylie Rogers-Strahan . . . . .	
Joy Allaire . . . . .	13	Mark Emmert . . . . .	6	Debra Mack . . . . .	1	Lori Sallek . . . . .	6
Shannon Arnett . . . . .	2	Ed Evert . . . . .	8	Sally Mangles . . . . .	12	Diana Soule . . . . .	14
Trina Austin . . . . .	10	Loretta Farnsworth . . . . .	46	Vicie McClung . . . . .	13	Karla Spoor . . . . .	19
Lauren Boehlke . . . . .		Deborah Fedewa . . . . .	2	Angela McPhail . . . . .	6	Sharon Thompson . . . . .	31
Debra Borst . . . . .	24	Craig Goble . . . . .	23	Michelle Memenga . . . . .	2	Barb Titus . . . . .	24
Barbara Brevick . . . . .		Cindy Hamilton . . . . .	5	Debra Miles . . . . .	23	Debra Town . . . . .	10
Colleen Briggs . . . . .	31	Kimberly Harless . . . . .	5	Becky Moore . . . . .	7	Mary Tressel . . . . .	13
Pennie Brownlee . . . . .	8	Larry Howe . . . . .	12	John Morris . . . . .	5	Devon Upton . . . . .	31
Elfriede Cairns . . . . .	9	Mark Howe . . . . .	25	Shelly Motes . . . . .		Adrienne Vandecar . . . . .	
Jennifer Campbell . . . . .	5	Connie Ireland . . . . .	17	Jack Mulholland . . . . .		Brian Vicary . . . . .	1
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Miranda Cloud . . . . .	4	Tammy Jenks . . . . .	6	Teri Myers . . . . .	3	Kevin Waldie . . . . .	2
Scott Cornell . . . . .	5	Jamie Jones . . . . .		Heather Newman . . . . .	4	Timothy Walling . . . . .	2
Douglas Crips . . . . .	3	Natasha Kirchmeier . . . . .	8	Tara Owens . . . . .	12	Heather Walters . . . . .	10
Melanie Dart . . . . .	5	Julie Konen . . . . .	1	Charles Parker . . . . .	1	Jacob Walters . . . . .	4
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John Dodge . . . . .	2	Amy Lane . . . . .	6	Jill Raab . . . . .	12	Judith Wentland . . . . .	8
Ellen Dral . . . . .		Stephanie LaPratt . . . . .	10	Sally Rae . . . . .	33		
Diana Ebare . . . . .	25	Devin Lavengood . . . . .	4	Mary Ribby . . . . .	5		

*Dart Bank has a written Affirmative Action Compliance Plan on equal employment opportunity.*

*It is designed to provide guidance to management with respect to the bank's commitment to full implementation of its Equal Opportunity/Affirmative Action policy.*

## DONATIONS 2010 (PARTIAL LIST)

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City Rescue Mission of Lansing  
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Grand Ledge Music Boosters  
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Holt Education Foundation  
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# Community

### **COMMUNITY:**

*We're a caring family, living and working together,  
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