# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
# Washington, D.C. 20549
# Form 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

**For the fiscal year ended December 31, 2014**

**or**

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___________to ___________

Commission file number 0-25752

# FNBH BANCORP, INC.

(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| **MICHIGAN** | **No. 38-2869722** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **101 East Grand River, Howell, Michigan** | **48843** |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code: (517) 546-3150

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

**Common Stock, no par value**

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Exchange Act Rule 12b-2). Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter. The aggregate market value of common stock held by non-affiliates as of June 30, 2014, was $10,995,296.

The number of outstanding shares of common stock (no par value) as of March 31, 2015 was 27,770,423.

Documents Incorporated by Reference:

Portions of the Corporation's Proxy Statement for the Annual Meeting of Shareholders to be held May 28, 2015 are incorporated by reference into Part III of this report.

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## FORWARD-LOOKING STATEMENTS

*Discussions and statements in this Annual Report on Form 10-K that are not statements of historical fact, including, without limitation, statements that include terms such as "will," "may," "should," "believe," "expect," "forecast," "anticipate," "estimate," "project," "intend," "likely," "optimistic" and "plan," and statements about future or projected financial and operating results, plans, projections, objectives, expectations, and intentions and other statements that are not historical facts, are forward-looking statements. Forward-looking statements include, but are not limited to, statements about the likelihood of additional regulatory enforcement action against our Bank or the Bank's ability to comply with the existing Consent Order; descriptions of plans and objectives for future operations, products or services; projections of our future revenue, earnings or other measures of economic performance; forecasts of credit losses and other asset quality trends; judgments concerning the likelihood of future negative provision expense and/or reinstatement of net deferred tax assets; predictions as to our Bank's ability to maintain certain regulatory capital standards, including the impact of Basel III; our expectation that we will have or be able to maintain sufficient cash to meet expected obligations during 2015; and descriptions of other steps we may take to improve our capital position. These forward-looking statements express our current expectations, forecasts of future events, or long-term goals and, by their nature, are subject to assumptions, risks, and uncertainties. Although we believe that the expectations, forecasts, and goals reflected in these forward-looking statements are reasonable, actual results could differ materially for a variety of reasons, including, among others:*

- *our ability to comply with the various requirements imposed by the regulatory Consent Order against the Bank;*
- *our ability to implement our recovery plan initiatives;*
- *economic, market, operational, liquidity, credit, and interest rate risks associated with our business;*
- *economic conditions generally and in the financial services industry, particularly economic conditions within Michigan and the regional and local real estate markets in which our Bank operates;*
- *the failure of assumptions underlying the establishment of, and provisions made to, our allowance for loan losses;*
- *the ability of our Bank to maintain certain regulatory capital standards;*
- *increased competition in the financial services industry, either nationally or regionally;*
- *our ability to achieve loan and deposit growth;*
- *volatility and direction of market interest rates;*
- *limitations on our ability to access and rely on wholesale funding sources;*
- *the continued services of our management team and*
- *implementation of new legislation and regulatory initiatives, which may have significant effects on us and the financial services industry*

*This list provides examples of factors that could affect the results described by forward-looking statements contained in this Annual Report on Form 10-K, but the list is not intended to be all inclusive. The risk factors disclosed in Part I – Item A below, include all known risks our management believes could materially affect the results described by forward-looking statements in this report. However, those risks may not be the only risks we face. Our results of operations, cash flows, financial position, and prospects could also be materially and adversely affected by additional factors that are not presently known to us that we currently consider to be immaterial, or that develop after the date of this report. We cannot assure you that our future results will meet expectations. While we believe the forward-looking statements in this report are reasonable, you should not place undue reliance on any forward-looking statement. In addition, these statements speak only as of the date made. We do not undertake, and expressly disclaim, any obligation to update or alter any statements, whether as a result of new information, future events, or otherwise, except as required by applicable law.*

## PART I

### Item 1. Business.

FNBH Bancorp, Inc. (the “Corporation”), a Michigan business corporation, is a one-bank holding company, which owns all of the outstanding capital stock of First National Bank in Howell (the “Bank”). The Corporation and the Bank are collectively herein referred to as “FNBH”. The Bank was organized in 1934 as a national banking association. The Corporation was formed in 1988 for the purpose of becoming a holding company for the Bank, which occurred through a transaction effective in May 1989. Our website address is www.fnbh.com. Through our website, we make available free of charge, as soon as reasonably practical after such information has been filed with the Securities and Exchange Commission (the “SEC”), our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed with the SEC. Also available on our website are the respective charters of the Board’s Audit Committee, Compensation Committee, and Nominating and Corporate Governance Committee, as well as the Corporation’s Code of Ethics for Chief Executive Officer and Senior Financial Officers.

As of December 31, 2014, the Bank had approximately 86 full-time and part-time employees. None of the Bank’s employees are subject to collective bargaining agreements. The Corporation does not directly employ any personnel. The Bank serves primarily five communities, Howell, Brighton, Green Oak Township, Hartland, and Fowlerville, all of which are located in Livingston County. The county has historically been rural in character but has a growing suburban population.

The Bank is currently subject to a Consent Order with its primary federal regulator, the Office of the Comptroller of the Currency (the "OCC"), dated October 31, 2013 (which Consent Order replaced an earlier Consent Order issued September 24, 2009). As discussed in this Annual Report on Form 10-K, the Consent Order requires the Bank to maintain total capital equal to 11% of risk weighted assets and Tier 1 capital equal to at least 8.5% of adjusted total assets (which were also the minimum capital ratios required by the 2009 Consent Order) and also requires the Board of Directors and management of the Bank to take a number of actions designed to improve the Bank's operations, including several measures intended to enhance the Bank's risk management policies and practices.

In 2013, FNBH completed a recapitalization that caused the Bank to meet the minimum capital ratios required by the Consent Order as of December 31, 2013 and through the current date. That recapitalization included (1) the issuance of 17,510 shares of the Corporation's Series B Mandatorily Convertible Non-Cumulative Junior Participating Preferred Stock in a private placement transaction that closed December 11, 2013, which raised aggregate net proceeds of approximately $16.5 million, and (2) the issuance of 2.3 million shares of the Corporation's common stock pursuant to a rights offering registered with the SEC that closed March 27, 2014, which raised aggregate net proceeds of approximately $1.5 million. A total of approximately $16.0 million of these net proceeds have been contributed by the Corporation to the Bank to restore the Bank's capital.

As a result of this recapitalization, the Bank currently remains in compliance with the minimum capital ratios required by the Consent Order. The Bank continues to work to comply with the remaining provisions of the Consent Order, but expects the Consent Order to remain in place for some period of time until the Bank can demonstrate full compliance with its requirements.

#### Bank Services

The Bank is a full-service bank offering a wide range of commercial and personal banking services. These services include checking accounts, savings accounts, certificates of deposit, commercial loans, real estate loans, installment loans, wealth management services, collections, night depository, safe deposit box, telephone banking, internet banking, mobile banking, and online bill pay. The Bank maintains correspondent relationships with major banks, pursuant to which the Bank engages in the clearance of checks and certain foreign currency transactions. In addition, the Bank participates with other financial institutions to fund certain large loans which would exceed the Bank’s legal lending limit if made solely by the Bank.

The Bank has a relationship with the Federal Home Loan Bank of Indianapolis (“FHLBI”) where it makes short term investments and where it has a line of credit of $21.8 million of which no amounts were outstanding as of year-end. The Bank also has a relationship with the Federal Reserve Bank of Chicago, where it has a line of credit through the Federal Reserve's discount window of $4.0 million of which no amounts were outstanding at year-end. Each of the lines is collateralized by specific pledged loans and/or investment securities. Due to the Bank’s condition, borrowing availability under the lines is subject to approval by the FHLBI and Federal Reserve, respectively, and terms may be limited or restricted.

The Bank’s deposits are generated in the normal course of business, and the loss of any one depositor would not have a materially adverse effect on the business of the Bank. As of December 31, 2014 and 2013, the Bank’s certificates of deposit of $100,000 or more constituted approximately 9% and 10% of total deposit liabilities, respectively. The Bank’s deposits are primarily from its service areas, and the Bank does not traditionally seek or encourage large deposits from outside the area.

The Bank’s principal sources of revenue are interest and fees on loans and interest on investment securities. Interest and fees on loans constituted approximately 65% and 70% of total revenues for the years ended December 31, 2014 and 2013. Interest and dividends on investment securities, including short-term investments and certificates of deposit, constituted approximately 15% of total revenues in 2014 and 9% of total revenues in 2013. Revenues were also generated from deposit service charges and other financial service fees.

The Bank provides loans secured by real estate and consumer and commercial loans to customers in its market. As of December 31, 2014, 87% of outstanding loans were secured by real estate of which 81% were secured by non-farm, non-residential properties or construction and land development loans. The Bank’s loan portfolio is comprised of 63% fixed rate and 37% variable rate loans. Most of the Bank’s loans, approximately 75%, mature within five years. Loans with fixed rates totaling approximately $15.6 million (or about 10% of the Bank’s total loan portfolio) have remaining balances that mature after five years. Sixty-four percent of the Bank’s interest-bearing deposits are in NOW, savings, and MMDAs, all of which are variable rate products. As of December 31, 2014, certificates of deposits totaled approximately $68.2 million with $38.9 million maturing within a year, and the majority of the balance maturing within a five year period.

Requests to the Bank for credit are considered on the basis of the creditworthiness of each applicant, without consideration to race, color, religion, national origin, sex, marital status, physical handicap, age, or the receipt of income from public assistance programs. Consideration is also given to the applicant's capacity for repayment, collateral, capital and alternative sources of repayment. Loan applications are accepted at all the Bank's offices and are approved under each lending officer's authority. Request for loans from borrowers with aggregate indebtedness to the Bank in excess of $1.5 million are required to be presented to the Board of Directors or the Executive Committee of the Board for review and approval.

As described in more detail below, FNBH's cumulative one year gap ratio of rate sensitive assets to rate sensitive liabilities was 232% and 173% asset sensitive at December 31, 2014 and 2013, respectively. See Item 7A "Quantitative and Qualitative Disclosures about Market Risk" below.

The Bank sells participations in commercial loans to other financial institutions approved by the Bank for the purpose of meeting legal lending limit requirements or loan concentration considerations. Loans are classified as held for investment unless management does not have the intent or ability to hold the loans for the foreseeable future, or until maturity or payoff. The Bank utilizes a third party vendor to provide residential mortgage loans to Bank customers. The Bank also may purchase loans that meet its normal credit standards.

The Bank's investment policy is designed to provide a framework within which the Bank may maximize earnings potential by acquiring assets designed to enhance profitability, absorb excess funds, provide liquidity, maintain a high credit quality, implement interest rate risk measures, provide collateral for pledging, generate a favorable return on investments, and provide tax-exempt income as appropriate. Safety, liquidity, and interest rate risk standards are not compromised in favor of increased return. When making investment decisions, the Bank considers investment type, credit quality (including maximum credit exposure to one obligor at any one time) and maturity of investments. Consideration is also given to each investment's risk-weight as determined by regulatory Risk-Based Capital Guidelines.

The investment portfolio is coordinated with the overall asset/liability management of the balance sheet. The use of the investment portfolio for market oriented trading activities or speculative purposes is expressly prohibited unless otherwise approved by the Board of Directors. Investments are acquired for which the Bank has both the ability and intent to hold to maturity. Specific limits determine the types, maturities, and amounts of securities the Bank intends to hold. Guidelines on liquidity requirements, as well as an acknowledgement of the Bank's credit profile and capital position may affect the Bank's ability to hold securities to maturity. It is not the intention of management to profit from short-term securities price movements. Business reasons for securities purchases and sales are noted at the time of the transaction. All securities dealers effecting transactions in securities held or purchased by the Bank must be approved by the Board of Directors.

**Bank Competition**

The Bank has eight offices within the five communities it serves, all of which are located in Livingston County, Michigan. Three of the offices, including the main office, are located in Howell. There are two facilities in Brighton, and one each in Green Oak Township, Hartland, and Fowlerville. See "Properties" below for more detail on these facilities. Within these communities, the Bank's principal competitors are JP Morgan Chase Bank, Fifth Third Bank, PNC Bank, FirstMerit Bank, Comerica Bank, TCF Bank and Bank of America. Each of these financial institutions, all of which are headquartered in larger metropolitan areas, has significantly greater assets and financial resources than FNBH. Among the principal competitors in the communities in which the Bank operates, the Bank is the only financial institution with a local community headquarters. Based on deposit information as of June 30, 2014, the Bank holds approximately 13.0% of local deposits, compared to approximately 14.4% held by JP Morgan Chase Bank, approximately 12.9% by Fifth Third Bank, approximately 11.5% held by PNC Bank, approximately 9.5% held by Comerica Bank, approximately 9.1% held by FirstMerit Bank, and approximately 8.8% held by TCF Bank. Information as to asset size of competitor financial institutions is derived from publicly available reports filed by and with regulatory agencies. Within the Bank's markets, JP Morgan Chase Bank operates six branch offices, Fifth Third Bank maintains five branch offices, PNC Bank operates six branch offices, Comerica Bank has three branch offices, FirstMerit Bank has five offices, and TCF Bank has three branch offices. Management is not aware of any plans by these financial institutions to expand their presence in the Bank's market.

The Bank competes with other commercial banks, savings banks, credit unions, mortgage banking companies, securities brokerage companies, insurance companies, and money market mutual funds. Many of these competitors have substantially greater resources than we do and offer certain services that we do not generally provide. Such competitors may also have greater lending limits than our Bank. In addition, non-bank competitors are generally not subject to the extensive regulations applicable to us.

**Condition of FNBH**

The following table sets forth certain information regarding the consolidated condition of FNBH:

| | Balances as of December 31, (in thousands) | | | | |
|---|---|---|---|---|---|
| | 2014 | 2013 | 2012 | 2011 | 2010 |
| Total Assets | $ 322,826 | $ 312,290 | $ 296,871 | $ 292,080 | $ 305,341 |
| Loans | 160,046 | 165,115 | 180,191 | 208,844 | 235,938 |
| Securities | 133,315 | 68,459 | 73,365 | 33,104 | 28,171 |
| Noninterest-Bearing Deposits | 102,258 | 93,953 | 95,779 | 83,506 | 62,294 |
| Interest-Bearing Deposits | 188,121 | 191,360 | 191,903 | 200,147 | 230,986 |
| Total Deposits | 290,379 | 285,313 | 287,682 | 283,652 | 293,280 |
| Shareholders' Equity | 31,144 | 25,106 | 7,369 | 6,610 | 10,134 |

In 2014, loans decreased as management continued its focus on asset quality improvement and remediation of problem loans. In addition, limited loan demand by creditworthy borrowers and increased market competition curtailed new loan originations during 2014. In response to the loan run-off and excess funding levels experienced during 2014, management acted to support earnings through investment purchases. During 2014 average total deposits remained relatively comparable to 2013 due to the strength and stability of the Bank's core deposit base as maturing time deposits shifted to demand, savings and money market deposits. Shareholders' equity increased in 2014 due to net income of $3.1 million, completion of a rights offering which raised approximately $1.5 million in equity, and $1.5 million of other comprehensive income related to appreciation in the available for sale investment portfolio.

**Supervision and Regulation**

The following is a summary of certain statutes and regulations affecting the Corporation and the Bank. This summary is qualified in its entirety by such statutes and regulations. A change in applicable laws or regulations may have a material effect on the Corporation and the Bank.

**General**

Financial institutions and their holding companies are extensively regulated under federal and state law. Consequently, our growth and earnings performance can be affected not only by management decisions and general economic conditions, but also by the statutes administered by, and the regulations and policies of, various governmental regulatory authorities. Those authorities include, but are not limited to, the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Federal Deposit Insurance Corporation (the "FDIC"), the OCC, the Internal Revenue Service, and state taxing authorities. The effect of such statutes, regulations and policies can be significant, and cannot be predicted with a high degree of certainty.

Federal and state laws and regulations generally applicable to financial institutions and their holding companies regulate, among other things, the scope of business, investments, reserves against deposits, capital levels, lending activities and practices, the nature and amount of collateral for loans, the establishment of branches, mergers, consolidations and dividends. The system of supervision and regulation applicable to the Corporation and the Bank establishes a comprehensive framework for their respective operations and is intended primarily for the protection of the FDIC's deposit insurance funds, the depositors of the Bank, and the public, rather than shareholders of the Corporation.

Federal law and regulations establish supervisory standards applicable to the lending activities of the Bank, including internal controls, credit underwriting, loan documentation and loan-to-value ratios for loans secured by real property.

**Regulatory Developments**

Homeowner Affordability and Stability Plan. On February 18, 2009, President Obama announced the Homeowner Affordability and Stability Plan ("HASP"). HASP is intended to support a recovery in the housing market and ensure that workers can continue to pay off their mortgages through the following elements:

- provide access to low-cost refinancing for responsible homeowners suffering from falling home prices;
- a $75 billion homeowner stability initiative to prevent foreclosure and help responsible families stay in their homes; and
- support for low mortgage rates by strengthening confidence in Fannie Mae and Freddie Mac.

The U.S. Department of Treasury has issued extensive guidance on the scope and mechanics of the various components of HASP. We continue to monitor these developments and assess their potential impact on our business.

Dodd-Frank Act. On July 21, 2010, the President signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") into law. This federal law includes the following:

- the creation of the Consumer Financial Protection Bureau (CFPB) with power to promulgate and, with respect to financial institutions with more than $10 billion in assets, enforce consumer protection laws;
- the creation of the Financial Stability Oversight Council chaired by the Secretary of the Treasury with authority to identify institutions and practices that might pose a systemic risk to the U.S. economy;
- provisions affecting corporate governance and executive compensation of all companies whose securities are registered with the SEC;
- a provision that broadens the base for FDIC insurance assessments and permanently increases FDIC deposit insurance to $250,000;
- provisions that change the assessment base for federal deposit insurance (from the amount of insured deposits to consolidated assets less tangible capital) and increase the minimum ratio of reserves to deposits to 1.35%;
- a provision under which interchange fees for debit cards of issuers with at least $10 billion in assets will be set by the Federal Reserve under a restrictive "reasonable and proportional cost" per transaction standard;
- a provision that requires bank regulators to set minimum capital levels for bank holding companies that are at least as strong as those required for their insured depository subsidiaries, subject to a grandfather clause for financial institutions with less than $15 billion in assets as of December 31, 2009; and
- new restrictions on how mortgage brokers and loan originators may be compensated.

The CFPB has issued new consumer protection regulations, including regulations that impact residential mortgage lending and servicing. We expect to experience increased costs and expenses related to compliance with these and other new consumer protection and other regulations. The Dodd-Frank Act and regulations being issued as a result of the Dodd-Frank Act have had, and we expect will continue to have, a significant impact on the banking industry, including our organization.

JOBS Act. On April 5, 2012, the Jumpstart Our Business Startups Act (JOBS Act) was signed into law. The JOBS Act is intended to stimulate economic growth by helping smaller and emerging growth companies access the U.S. capital markets. Among other provisions, the JOBS Act increases the statutory threshold for deregistration under the Securities Exchange Act of 1934 for bank holding companies from 300 shareholders to 1,200 shareholders of record. This makes it easier for smaller financial institutions, such as FNBH, to avoid SEC reporting and other obligations by deregistering their stock.

New Capital Rules Under Basel III. On July 2, 2013, the Federal Reserve approved a final rule that establishes an integrated regulatory capital framework (the "New Capital Rules") which is effective beginning January 1, 2015, with additional phase-in requirements through January 1, 2019. The rule implements in the United States the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Act. In general, under the New Capital Rules, minimum requirements have increased for both the quantity and quality of capital held by banking organizations. Consistent with the international Basel framework, the New Capital Rules include a new minimum ratio of common equity

Tier 1 capital to risk-weighted assets of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets that applies to all supervised financial institutions. The rule also raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6% and includes a minimum leverage ratio of 4% for all banking organizations. As to the quality of capital, the New Capital Rules emphasize common equity Tier 1 capital, the most loss-absorbing form of capital, and implement strict eligibility criteria for regulatory capital instruments. The New Capital Rules also change the methodology for calculating risk-weighted assets to enhance risk sensitivity. The application of the New Capital Rules to our organization is described below under "The Corporation – Capital Requirements" and "The Bank – Capital Requirements".

Volcker Rule. The federal banking agencies and the SEC published final regulations to implement the Volcker Rule on December 10, 2013. The Volcker rule generally prohibits banking entities from engaging in proprietary trading and from owning and sponsoring "covered funds" (e.g., hedge funds and private equity funds). The final rule became effective April 1, 2014, with full compliance generally required by July 31, 2015. We do not currently expect implementation of the Volcker Rule to have a material impact on our business as we believe our investment activity will involve only investments exempt from the Volcker Rule.

Future Legislation. Various other legislative and regulatory initiatives, including proposals to overhaul the banking regulatory system, are from time to time introduced in Congress and state legislatures, as well as regulatory agencies. Such future legislation regarding financial institutions may change banking statutes and our operating environment in substantial and unpredictable ways, and could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance depending on whether any such potential legislation is introduced and enacted. The nature and extent of the future legislative and regulatory changes affecting financial institutions is very unpredictable. We cannot determine the ultimate effect that any such potential legislation, if enacted, would have upon our financial condition or results of operations.

**The Corporation**

General. The Corporation is a bank holding company and, as such, is registered with, and subject to regulation by, the Federal Reserve under the Bank Holding Company Act, as amended (the "BHCA"). Under the BHCA, the Corporation is subject to periodic examination by the Federal Reserve and is required to file periodic reports of its operations and such additional information as the Federal Reserve may require.

In accordance with Federal Reserve policy, the Corporation is expected to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances where the Corporation might not do so absent such policy. The Dodd-Frank Act codified this policy as a statutory requirement. Such support may be required by the Federal Reserve at times when we might otherwise determine not to provide it.

In addition, if the Bank's capital becomes impaired, the OCC may require the Bank to restore its capital by a special assessment upon the Corporation as the Bank's sole shareholder. If the Corporation were to fail to pay any such assessment, the directors of the Bank would be required, under federal law, to sell the shares of the Bank's stock owned by the Corporation at public auction and use the proceeds of the sale to restore the Bank's capital.

Because of the condition of the Corporation and the Bank, the Corporation is required to receive prior approval from the Federal Reserve before the payment of dividends, issuance of debt, or redemption of stock. Additional restrictions imposed on the Corporation by the Federal Reserve relate to changes in the composition of board members, the employment of senior executive officers or changes in the responsibilities of senior executive officers, and limitations on indemnification and severance payments.

Investments and Activities. Federal law places restrictions on the ability of our holding company to engage in certain transactions, make investments, and participate (directly or indirectly through a subsidiary) in various activities.

In general, any direct or indirect acquisition by a bank holding company of any voting shares of any bank which would result in the bank holding company's direct or indirect ownership or control of more than 5% of any class of voting shares of such bank, and any merger or consolidation of the bank holding company with another bank holding company, will require the prior written approval of the Federal Reserve under the BHCA. In acting on such applications, the Federal Reserve must consider various statutory factors including the effect of the proposed transaction on competition in relevant geographic and product markets and each party's financial condition, managerial resources, and record of performance under the Community Reinvestment Act.

In addition and subject to certain exceptions, the Change in the Bank Control Act ("Control Act") and regulations promulgated thereunder by the Federal Reserve, requires any person acting directly or indirectly, or through or in concert with one or more persons, to give the Federal Reserve 60 days' written notice before acquiring control of a bank holding company. Transactions which are presumed to constitute the acquisition of control include the acquisition of any voting securities of a bank holding company having securities registered under Section 12 of the Securities Exchange Act of 1934, as amended, if, after the transaction, the acquiring person (or persons acting in concert) owns, controls or holds with power to vote 10% or more of any class of voting securities of the institution. The acquisition may not be consummated subsequent to such notice if the Federal Reserve issues a notice within 60 days, or within certain extensions of such period, disapproving the acquisition.

The merger or consolidation of an existing bank subsidiary of a bank holding company with another bank, or the acquisition by such a subsidiary of assets of another bank, or the assumption of liability by such a subsidiary to pay any deposits in another bank, will require the prior written approval of the responsible federal depository institution regulatory agency under the Bank Merger Act, based upon a consideration of statutory factors similar to those outlined above with respect to the BHCA. In addition, in certain such cases, an application to, and the prior approval of, the Federal Reserve under the BHCA and/or the OCC, may be required.

With certain limited exceptions, the BHCA prohibits any bank holding company from engaging, either directly or indirectly through a subsidiary, in any activity other than managing or controlling a bank unless the proposed non-banking activity is one that the Federal Reserve has determined to be so closely related to banking or managing or controlling a bank as to be a proper incident thereto. Under current Federal Reserve regulations, such permissible non-banking activities include such things as mortgage banking, equipment leasing, securities brokerage, and consumer and commercial finance company operations. Well-capitalized and well-managed bank holding companies may engage *de novo* in certain types of non-banking activities without prior notice to, or approval of, the Federal Reserve, provided that written notice of the new activity is given to the Federal Reserve within 10 business days after the activity is commenced. If a bank holding company wishes to engage in a non-banking activity by acquiring a going concern, prior notice and/or prior approval will be required, depending upon the activities in which the company to be acquired is engaged, the size of the company to be acquired and the financial and managerial condition of the acquiring bank holding company.

Eligible bank holding companies that elect to operate as financial holding companies may engage in, or own shares in companies engaged in, a wider range of non-banking activities, including securities and insurance activities and any other activity that the Federal Reserve, in consultation with the Treasury, determines by regulation or order is financial in nature, incidental to any such financial activity or complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. The BHCA generally does not place territorial restrictions on the domestic activities of non-bank subsidiaries of bank or financial holding companies. The Corporation has not applied for approval to operate as a financial holding company and has no current intention to do so.

Capital Requirements. The Federal Reserve uses capital adequacy guidelines in its examination and regulation of bank holding companies. If capital falls below minimum guidelines, a bank holding company may, among other things, be denied approval to acquire or establish additional bank or non-bank businesses.

The Federal Reserve's capital guidelines establish the following minimum regulatory capital requirements for small bank holding companies with assets of less than $500 million: (i) a leverage capital requirement expressed as a percentage of total average assets, and (ii) a risk-based requirement expressed as a percentage of total risk-weighted assets. The leverage capital requirement consists of a minimum ratio of Tier 1 capital (which consists principally of shareholders' equity) to total average assets of 3% for the most highly rated companies with minimum requirements of 4% to 5% for all others. The risk-based requirement consists of a minimum ratio of total capital to total risk-weighted assets of 8%, of which at least one-half must be Tier 1 capital. The risk-based and leverage standards presently used by the Federal Reserve are minimum requirements, and higher capital levels may be required if warranted by the particular circumstances or risk profiles of individual banking organizations. The federal bank regulatory agencies are required biennially to review risk-based capital standards to ensure that they adequately address interest risk, concentration of credit risk and risks from non-traditional activities. The Federal Reserve has not advised FNBH of any specific capital ratios applicable to it. Moreover, as a bank holding company with less than $500 million in assets, FNBH is not subject to the New Capital Rules under Basel III as described above.

Dividends. The Corporation is an entity separate and distinct from the Bank. The primary source of the Corporation's revenues are dividends paid by the Bank. Thus, the Corporation's ability to pay dividends to its shareholders is limited by statutory restrictions on the Bank's ability to pay dividends as described below. Further, in a policy statement, the Federal Reserve has expressed its view that a bank holding company experiencing earnings weaknesses should not pay cash dividends exceeding its net income or which can only be funded in ways that weaken the bank holding company's financial health, such as by borrowing. Additionally, the Federal Reserve possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by bank and bank holding companies. Due to the current regulatory and financial condition of FNBH, the Corporation is currently prohibited from paying any dividends on its common stock without prior approval from the Federal Reserve. We do not foresee being able to pay dividends to our shareholders in the near future.

In addition to the restrictions on dividends imposed by the Federal Reserve, the Michigan Business Corporation Act provides that dividends may be legally declared or paid only if after the distribution, a corporation can pay its debts as they come due in the usual course of business and its total assets equal or exceed the sum of its liabilities plus the amount that would be needed to satisfy the preferential rights upon dissolution of any holders of preferred stock whose preferential rights are superior to those receiving the distribution. The Corporation's Articles of Incorporation authorize the issuance of up to 30,000 shares of preferred stock, with such rights, preferences, and designations as determined by the Board of Directors. In October 2011, the Corporation designated 10,000 of these shares of preferred stock as Series A Junior Participating Preferred Stock (the "Series A Preferred Shares") in connection with its Tax Benefits Preservation Plan. In December 2013, the Corporation designated the remaining 20,000 of these preferred shares as Series B Mandatorily Convertible Non-Cumulative Junior Participating Preferred Stock (the "Series B Preferred Shares") for issuance in connection with the Corporation's private placement transaction. In May 2014, the 17,510 outstanding shares of Series B Preferred Shares issued in the December 2013 private placement offering were converted into 25,014,256 shares of common stock. At December 31, 2014, no Series B Preferred Shares are issued and outstanding. No Series A Preferred Shares have been issued.

Federal Securities Regulation. The Corporation's common stock is registered with the SEC under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). As a result, the Corporation is subject to the information, proxy solicitation, insider trading and other rules and requirements of the SEC under the Exchange Act. Pursuant to an exemption from registration available under federal securities laws, the Corporation's Series B Preferred Shares (issued in the December 2013 private placement transaction) were not registered with the SEC or any applicable state securities laws. None of the Corporation's securities are listed for trading on any national or regional securities exchange.

**The Bank**

General. The Bank is organized as a national banking association and is, therefore, regulated and supervised by the OCC. The deposit accounts of the Bank are insured by the Deposit Insurance Fund (the "DIF") of the FDIC. Consequently, the Bank is also subject to the provisions of the Federal Deposit Insurance Act. The Bank is subject to the examination, supervision, reporting and enforcement requirements of the OCC as its primary federal regulator. The OCC and the federal and state laws applicable to the Bank and its operations extensively regulate various aspects of the banking business including, among other things, permissible types and amounts of loans, investments and other activities, capital adequacy, branching, interest rates on loans and on deposits, the maintenance of noninterest bearing reserves on deposit accounts, and the safety and soundness of banking practices.

Deposit Insurance. As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. Under the FDIC's risk-based assessment system for deposit insurance premiums, all insured depository institutions are placed into one of four categories (Risk Categories I, II, III, and IV), based primarily on their level of capital and supervisory evaluations, for purposes of determining the institution's assessment rate. Deposit insurance premium assessments are generally based on an institution's total assets minus its tangible equity.

For information about the deposit insurance premiums payable by the Bank, see "Noninterest Expense" under Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" below.

FICO Assessments. The Bank, as a member of the DIF, is subject to assessments to cover the payments on outstanding obligations of the Financing Corporation ("FICO"). FICO was created to finance the recapitalization of the Federal Savings and Loan Insurance Corporation, the predecessor to the FDIC's Savings Association Insurance Fund, which was created to insure the deposits of thrift institutions and was merged with the Bank Insurance Fund into the DIF in 2006. From now until the maturity of the outstanding FICO obligations in 2019, DIF members will share the cost of the interest on the FICO bonds on a pro rata basis. Currently, on an annualized basis, FICO assessments payable by the Bank approximate 0.006% of average tangible assets.

OCC Assessments. National banks are required to pay supervisory fees to the OCC to fund the operations of the OCC. The amount of supervisory fees paid by a national bank is primarily based upon the bank's total assets, as reported to the OCC. Due to the existing Consent Order, the Bank is also subject to a surcharge by the OCC due to the Bank's need for increased regulatory supervision.

Capital Requirements. The OCC has established the following minimum capital standards for national banks: a leverage requirement consisting of a minimum ratio of Tier 1 capital to total average assets of 3% for the most highly-rated banks, with minimum requirements of 4% to 5% for all others, and a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8%, at least one-half of which must be Tier 1 capital. Tier 1 capital consists principally of shareholders' equity. These capital requirements are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions. As described below, the OCC has imposed higher capital levels on the Bank pursuant to a Consent Order.

Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators' powers depends on whether the institution in question is "well capitalized", "adequately capitalized", "undercapitalized", "significantly undercapitalized", or "critically undercapitalized". Federal regulations define these capital categories as follows:

| | Total Risk-Based Capital Ratio | Tier 1 Risk-Based Capital Ratio | Leverage Ratio |
|---|---|---|---|
| Well capitalized | 10% or above | 6% or above | 5% or above |
| Adequately capitalized | 8% or above | 4% or above | 4% or above |
| Undercapitalized | Less than 8% | Less than 4% | Less than 4% |
| Significantly undercapitalized | Less than 6 % | Less than 3% | Less than 3% |
| Critically undercapitalized | -- | -- | A ratio of tangible equity to total assets of 2% or less |

Beginning January 1, 2015, the Bank is subject to the New Capital Rules Under Basel III described above. The 2.5% capital conservation buffer is being phased in over a four-year period beginning in 2016. We believe that the Bank currently exceeds all the capital ratio requirements of the New Capital Rules.

In general, a depository institution may be reclassified to a lower category than is indicated by its capital levels if the appropriate federal depository institution regulatory agency determines the institution to be otherwise in an unsafe or unsound condition, be engaged in an unsafe or unsound practice, or have received an unsatisfactory examination rating with respect to certain matters.

Depending upon the capital category to which an institution is assigned, the regulators' corrective powers may include: restricting the payment of dividends, capital distributions and management fees; requiring the submission of a capital restoration plan; placing limits on asset growth and restrictions on activities; requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; restricting transactions with affiliates; restricting the acceptance, renewal, or roll-over of brokered deposits; restricting the interest rate the institution may pay on deposits; ordering a new election of directors of the institution; requiring that senior executive officers or directors be dismissed; prohibiting the institution from accepting deposits from correspondent banks; requiring the institution to divest certain subsidiaries; prohibiting the payment of principal or interest on subordinated debt; and ultimately, appointing a receiver for the institution. As described below, as a result of the Bank's capital category, the Bank is currently subject to many of these restrictions.

On October 31, 2013, the Bank consented to the issuance of a new Consent Order with the OCC to replace a prior Consent Order issued September 24, 2009. The new Consent Order continues to require the Bank to achieve and maintain total capital equal to 11% of risk weighted assets and Tier 1 capital equal to at least 8.5% of adjusted total assets (which were also the minimum capital ratios required by the 2009 Consent Order). As a result of the Corporation's completion of the private placement transaction and shareholder rights offering in December 2013 and March 2014, respectively, and the subsequent contributions of $15.4 million and $550,000 of equity capital to the Bank, the Bank has satisfied the minimum capital ratios required by the Consent Order since December 31, 2013 and through the current date.

Although the Bank's capital ratios exceed those required for a well-capitalized institution, as shown in the table above, the Bank is currently considered to be "adequately capitalized" for purposes of the OCC's Prompt Corrective Action ("PCA") powers. At December 31, 2014 and through the current date, the Bank does not meet the definition of "well-capitalized" because it remains subject to the Consent Order issued by the OCC. The Bank's capital category is determined solely for purposes of applying PCA; the capital category may not constitute an accurate representation of the Bank's overall financial condition or prospects.

Dividends. Under federal law, the Bank is restricted as to the maximum amount of dividends it may pay on its common stock owned by the Corporation. The Bank may not pay dividends except out of undivided net profits then on hand after deducting its losses and bad debts. In addition, the Bank is required by federal law to obtain the prior approval of the OCC for the declaration or payment of a dividend if the total of all dividends declared by the Bank's Board of Directors in any year will exceed the total of (i) the Bank's retained net income (as defined and interpreted by regulation) for that year plus (ii) the retained net income for the preceding two years, less any required transfers to surplus.

Federal law generally prohibits a depository institution from making any capital distribution (including payment of a dividend) or paying any management fee to its holding company if the depository institution would thereafter be undercapitalized. Further, federal regulatory agencies can prohibit a banking institution or bank holding company from engaging in unsafe and unsound business practices and could prohibit payment of dividends if such payment could be currently deemed an unsafe and unsound business practice.

Due to these requirements and based upon the Bank's current regulatory condition, the Bank cannot pay a dividend to the Corporation without the prior approval of the OCC.

Insider and Affiliate Transactions. The Bank is subject to certain restrictions on any extensions of credit to the Corporation or its subsidiaries, on investments in the stock or other securities of the Corporation or its subsidiaries, and the acceptance of the stock or other securities of the Corporation or its subsidiaries as collateral for loans. Certain limitations and reporting requirements are also placed on extensions of credit by the Bank to its directors and officers, to directors and officers of the Corporation and its subsidiaries, to principal shareholders of the Corporation, and to "related interests" of such directors, officers and principal shareholders. In addition, federal law and regulations may affect the terms upon which any person becoming a director or officer of the Corporation or one of its subsidiaries or a principal shareholder of the Corporation may obtain credit from a bank with which the Bank maintains a correspondent relationship.

Safety and Soundness Standards. The federal banking agencies have adopted guidelines to promote the safety and soundness of federally insured depository institutions. These guidelines establish standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings.

Consumer Protection Laws. The Bank's businesses include making a variety of types of loans to individuals. In making these loans, the Bank is subject to state usury laws and to various federal and state statutes and regulations, including the privacy of consumer financial information provisions of the Gramm-Leach-Bliley Act and regulations promulgated thereunder, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Real Estate Settlement Procedures Act, the Home Mortgage Disclosure Act, and other consumer protection laws. In holding deposits, the Bank is subject to extensive regulation under state and federal law and regulations, including the Truth in Savings Act, the Expedited Funds Availability Act, the Bank Secrecy Act, the Electronic Funds Transfer Act, and the Federal Deposit Insurance Act. Violation of these laws could result in the imposition of significant damages and fines upon the Bank and its directors and officers.

**Item 1A. Risk Factors.**

Our Bank remains subject to a Consent Order issued by the OCC that will result in increased costs and reduced earnings to us for the foreseeable future and could lead to more severe regulatory action against us.

Our subsidiary Bank has been subject to a Consent Order with the OCC, its primary federal regulator, since September 2009. On October 31, 2013, the September 2009 Consent Order was replaced with a new Consent Order. We expect the Bank will continue to be subject to the new Consent Order or some other regulatory enforcement action for some period of time while the Bank works to comply with various provisions of the Consent Order and demonstrate a period of performance with the requirements of the Consent Order.

The Consent Order requires management to take a number of actions, including achieving and maintaining certain minimum regulatory capital ratios. The Corporation completed a private placement transaction in December 2013 and a shareholder rights offering in March 2014, which raised sufficient additional capital that was contributed into the Bank to meet these minimum capital ratios as of December 31, 2013 and through the current date. However, there is no assurance that the Bank will be able to maintain these minimum capital ratios in 2015 or thereafter. If the Bank's capital ratios fall below the minimum ratios required by the Consent Order and the Corporation lacks a sufficient amount of cash to contribute to the Bank or if we are not able to raise additional capital or take other steps to increase the capital ratios, it is possible the OCC will take additional regulatory enforcement action against our Bank or require the Bank to remain subject to the Consent Order for an extended period of time.

In addition to the minimum capital ratios, the Consent Order requires the Board of Directors and management of the Bank to take a number of actions designed to improve the Bank's operations, including several measures intended to enhance the Bank's risk management policies and practices. Moreover, the Bank must demonstrate the sufficiency and effectiveness of improvements made to its operations and risk management policies and practices to gain compliance with the Consent Order. In addition, the Bank has previously been cited for various violations of laws and regulations. It is possible our efforts to comply with the requirements of the Consent Order will not be sufficient for the Bank to be deemed in compliance with the Consent Order or will not sufficiently improve our risk management policies and practices. As a result, there continues to be a risk of further regulatory enforcement action against our Bank. In addition, our financial condition and results of operations may be more susceptible to adverse consequences until our risk management policies and practices have been sufficiently improved.

Continuing to be subject to a Consent Order will result in increased expenses and reduced earnings. Our expenses will be higher because of the additional actions we are required to take by the Consent Order (or as a result of being subject to the Consent Order) that we might not otherwise take, including ongoing periodic reporting obligations. In addition, the premiums we pay for FDIC insurance will remain higher as long as we remain subject to the Consent Order. In addition to these increased expenses, we will likely have less opportunity to increase our earnings than would be the case if we were not subject to a Consent Order. This is because we are required to obtain approval from the Bank's regulator before taking certain actions to expand our business activities or to engage in certain significant transactions. We may not be permitted to pursue expanded business activities, new product lines, or other transactions as long as the Bank has failed to implement the appropriate risk management policies and practices related to such efforts.

As a result of the foregoing, we expect that our financial condition and results of operations in the foreseeable future will continue to be negatively impacted as a result of the existence of the Consent Order and the conditions at the Bank that warranted imposition of the Consent Order.

Continued higher FDIC deposit insurance premiums and restrictions related to our deposit base as a result of the Bank's current regulatory condition could, individually or collectively, materially limit the Corporation's operating results.

The amount of FDIC deposit insurance premiums required to be paid by financial institutions depends in part on the institution's risk rating and capital position. As a result of the Bank's current risk rating and regulatory capital position, the assessment rate to be paid by the Bank for FDIC deposit insurance remains elevated. These higher assessment rates charged against the Bank are expected to continue until such time as the Bank demonstrates a period of satisfactory performance with the requirements of the Consent Order.

In addition, as a result of the Bank's regulatory capital position, it is prohibited from accepting, renewing, or rolling over any brokered deposits, and the effective yield on deposits solicited by the Bank cannot be more than 75 basis points over national market yields for comparable size and maturity deposits. These restrictions could serve to limit the Bank's flexibility should conditions deteriorate or in the event of unexpected problems with the Bank's liquidity position.

We are in the business of lending, which involves substantial credit risk, and our allowance for loan losses may not be sufficient to cover actual loan losses.

If our loan customers do not repay their loans according to their respective terms, and if we are unable to collect on the loans through foreclosure of any collateral securing repayment, we may experience significant credit losses, which could have a material adverse effect on our operating results. We have established an allowance for loan losses that is intended to approximate credit losses inherent in our current loan portfolio and prevent negative effects on our operating results as a result of loan losses. In determining the size of the allowance, we make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In doing so, we rely primarily on our experience and our evaluation of current economic conditions, including use of current appraisals and valuations performed by licensed appraisers. If our assumptions or judgments prove to be incorrect, our current allowance for loan losses may not be sufficient to cover certain loan losses inherent in our loan portfolio, and adjustments may be necessary to allow for different economic conditions or adverse developments in our loan portfolio. Material additions to our allowance would materially decrease our net income.

As of December 31, 2014, approximately 83% of the Bank's loan portfolio is commercial purpose loans. Of these commercial purpose loans, approximately 85% are loans secured by commercial real estate, primarily including owner occupied and non-owner occupied properties, construction and land development properties, and single family home construction. Commercial loans are generally viewed as having more inherent risk of default than residential mortgages or consumer loans. Also, the commercial loan balance per borrower is generally greater than that of a residential mortgage loan or consumer loan, inferring higher potential losses on an individual loan basis.

In addition, federal regulators periodically review our allowance for loan losses and, if warranted, may require us to increase our provision for loan losses or recognize additional loan charge offs. Any increase in our allowance for loan losses or loan charge offs required by these regulatory agencies could have a material adverse effect on our results of operations and financial condition.

As a community bank, our financial condition is dependent, in part, on the general economic condition of the communities we serve.

Our operations are primarily limited to Livingston County and surrounding areas; and, therefore, our success depends to a great extent upon the general economic conditions of such region. In general, the economy of the State of Michigan has suffered in recent years as a result of the struggling automotive industry and other factors. According to data published by the federal Bureau of Labor Statistics, Michigan's unemployment rate in December 2014 was 6.4%, improved from 8.4% in December 2013, but still among the worst of all states. Unlike larger banks that are more geographically diversified, our loan portfolio, the ability of the borrowers to repay these loans and the value of the collateral securing these loans will be impacted, to a greater extent, by local economic conditions.

During the past year, the general business environment in our markets continued to have an overall adverse effect on our business. While we believe that there are now some signs of stabilization within segments of this business environment, conditions are not expected to improve dramatically in the near term. Until conditions improve, we expect our business, financial condition and results of operations to continue to be adversely affected. A continued economic slowdown could have many adverse consequences, including the following: loan delinquencies may increase, problem assets and foreclosures may increase, demand for our products and services may decline, and collateral for our loans may decline in value, in turn reducing customers' borrowing power and reducing the value of assets and collateral associated with existing loans. In particular, our level of nonperforming loans remains elevated from pre-2007 historical levels despite improved current year trending in net loan charge offs, loan delinquencies and provision for loan losses.

We are heavily weighted with loans secured by real estate, and further declines in the real estate market may result in higher loan losses.

A large majority of our loans are secured by commercial and residential real estate. As of December 31, 2014, 87% of our outstanding loans were secured by real estate of which 81% were secured by non-farm, non-residential properties or were construction and land development loans. While cash flows from our commercial customers' business operations are intended to provide for repayment of their loans, further declines in the economy may impact their ability to do so. The Bank relies on the underlying collateral of a loan as the secondary source of repayment. Dramatic declines in the commercial and residential real estate markets in recent years, as evidenced by falling prices and foreclosures, have resulted in, and may continue to result in, significant write-downs of our asset values. For example, the average median value of an owner-occupied residence in our primary market area of Livingston County between 2008 and 2012 was $191,000, a decline of almost 12% from the average median value of $216,400 between 2006 and 2010. (Source: USA.com) If collateral values continue to decline because of further declines in the overall real estate market, the Bank may incur increased loan losses.

Fluctuations in interest rates could reduce our profitability.

We realize income primarily from the difference between interest earned on loans and investments and the interest paid on deposits and borrowings. Our interest income and interest expense are affected by general economic conditions and by the policies of regulatory authorities. While we have taken measures intended to manage the risks of operating in a changing interest rate environment, there can be no assurance that these measures will be effective in avoiding undue interest rate risk. We expect that we will periodically experience "gaps" in the interest rate sensitivities of our assets and liabilities, meaning that either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-earning assets, or vice versa. In either event, if market interest rates should move contrary to our position, this "gap" will work against us, and our earnings may be negatively affected.

Moreover, we are unable to predict fluctuations of market interest rates, and among other factors, changes in the following:

- Inflation or deflation rates;
- Levels of business activity;
- Recession;
- Unemployment levels;

- Money supply;
- Domestic or foreign events; and
- Instability in domestic and foreign financial markets

Competition with other financial institutions and financial service providers could adversely affect our profitability**.**

We face vigorous competition from banks and other financial institutions, including savings and loan associations, savings banks, finance companies, and credit unions. Many of these banks and other financial institutions have substantially greater resources and lending limits, larger branch systems, and a wider array of banking services. In addition, the current condition of our Bank and the fact that it is subject to, but out of compliance with, a formal regulatory enforcement action, increases our operating costs in various ways, as disclosed in this Annual Report. To a limited extent, we also compete with other providers of financial services, such as money market mutual funds, brokerage firms, consumer finance companies, and insurance companies, which are not subject to the same degree of regulation as that imposed on bank holding companies. As a result, these non-bank competitors may have an advantage over us in providing certain services, and this competition may reduce or limit our margins on banking services, reduce our market share, and adversely affect our results of operations and financial condition.

We operate in a highly regulated environment and may be adversely affected by changes in laws and regulations**.**

We are subject to extensive regulation, supervision, and examination by federal banking authorities. Any change in applicable legislation could have a substantial impact on us and our Bank and its operations. Additional legislation may be enacted or adopted in the future that could significantly affect our powers, authority, and operations, which could increase our costs of doing business and, as a result, give an advantage to our competitors who may not be subject to similar legislative and regulatory requirements. Further, regulators have significant discretion and power to interpret these regulations as well as to take actions to prevent or remedy unsafe or unsound practices or violations of laws by banks and bank holding companies in the performance of their supervisory and enforcement duties. The exercise of regulatory power may have a negative impact on our results of operations and financial condition.

We may face challenges in managing our operational risk, including the failure of technology infrastructure or information security incidents that could adversely affect our business operations**.**

Like other financial services companies, we face a number of operational risks, including the potential for processing errors, internal or external fraud, failure of computer systems, and external events beyond our control such as natural disasters. Acts of fraud are difficult to detect and deter, and we cannot assure investors that our risk management procedures and controls will prevent losses from fraudulent activity. In addition, our operations rely on the secure processing, storage and transmission of confidential and other information on our technology systems and networks. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems.

We also face the risk of operational disruption, failure or capacity constraints due to our dependency on third party vendors for components of our business infrastructure. While we have selected these third party vendors carefully, we do not control their operations. As such, any failure on the part of these business partners to perform their various responsibilities could also adversely affect our business and operations.

We may also be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control, which may include, for example, computer viruses, cyber-attacks, spikes in volumes and/or customer activity, electrical or telecommunications outages, or natural disasters. Although we have programs in place related to business continuity, disaster recovery and information security to maintain the confidentiality, integrity, and availability of our systems, business applications and customer information, such disruptions may give rise to interruptions in service to customers and loss or liability to us.

The occurrence of any failure or interruption in our operations or information systems, or any security breach, could cause reputational damage, jeopardize the confidentiality of customer information, result in a loss of customer business, subject us to regulatory intervention or expose us to civil litigation and financial loss or liability, any of which could have a material adverse effect on us.

Difficult national and global economic and market conditions have adversely affected our industry and financial performance.

The difficult economic conditions experienced during the recent national and global recessions have, among other things, negatively impacted the credit performance of real estate related loans and resulted in significant write-downs of asset values by financial institutions. This has also resulted in the write-downs of asset-backed securities and other securities and loans. Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders and institutional investors have reduced or ceased providing funding to borrowers, including to other financial institutions. This market turmoil and tightening of credit have led to an increased level of commercial and consumer delinquencies, lack of consumer confidence, increased market volatility and reduced business activity generally. Further negative market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates, which may impact our charge offs and provision for credit losses. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and others in the financial institutions industry.

We have credit risk inherent in our securities portfolio.

We maintain diversified securities portfolios, which may include obligations of the U.S. Treasury and government-sponsored agencies as well as securities issued by states and political subdivisions, mortgage-backed securities, and asset-backed securities. We also invest in capital securities which includes preferred stocks. We seek to limit credit losses in our securities portfolios by generally purchasing only highly rated securities (rated “AA” or higher by a major debt rating agency) or by conducting significant due diligence on the issuer for unrated securities. However, we may, in the future, experience additional losses in our securities portfolio which may result in charges that could materially adversely affect our results of operations.

Changes in accounting standards could impact our reported earnings.

Financial accounting and reporting standards are periodically changed by the Financial Accounting Standards Board (FASB), the SEC, and other regulatory authorities. Such changes affect how we are required to prepare and report our consolidated financial statements. These changes are often hard to predict and may materially impact our reported financial condition and results of operations. In some cases, we may be required to apply a new or revised standard retroactively, resulting in the restatement of prior period financial statements.

We may not pay dividends on our common stock for the foreseeable future.

Holders of shares of our common stock are only entitled to receive such dividends as our Board of Directors may declare out of funds legally available for such payments. We currently are prohibited from paying any dividends to our shareholders as a result of the financial condition of our Bank and the various regulatory matters described in this Annual Report. We do not foresee being able to pay dividends to our shareholders in the near future. Our inability to pay dividends to our common stock shareholders could adversely affect the market price of our stock.

One of our directors controls approximately 40% of our outstanding voting stock and has the ability to exert significant influence over our management and operations.

One of the directors of the Corporation and the Bank is currently the beneficial owner of approximately 40% of our outstanding voting stock. In addition, certain of the director's family members control an additional 7% of our outstanding voting stock. The director also has certain rights to appoint representatives to the respective Boards of the Directors of the Corporation and the Bank and his consent is required for either the Corporation or the Bank to increase the size of the Board of Directors to a number greater than 9 directors.

As a result of the foregoing, the director has the ability to exercise significant influence on the respective Boards of Directors of the Corporation and the Bank as well as on matters submitted to our shareholders for approval. It is possible that the director's interests with respect to the Corporation may not coincide with interests of smaller shareholders. In addition, having a shareholder who controls approximately 40% of our outstanding common stock will likely make future transactions more difficult or even impossible to complete without the support of such shareholder. These possibilities could have an adverse effect on the market price of our common stock.

There is no guarantee our common stock will continue to be publicly-traded or that we will continue to file reports with the SEC.

Recent changes to federal law that increase the number of shareholders a company may have without filing reports with the SEC make it easier for the Corporation to deregister with the SEC. Deregistering with the SEC would mean that trades of our common stock would no longer be quoted on the OTC Bulletin Board. This would negatively affect the liquidity of our stock. Investors should not base a decision to invest in our common stock on the assumption that we will continue to file reports with the SEC for any specific period of time or that trades of our stock will continue to be quoted on the OTC Bulletin Board.

The trading price of our common stock may be subject to continued significant fluctuations and volatility.

The market price of our common stock could be subject to significant fluctuations due to, among other things:

- actual or anticipated quarterly fluctuations in our operating and financial results;
- our ability to comply with the terms of the Consent Order issued against our Bank and the possibility of future regulatory enforcement actions against us;
- announcements regarding significant transactions in which we may engage;
- changes or perceived changes in our operations or business prospects;
- legislative or regulatory changes affecting our industry generally or our businesses and operations;
- the failure of general market and economic conditions to stabilize and recover, particularly with respect to economic conditions in Michigan, and the pace of any such stabilization and recovery;
- the operating and share price performance of companies that investors consider to be comparable to us;
- future offerings by us of debt or preferred equity, each of which would be senior to our common stock upon liquidation and for purposes of dividend distributions;
- actions of our controlling shareholder and other current shareholders, including future sales of common stock; and
- other changes in global financial markets, economies, and market conditions, such as interest or foreign exchange rates, stock, commodity, credit or asset valuations or volatility.

Any future offerings of debt or preferred equity, each of which would be senior to our common stock upon liquidation and for purposes of dividend distributions, and any future equity offerings may adversely affect the market price of our common stock.

As noted above, our Bank is required by the Consent Order issued against it by the OCC to maintain certain minimum capital ratios. If future losses or other factors cause the Bank to fall below those capital ratios, it may be necessary for the Corporation to raise capital through the sale of additional securities. Even if not required to do so by the Consent Order, our Board of Directors may decide to increase our capital resources, or we or our Bank could be forced by federal bank regulators to raise additional capital, including through the sale of debt securities, equity securities that have priority over our common stock, or additional shares of our common stock. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive distributions of our available assets prior to the holders of our outstanding shares of common stock. Additional equity offerings may dilute the holdings of our existing shareholders or reduce the market price of our common stock, or both. Holders of our common stock are not entitled to preemptive rights or other protections against dilution.

Our Board of Directors is authorized to issue one or more classes or series of preferred stock from time to time without any action on the part of our shareholders. Our Board also has the power, without shareholder approval, to set the terms of any such classes or series of preferred stock that may be issued, including voting rights, dividend rights, and preferences over our common stock with respect to dividends or upon our dissolution, winding-up and liquidation, and other terms. If we issue preferred stock in the future that has a preference over our common stock with respect to the payment of dividends or upon our liquidation, dissolution, or winding up, or if we issue preferred stock with voting rights that dilute the voting power of our common stock, the rights of holders of our common stock or the market price of our common stock could be adversely affected.

Our Articles of Incorporation, certain banking laws, and our Tax Benefits Preservation Plan may have an anti-takeover effect.

Provisions of our Articles of Incorporation and certain federal banking laws, including regulatory approval requirements, could make it more difficult for a third party to acquire us, even if doing so would be perceived to be beneficial to our shareholders. In addition, we have a Tax Benefits Preservation Plan that is intended to discourage any person from acquiring 5% or more of our outstanding stock (with certain limited exceptions). The combination of these provisions may inhibit a merger or other business combination, which, in turn, could adversely affect the market price of our common stock.

We rely heavily on our management team, including our loan officers, and the unexpected loss of key employees may adversely affect our operations**.**

As a community bank, our success depends largely on our ability to attract and to retain key employees who are experienced in banking and financial services and who have developed relationships within the communities served by our Bank. Our ability to retain these key employees will continue to be important to our business and financial results. None of the Bank's employees are subject to employment agreements or any formal non-compete agreement. The unexpected loss of services of key personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business and financial results.

**Item 1B. Unresolved Staff Comments.**

None.

**Item 2. Properties.**

The Bank operates from eight facilities, located in five communities, in Livingston County, Michigan. The executive offices of the Corporation are located at the Bank's main office, 101 East Grand River, Howell, Michigan. The Bank maintains two branches in Howell at 4299 East Grand River and 2400 West Grand River. The Bank also maintains branch offices at 9911 East Grand River, Brighton, Michigan; 8080 Challis Road, Brighton, Michigan; 760 South Grand Avenue, Fowlerville, Michigan; 10700 Highland Road, Hartland, Michigan; and 9775 M-36, Whitmore Lake, Michigan. All of the offices have ATM machines and all except the West Grand River branch, which is in a grocery store, have drive-up services. All of the properties are owned by the Bank except for the West Grand River branch, which is leased from a third party. The lease is for five years with two five-year renewal options, expiring September 2022. The average lease payment over the remaining life of the lease is $4,000 monthly.

**Item 3. Legal Proceedings.**

The Corporation is not involved in any material legal proceedings. The Bank is involved in ordinary routine litigation incident to its business; however, no such proceedings are expected to result in any material adverse effect on the operations or earnings of the Bank. Neither the Bank nor the Corporation is involved in any proceedings to which any director, principal officer, affiliate thereof, or person who owns of record or beneficially more than five percent (5%) of the outstanding stock of either the Corporation or the Bank, or any associate of the foregoing, is a party or has a material interest adverse to the Corporation or the Bank.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Additional Item – Executive Officers of Registrant**

Executive officers of the Corporation are appointed annually by the Board of Directors. There are no family relationships among these officers and/or the directors of the Corporation, or any arrangement or understanding between any officer and any other person pursuant to which the officer was elected.

The Corporation's executive officers as of March 31, 2015 are as follows:

Ronald L. Long (Age 55), President, Chief Executive Officer, since May 12, 2008; Senior Vice President and Senior Business Development Officer, Independent Bank from October 2007 through January 2008; President and Chief Executive Officer, Independent Bank East Michigan from 1993 through September 2007.

Mark J. Huber (Age 46), Senior Vice President, Chief Financial Officer, since June 4, 2009; Senior Manager, specializing in financial institutions, with Plante & Moran, PLLC from 1993 – 2009.

Gerald Moyer (Age 61), Senior Vice President, Commercial Loan Officer since April 13, 2009; Chief Work Out Officer August 16, 2008 – April 12, 2009; Vice President, Commercial Loan Officer April 21, 2008 – August 15, 2008; Vice President and Senior Relationship Manager, Private Financial Group, with Huntington National Bank from June 2001 – March 2008.

Daniel J. Wollschlager (Age 64), Senior Vice President, Chief Credit Officer, since October 27, 2011; Executive Vice President, Senior Lending Officer and Director, the State Bank from October 2008 to October 2011; Chief Executive Officer and Chief Credit Officer and Director, Main Street Bank from September 2007 to October 2008; Principal, BBK, LTD. from September 2004 to September 2007; Executive Vice President, Corporate Special Assets Manager, National City Bank (Cleveland, OH) from 2002 - 2004. Mr. Wollschlager will be retiring from the Bank effective May 4, 2015.

Rick James (Age 52), Senior Vice President Enterprise Risk Management, since November 25, 2013, Director of Enterprise Risk Reporting at Capitol Bancorp Ltd. from January 2010 through November 2013; Vice President – Office of the Chairman, Capitol Bancorp Ltd., January 2008 through

February 2010; Vice President - Bank Performance, Capitol Bancorp Ltd., April 2003 through January 2008; Vice President of Loan Administration and of Commercial Lending at Ann Arbor Commerce Bank March 1994 through April 2003.

## PART II

### Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities.

The Corporation's common stock is not listed on any national securities exchange; however, the common stock is quoted on the OTC bulletin board under the symbol "FNHM". High and low closing prices of our common stock for each quarter for the years ended December 31, 2014 and 2013 are set forth below. No dividends were declared on common stock during 2014 and 2013. The approximate number of holders of record of our common stock as of March 15, 2015 was 850.

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | High | Low | Dividends Declared | High | Low | Dividends Declared |
| First Quarter | $ 2.81 | $ 1.10 | $ - | $ 2.01 | $ 1.14 | $ - |
| Second Quarter | $ 1.13 | $ 0.94 | $ - | $ 2.50 | $ 1.40 | $ - |
| Third Quarter | $ 1.11 | $ 0.95 | $ - | $ 1.50 | $ 1.00 | $ - |
| Fourth Quarter | $ 1.07 | $ 0.86 | $ - | $ 3.00 | $ 0.95 | $ - |

The holders of the Corporation's common stock are entitled to dividends when, as, and if declared by the Board of Directors of the Corporation out of funds legally available for that purpose. In determining dividends, the Board of Directors considers the earnings, capital requirements and financial condition of the Corporation and the Bank, along with other relevant factors. The Corporation's principal source of funds for cash dividends is the dividends paid by the Bank. The ability of the Corporation and Bank to pay dividends is subject to statutory and regulatory restrictions and requirements. The Bank cannot currently, under these requirements, pay a dividend to the Corporation without the prior approval of the OCC.

The Corporation did not repurchase any of its stock during the fourth quarter of 2014, nor has the Corporation's Board adopted or approved a stock repurchase program.

### Item 6. Selected Financial Data.

**SUMMARY FINANCIAL DATA**

| | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| (in thousands, except per share data) | | | | | |
| **Statement of Operations Data:** | | | | | |
| Interest income | $ 10,239 | $ 10,455 | $ 11,064 | $ 12,692 | $ 14,227 |
| Interest expense | 703 | 925 | 1,092 | 1,571 | 2,496 |
| Net interest income | 9,536 | 9,530 | 9,972 | 11,121 | 11,731 |
| Provision for loan losses | (2,500) | (2,250) | 1,325 | 6,200 | 5,975 |
| Noninterest income | 2,422 | 2,865 | 3,271 | 2,922 | 3,225 |
| Gain (loss) on available for sale securities (1) | 2 | - | (3) | 337 | 329 |
| Noninterest expense | 11,390 | 11,567 | 11,690 | 11,753 | 13,146 |
| Income (loss) before federal income taxes | 3,070 | 3,078 | 225 | (3,573) | (3,836) |
| Net income (loss) | 3,050 | 2,974 | 329 | (3,573) | (3,893) |
| **Per Share Data(2) (3):** | | | | | |
| Basic and diluted net income (loss) per share | $ 0.11 | $ 1.57 | $ 0.72 | $ (7.81) | $ (8.53) |
| Dividends paid | - | - | - | - | - |
| Weighted average basic and diluted shares outstanding | 27,228,196 | 1,896,613 | 457,416 | 457,318 | 456,633 |
| **Balance Sheet Data:** | | | | | |
| Total assets | $ 322,826 | $ 312,290 | $ 296,871 | $ 292,080 | $ 305,341 |
| Loans, gross | 160,046 | 165,115 | 180,191 | 208,844 | 235,938 |
| Allowance for loan losses | 7,109 | 9,214 | 11,769 | 12,690 | 13,970 |
| Deposits | 290,379 | 285,313 | 287,682 | 283,652 | 293,280 |
| Shareholders' equity | 31,144 | 25,106 | 7,369 | 6,610 | 10,134 |
| **Ratios:** | | | | | |
| Dividend payout ratio | N/A | N/A | N/A | N/A | N/A |
| Average equity to average asset ratio | 8.99% | 3.37% | 2.35% | 2.96% | 4.31% |

(1) Included in noninterest income in the "Consolidated Statements of Operations" and discussed under the caption "Noninterest Income" under Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations".

(2) Per share data and number of shares are adjusted to reflect the 1-for-7 reverse stock split effective October 3, 2011.

(3) 2014 and 2013 per share data and number of shares include 17,510 shares of Mandatorily Convertible Non-Cumulative Junior Participating Preferred Stock, Series B, converted to common shares at a rate reflecting a price per common share of $0.70.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

This discussion provides additional information to assess the consolidated financial condition and results of operations of FNBH Bancorp, Inc. (the "Corporation") and its subsidiary bank (the "Bank"). This section should be read in conjunction with the consolidated financial statements and the supplemental financial data contained elsewhere in this Annual Report.

Included or incorporated by reference in this document are certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements are based on the beliefs of the Corporation's management as well as on assumptions made by, and information currently available to, the Corporation at the times such statements were made. Actual results could differ materially from those included in such forward-looking statements as a result of, among other things, factors set forth below in this Report generally, and certain economic and business factors, some of which may be beyond the control of the Corporation. Investors are cautioned that all forward-looking statements involve risks and uncertainty. Please read the cautionary language regarding these forward-looking statements set forth at the beginning of this Annual Report.

The Bank has been subject to regulatory enforcement actions since 2008. The level of regulatory enforcement action taken against the Bank by the Office of the Comptroller of the Currency (OCC) escalated from a formal agreement entered in October 2008 to the issuance of a Consent Order in September 2009, which was subsequently revised and reissued as a new Consent Order in October 2013 (the "Consent Order"). Pursuant to the new Consent Order, the Bank continues to be required to maintain total capital equal to 11% of risk weighted assets and Tier 1 capital equal to at least 8.5% of adjusted total assets. The Bank has satisfied these required minimum ratios since December 31, 2013 due to receipt of a $15.4 million capital infusion from the Corporation using proceeds from a private placement transaction completed by the Corporation in December 2013. In addition, on March 28, 2014, the Corporation provided a second capital infusion to the Bank of $550,000 using proceeds from the issuance of 2.3 million shares of its common stock in a rights offering registered with the SEC which closed on March 27, 2014. Based on our projections, the Corporation currently expects that the Bank will be able to maintain the required capital ratios throughout 2015. However, there is no guarantee that this will occur. Please see "Capital" below for more details.

In addition, despite exceeding minimum regulatory capital ratios for a well-capitalized institution at December 31, 2014, the Bank is presently categorized as "adequately capitalized" for purposes of the OCC's Prompt Corrective Action ("PCA") enforcement powers because the Bank remains subject to the new Consent Order. As a result of this classification, for purposes of PCA, the Bank is subject to a number of additional restrictions. These include, among other things, (1) restrictions on the payment of dividends, capital distributions and management fees, (2) the requirement that the Bank obtain prior written approval of the OCC before paying any bonus or increase in the compensation of any senior executive officer of the Bank, (3) prohibitions on the acceptance of employee benefit plan deposits, (4) restrictions on interest rates paid on deposits, and (5) restrictions on the acceptance, renewal, or roll-over of brokered deposits. The Bank's capital category is determined solely for purposes of applying PCA; the capital category may not constitute an accurate representation of the Bank's overall financial condition or prospects.

The Consent Order imposes many other requirements on the Bank in addition to the minimum capital ratios. It will be imperative for the Bank to comply with these requirements in order to avoid further regulatory enforcement action. As long as the Bank is subject to the Consent Order, the financial performance of the Corporation will be adversely impacted by elevated FDIC insurance premiums paid by the Bank and ongoing costs incurred to correct deficiencies underlying the requirements of the Consent Order. The Corporation also remains challenged to a great extent by the economic conditions in Livingston County and the surrounding area. The Corporation has in general experienced a slowing or stagnant economy in Michigan since 2001. In particular, Michigan's current unemployment rate of approximately 6.4%, although improved from highs near 14% during 2009, remains among the worst for all states. Unlike larger banks that are more geographically diversified, we provide banking services to customers primarily in Livingston County. Our loan portfolio, the ability of the borrowers to repay these loans, and the value of the collateral securing these loans is impacted by local economic conditions. The continued economic difficulties in Michigan have had and may continue to have many adverse consequences as described below in "Loans".

The dramatic declines in the housing market in recent years, with falling home prices and elevated levels of foreclosures and unemployment, resulted in and may continue to cause significant write-downs of asset values by us and other financial institutions if borrowers continue to struggle. These write-downs have caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail. Additionally, capital and credit markets have continued to experience elevated levels of volatility and disruption in recent years. This market turmoil and tightening of credit have led to a lack of general consumer confidence and a reduction in business activity.

Although improved significantly from December 31, 2013, our nonperforming assets comprise approximately 26% of our capital plus allowance for loan losses at December 31, 2014. As described elsewhere in this Form 10-K, we have established our allowance for loan losses at a level we currently believe, based on the data available to us, is sufficient to absorb expected losses in our loan portfolio. However, this process involves a very significant degree of judgment, is based on numerous different assumptions that are difficult to make and, by its nature, is inherently uncertain. Moreover, the performance of our existing loan portfolio is, in many respects, dependent on external factors such as our borrowers' ability to repay their loan obligations and the value of collateral securing those obligations, which in turn depend on macro and micro economic conditions including the pace of economic recovery in southeast Michigan. If our loan portfolio performs worse than we currently expect, we may not have sufficient capital to absorb all of the losses and still maintain the minimum capital levels required under the Consent Order.

As described in Note 2 to the consolidated financial statements, management has undertaken various initiatives to address the current challenges facing the Bank. The successful implementation of the various actions being undertaken by management will be difficult in the current economic environment. Even if such actions are successfully implemented, such strategy or results may not be sufficient to sustain the Bank's capital levels at satisfactory levels, return the Bank to profitability, or otherwise avoid further regulatory enforcement action.

In response to these regulatory actions, difficult market conditions and significant losses incurred from 2007 through 2011, we have taken steps or initiated action plans to restore our capital levels, improve our operations and return to profitability, with the primary objective of fully satisfying all requirements of the Consent Order in as timely a manner as possible.

There can be no assurance that management's efforts will improve the Bank's financial condition. Further deterioration of the Bank's capital position is possible. The current economic environment in southeast Michigan and local real estate market conditions will continue to impose challenges on the Bank.

It is against this backdrop that we discuss our financial condition and results of operations in 2014 as compared to earlier periods.

## FINANCIAL CONDITION

Total assets were $322.8 million at December 31, 2014 compared to $312.3 million at December 31, 2013; an increase of $10.5 million (3.4%). Cash and cash equivalents decreased by $51.7 million (66.2%) to $26.3 million at December 31, 2014. Investment securities increased $64.9 million (94.7%) to $133.3 million and gross loans decreased $5.1 million (3.1%) to $160.0 million. Deposits increased $5.1 million (1.8%) to $290.4 million. Shareholders' equity increased $6.0 million (24.1%) to $31.1 million.

### Cash and Due from Banks

During 2014, in response to the difficult lending environment, management acted to support earnings through purchases of investment securities which decreased cash and due from banks balances by $51.7 million.

### Securities

During 2014, investments securities increased $64.9 million due to the purchase of $86.9 million of securities offset by proceeds from principal pay downs of $18.8 million, a call of $3.3 million, sale proceeds of $200,000, net amortization of $1.2 million, and a $1.5 million decrease in the portfolio's net unrealized losses.

The following table sets forth the fair value of available for sale securities and the book value of other securities at December 31:

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | | (in thousands) | |
| **Available for sale securities:** | | | |
| Mortgage-backed/CMO | $ 107,137 | $ 65,169 | $ 67,862 |
| U.S. Agency | 23,130 | - | 3,007 |
| Obligations of state and political subdivisions | 1,605 | 1,794 | 1,580 |
| Preferred stock | 303 | 717 | 137 |
| Total available for sale securities | $ 132,175 | $ 67,680 | $ 72,586 |
| **Other securities:** | | | |
| FRB stock | $ 523 | $ 44 | $ 44 |
| FHLBI stock | 617 | 735 | 735 |
| Total other securities | $ 1,140 | $ 779 | $ 779 |

The following sets forth the fair value contractual maturities of securities at December 31, 2014 and the weighted average coupon rate of such securities:

| | Maturing Within One Year | | Maturing After One but Within Five Years | | Maturing After Five but Within Ten Years | | Maturing After Ten Years | |
|---|---|---|---|---|---|---|---|---|
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| | | | | (in thousands) | | | | |
| Mortgage-backed/CMO | $ - | - | $ - | - | $ 17,914 | 2.98% | $ 89,223 | 3.10% |
| U.S. Agency | 4,023 | 0.94% | 17,101 | 1.21% | 2,006 | 2.33% | - | - |
| Obligations of states and political subdivisions | 255 | 3.00% | 505 | 0.86% | 306 | 4.00% | 539 | 4.14% |
| Preferred stock | - | - | - | - | - | - | 303 | - |
| FRB stock | - | - | - | - | - | - | - | 5.86% |
| FHLBI stock | - | - | - | - | - | - | - | 4.99% |
| Total | $ 4,278 | 1.06 | $ 17,606 | 1.20% | $ 20,226 | 2.93% | $ 90,065 | 3.12% |
| Tax equivalent adjustment for calculation of yield | $ - | | $ - | | $ 7 | | $ 12 | |

The rates set forth in the table below for obligations of state and political subdivisions have been restated on a fully tax equivalent basis assuming a 34% marginal tax rate. The amount of the adjustment is as follows:

| | Tax-Exempt Rate | Adjustment | Equivalent Basis |
|---|---|---|---|
| Under 1 year | - | - | - |
| 1-5 years | - | - | - |
| 5-10 years | 4.00% | 2.25% | 6.25% |
| 10 years or more | 4.14% | 2.25% | 6.39% |

The following shows the percentage composition of the securities portfolio as of December 31:

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| Mortgage-backed/CMO | 80.4% | 95.2% | 92.5% |
| U.S. Agency | 17.3% | 0.0% | 4.1% |
| Obilgations of state and political subdivisions | 1.2% | 2.6% | 2.2% |
| Preferred stock | 0.2% | 1.1% | 0.2% |
| Other | 0.9% | 1.1% | 1.0% |
| **Total securities** | 100.0% | 100.0% | 100.0% |

**Loans**

The senior management and Board of Directors of the Bank retain the authority and responsibility for credit decisions. We have adopted uniform underwriting standards documented in our various loan policies. Our delegated loan authorities and loan committee structure attempt to provide requisite controls and promote compliance with such established underwriting standards. Loans to a borrower with aggregate indebtedness in excess of $1.5 million are approved by a committee of the Board or the entire Board. There can be no assurance that the aforementioned lending procedures and the use of uniform underwriting standards will prevent us from incurring significant credit losses in our lending activities and, in fact, our loan losses were elevated from 2007 through 2012 relative to prior historical levels.

The loan portfolio decreased $5.1 million (3.1%) in 2014. The decrease was attributable in part to receipt of scheduled payments from our borrowers and pay-offs received as borrowers refinanced at other financial institutions. In addition, loan charge offs incurred in 2014 reduced loans by $474,000. These factors, coupled with limited loan demand by creditworthy borrowers and increased market competition, reduced loans outstanding during 2014.

The following table reflects the composition of the commercial and consumer loans in the Consolidated Financial Statements. Included in the residential first mortgage totals below are the "real estate mortgage" loans listed in the Consolidated Financial Statements and other loans to customers who pledge their homes as collateral for their borrowings. A portion of the loans listed in residential first mortgages represent commercial loans where the borrower has pledged a 1- 4 family residential property as collateral. In the majority of the loans to commercial customers, the Bank is relying on the borrower's cash flow to service the loans.

The following shows the balance and percentage composition of loans as of December 31:

| | 2014 | | 2013 | | 2012 | | 2011 | | 2010 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Balances | Percent | Balances | Percent | Balances | Percent | Balances | Percent | Balances | Percent |
| | (in thousands) | | | | (in thousands) | | | | | |
| Secured by real estate: | | | | | | | | | | |
| Residential first mortgage | $ 15,880 | 9.9% | $ 17,596 | 10.7% | $ 19,782 | 11.0% | $ 21,755 | 10.4% | $ 24,546 | 10.4% |
| Residential home equity/other junior liens | 10,827 | 6.8% | 11,236 | 6.8% | 10,040 | 5.6% | 12,246 | 5.9% | 14,967 | 6.3% |
| Construction, land development and other land | 5,050 | 3.2% | 5,826 | 3.5% | 8,741 | 4.8% | 13,918 | 6.7% | 19,641 | 8.3% |
| Commercial (nonfarm, nonresidential) | 106,874 | 66.7% | 109,334 | 66.1% | 120,617 | 66.9% | 142,539 | 68.2% | 155,006 | 65.7% |
| Commercial | 15,130 | 9.4% | 15,019 | 9.1% | 16,112 | 8.9% | 13,590 | 6.5% | 16,196 | 6.9% |
| Consumer and Other | 6,444 | 4.0% | 6,273 | 3.8% | 5,103 | 2.8% | 4,992 | 2.3% | 5,784 | 2.4% |
| Total gross loans | 160,205 | 100.0% | 165,284 | 100.0% | 180,395 | 100.0% | 209,040 | 100.0% | 236,140 | 100.0% |
| Net unearned fees | (159) | | (169) | | (204) | | (196) | | (202) | |
| **Total Loans** | $ 160,046 | | $ 165,115 | | $ 180,191 | | $ 208,844 | | $ 235,938 | |

Loans secured by residential first mortgages decreased $1.7 million (9.8%) in 2014 as the mortgage loan portfolio experienced runoff from scheduled payments, payoffs, charge offs and transfers into other real estate upon foreclosure. Since 2010 and through the current date, the Bank's ability to originate residential mortgage loans is constrained by the lack of an in-house residential lending program and reliance on a third-party to provide residential mortgage loans to the Bank's customers. Consequently, during this time the portfolio has continued to self-liquidate absent the opportunity to portfolio newly originated residential mortgages.

Despite the continued and relatively low interest rates during 2014, coupled with improved residential property values compared to recent prior year depressed property values, loans secured by residential equity liens decreased modestly in 2014 by $409,000 (3.6%) as repayments outpaced draws and new originations. At December 31, 2014, the Bank had $3.8 million of home equity interest-only loans; none of these loans were originated at low promotional rates.

Construction, land development and other land loans at December 31, 2014 totaled $5.0 million and included $4.4 million of loans secured by non 1-4 family residential properties and $600,000 secured by 1-4 family residential construction loans. During 2014, these loans experienced a decline of $776,000 (13.3%) attributable primarily to self-liquidation of the portfolio through receipt of scheduled payments and the Bank's desire for continued diversification away from these higher risk loans given the relatively poor economic conditions for real estate development. Minimal charge offs were incurred for this portfolio in 2014 due to significant impairment charges recognized in prior years when real estate values experienced dramatic declines. Additionally, no new money construction or land development loans were originated in 2014.

Commercial real estate loans (nonfarm and nonresidential) decreased $2.5 million (2.2%) from 2013 to 2014. The decrease resulted in part from receipt of scheduled payments from performing borrowers and pay-offs received from borrowers refinancing at other financial institutions. At December 31, 2014, the commercial real estate portfolio includes: $56.9 million of loans secured by non-owner occupied properties, $47.4 million of loans secured by owner occupied properties, and $2.6 million of loans secured by multifamily housing. The Bank's ability to originate new money owner and non-owner occupied commercial real estate loans during 2014 was restricted by the Bank's regulatory condition and loan concentration levels. Additionally, competition from other financial institutions and limited demand from creditworthy borrowers further limited new lending opportunities.

Commercial loans experienced a slight net increase of $111,000 (0.7%) in 2014. These types of loans are made to finance commercial and industrial businesses and are not secured by real estate. As such, these loans present a desirable addition to the Bank's existing and heavily concentrated real estate portfolio. However, during 2014, lending opportunities for commercial and industrial loans remained limited as businesses continued to be cautious of the economy's resiliency and as competition for these loans from other financial institutions intensified.

Consumer and other loans increased approximately $171,000 (2.7%) from 2013 to 2014 The net increase primarily resulted from growth in the Bank's consumer auto loan portfolio following promotional efforts designed to diversify the Bank's loan portfolio into more retail lending given the existing commercial real estate concentrations.

The following shows the amount of commercial, financial, and agricultural loans outstanding as of December 31, 2014, which based on remaining scheduled repayments of principal, mature in the periods indicated:

| | Loans Maturing | | | |
|---|---|---|---|---|
| | Within One Year | After One but Within Five Years | After Five Years | Total |
| | (in thousands) | | | |
| Secured by Real Estate: | | | | |
| Construction, land development and other land loans | $ 2,857 | $ 2,193 | $ - | $ 5,050 |
| Other (secured by commercial and multi-family) | 29,439 | 61,365 | 16,070 | 106,874 |
| Commercial (secured by business assets or unsecured) | 7,993 | 5,622 | 1,514 | 15,129 |
| Other (loans to farmers, and overdrafts) | - | - | - | - |
| Totals | $ 40,289 | $ 69,180 | $ 17,584 | $ 127,053 |

Below is a schedule of amounts due after one year which are classified according to their sensitivity to changes in interest rates:

| | Interest Sensitivity | |
|---|---|---|
| | Fixed Rate | Variable Rate |
| | (in thousands) | |
| Due after one but within five years | $ 52,776 | $ 16,404 |
| Due after five years | 12,226 | 5,358 |

At December 31, 2014 and 2013, the Bank's loan portfolio included significant industry concentrations for: lessors of non-residential building operators, lessors of mini warehouses/self-storage, lessors of residential buildings and dwellings, hotels and motels, and new single family home builders. Management determines such concentrations using NAICS codes and regulatory standards that define significant concentrations as greater than 25 percent of the Bank's capital, inclusive of the allowance for loan losses. In addition, management believes the Bank's most significant loan portfolio concentration and exposure relates to loans secured by real estate. There were no foreign loans outstanding at December 31, 2014.

The future size of the loan portfolio is dependent upon a number of economic, competitive and regulatory factors faced by the Bank. In light of the economic and regulatory challenges currently impacting the Bank, we anticipate that our efforts to achieve meaningful, quality and prudent loan growth within our concentration limits may be difficult during 2015. Moreover, any further declines in the loan portfolio caused by regulatory restrictions on the Bank's ability to make new loans, a lack of loan demand by qualified borrowers, or competition that leads to unanticipated payoffs of our existing loans or lower relative pricing on new loans could adversely impact our future operating results.

Nonperforming assets consist of loans accounted for on a nonaccrual basis, loans contractually past due 90 days or more as to interest or principal payments (but not included in nonaccrual loans), and other real estate which has been acquired through foreclosure and is actively managed through the time of disposition to minimize loss. Nonperforming loans include troubled debt restructured loans that are on nonaccrual status or past due 90 days or more. At December 31, 2014 and 2013, there were $4.3 million and $7.8 million of troubled debt restructurings included in nonperforming loans. Troubled debt restructured loans ("TDRs") that are not past due 90 days or more are excluded from nonperforming loan totals.

The aggregate amount of nonperforming loans and other nonperforming assets are presented below as of December 31:

| **Nonperforming Loans and Assets:** | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| | (dollars in thousands) | | | | |
| Nonaccrual loans | $ 8,304 | $ 11,067 | $ 12,839 | $ 22,962 | $ 30,858 |
| Loans past due 90 days and still accruing | 4 | - | 201 | 9 | - |
| Total nonperforming loans | 8,308 | 11,067 | 13,040 | 22,971 | 30,858 |
| Other real estate | 1,174 | 480 | 3,427 | 3,026 | 4,294 |
| Total nonperforming assets | $ 9,482 | $ 11,547 | $ 16,467 | $ 25,997 | $ 35,152 |
| | | | | | |
| Nonperforming loans as a percent of total loans | 5.19% | 6.70% | 7.24% | 11.00% | 13.08% |
| Allowance for loan losses as a percent of nonperforming loans | 85.57% | 83.26% | 90.25% | 55.25% | 45.27% |
| Nonperforming assets as a percent of total loans and other real estate | 5.88% | 6.97% | 8.97% | 12.27% | 14.63% |

There were no other interest bearing assets at December 31, 2014 that would be required to be disclosed under Item III(C) of Guide 3 of the Securities Act Industry Guide, if such assets were loans.

The following shows nonperforming loans by type of loan collateral and percentage composition of nonperforming loans as of December 31:

| **Nonperforming Loans** | **2014** | | **2013** | | **2012** | |
|---|---|---|---|---|---|---|
| | Amount | Percent | Amount | Percent | Amount | Percent |
| Secured by real estate: | | | (in thousands) | | | |
| Residential first mortgage | $ 2,902 | 34.9% | $ 2,504 | 22.6% | $ 3,147 | 22.9% |
| Residential home equity/other junior liens | 249 | 3.0% | 375 | 3.4% | 441 | 3.4% |
| Construction and land development and farmland | 1,692 | 20.4% | 1,849 | 16.7% | 2,391 | 18.6% |
| Commercial real estate (nonfarm, nonresidential) | 3,113 | 37.5% | 6,203 | 56.1% | 6,672 | 52.0% |
| Commercial | 233 | 2.8% | 12 | 0.1% | 264 | 2.1% |
| Consumer and Other | 119 | 1.4% | 124 | 1.1% | 125 | 1.0% |
| Total nonperforming loans | $ 8,308 | 100.0% | $ 11,067 | 100.0% | $ 13,040 | 100.0% |

At December 31, 2014, nonperforming loans decreased $2.8 million (24.9%) from December 31, 2013. The net decrease resulted from the combination of: payoffs, settlements, and continued receipt of payments from borrowers totaling approximately $2.7 million; upgrades of approximately $2.9 million of loans now demonstrating both improved cash flows and established payment history following the culmination of successful work-outs and/or restructurings; approximately $163,000 of charge offs; and the transfer of six loans for approximately $1.3 million to other real estate owned. Offsetting these decreases, approximately $4.3 million of new nonperforming loans were identified in 2014, including one loan totaling $4,000 past due greater than 90 days and still accruing interest at December 31, 2014. These loans were comprised principally of commercial real estate loans. Management continues to focus on reducing the level of nonperforming assets and making improvements in asset quality.

As of December 31, 2014, approximately $7.3 million (87.7%) of nonperforming loans are making scheduled payments on their loans. Management closely monitors each of these loans to identify opportunities where workout efforts or restructuring may improve borrowers' credit risk profiles to facilitate a return to accrual status for credits with sustained repayment histories. Loans categorized as 90 days past due and still accruing are well secured and in the process of collection. All nonperforming loans are reviewed regularly for collectibility and uncollectible balances are promptly charged off.

Management regularly evaluates the condition of problem credits and when reduced cash flows coupled with collateral shortfalls are evident, the loans are placed on nonaccrual. In addition, loans are generally placed on nonaccrual when principal or interest is past due ninety days or more. If management believes there is significant risk of not collecting full principal and interest, we may elect to place the loan on nonaccrual even if the borrower is current. Based on the reduced velocity of newly identified problem loans and remediation plans for existing problem loans, we anticipate other real estate owned to trend lower during 2015 as the Bank manages through the remaining problem loan portfolio.

Other real estate owned ("OREO") is comprised primarily of commercial real estate properties and totaled $1.2 million at December 31, 2014 compared to $480,000 at December 31, 2013. During 2014, OREO additions included four commercial real estate properties and two residential properties totaling approximately $1.3 million. Cost basis, as determined at the time of transfer into OREO based on current appraisals less estimated selling costs, included approximately $140,000 of fair value adjustments recognized as $96,000 of recoveries and $44,000 of valuation adjustments. OREO activity in 2014 also included the sale of four properties for $670,000 which generated gains of $79,000. Nonperforming loans may move into OREO when the foreclosure process is initiated (i.e., as "in substance foreclosure") through the time in which the foreclosure process is completed and any redemption period expires or from the receipt of deeds in lieu of foreclosure.

Since 2007, the decline in real estate sales and valuations in southeast Michigan has significantly and adversely impacted the quality of the Corporation's portfolio of loans secured by real estate. In addition, during this time the local economies served by the Corporation have been adversely impacted by the restructuring of the automotive market and related industries which in turn, has caused our borrowers to experience declining revenues, diminished cash flows, and reduced collateral values in their businesses. Due to these factors and the prolonged troubled economy, real estate values in general have remained distressed. Although there has been some recent stabilization in values and increased sales activity for certain real estate, because the Corporation continues to carry a relatively high concentration of loans secured by real estate, the Corporation continues to experience elevated levels of nonperforming loans and impaired loans relative to historical levels prior to 2007.

Although management has specific, aggressive remediation plans for a majority of the Bank's remaining significant classified and criticized loans, execution of such plans will take some time and is, in many respects, dependent on external factors such as the borrowers' ability to repay their obligations and/or to meet performance criteria and the value of collateral securing those obligations, which in turn depend on macro and micro economic conditions including the pace of recovery in southeast Michigan. Given the extent of the problem loans secured by real estate, these factors may delay remediation efforts and result in the Bank maintaining higher than anticipated balances of nonperforming loans which may adversely impact future provision for loan losses. Management continues to make oversight of these loans a priority.

At December 31, 2014, impaired loans totaled approximately $12.6 million, of which $3.5 million were assigned a specific reserve of $1.7 million. Impaired loans without specific reserve allocations totaled $9.1 million. A loan is considered impaired when it is probable that all or part of the amounts due according to contractual terms of the loan agreement will not be collected on a timely basis or the loan has been restructured and is classified as a troubled debt restructuring ("TDR"). Impairment is measured by comparing the Bank's recorded investment in the loan to the present value of expected future cash flows at the loan's effective interest rate, the fair value of the collateral less costs to sell, or the loan's observable market price. Impaired loans totaled $19.1 million at December 31, 2013 and $22.9 million at December 31, 2012. Impaired loans had specific reserves of $2.4 million at December 31, 2013 and $1.7 million at December 31, 2012.

Of the impaired loans reported at December 31, 2014, $5.6 million were on nonaccrual status, based on management's assessment using criteria discussed above and $5.3 million are commercial and commercial real estate loans identified as TDRs. All cash received on nonaccrual loans is applied to principal balance. Loans are considered for return to accrual status on an individual basis when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. Interest income is recognized on TDRs pursuant to the criteria noted below.

A key component of our asset quality improvement initiative includes procedures intended to improve asset quality levels within the loan portfolio. Management develops specific workout strategies on all significant impaired loans to attempt to mitigate the extent of potential future loss by the Bank and to remediate nonperforming assets, where possible. Loan work out strategies may include the Bank's willingness to modify the terms of a loan to improve our ability to collect amounts due. The modified terms are intended to enable customers to mitigate the risk of foreclosure by creating payment schedules that provide for continued loan payment requirements based on their current cash flow ability. Common modifications utilized by the Bank may include one or more of the following: interest rate reductions, extension of amortization periods, and forbearance of interest and/or principal payments. Management may extend concessions (i.e., modifications) to troubled borrowers in exchange for the pledge of additional collateral and/or guarantors. Loan modifications are considered TDRs when the modification includes terms outside of normal lending practices (i.e., concessions) to a borrower who is experiencing financial difficulties.

The following summarizes the troubled debt restructuring component of impaired loans at:

| | December 31, 2014 | | | December 31, 2013 | | |
|---|---|---|---|---|---|---|
| | Accruing Interest | Nonaccrual | Total | Accruing Interest | Nonaccrual | Total |
| | | (in thousands) | | | (in thousands) | |
| Current | $ 7,879 | $ 3,773 | $ 11,652 | $ 11,388 | $ 7,110 | $ 18,498 |
| Past due 30-89 days | 5 | 123 | 128 | - | 682 | 682 |
| Past due 90 days or more | - | 393 | 393 | - | 2 | 2 |
| Total troubled debt restructurings | $ 7,884 | $ 4,289 | $ 12,173 | $ 11,388 | $ 7,794 | $ 19,182 |

Troubled debt restructured loans accrue interest if the borrower complies with the revised terms and conditions and has demonstrated sustained payment performance consistent with the modified terms for a minimum of six consecutive payment cycles after the restructuring date and if collection of future payments is reasonably assured.

If the economy weakens further and/or real estate values decline further, the provision for loan losses may continue to be impacted by the Bank's concentration in real estate secured loans. While we have carefully considered these factors when determining the level of reserves, it is difficult to accurately predict future economic events, especially in the current environment.

The loan portfolio is periodically reviewed by internal and external parties and the results of these reviews are reported to the Bank's Board of Directors. The purpose of these reviews is to verify proper loan documentation, to provide for the early identification of potential problem loans, to challenge and validate internal risk grades assigned by management, to monitor collateral values and to assist the Bank in evaluating the adequacy of the allowance for loan losses.

**Allowance for Loan Losses**

The allowance for loan losses totaled $7.1 million at December 31, 2014 compared to $9.2 million at December 31, 2013, a decrease of $2.1 million. At December 31, 2012 the allowance balance was $11.8 million. The allowance for loan losses represented 4.44%, 5.58%, and 6.53% of gross loans and provided a coverage ratio to nonperforming loans of 85.57%, 83.26%, and 90.25% at December 31, 2014, 2013 and 2012, respectively. Management estimates the required allowance balance based on past loan loss experience, the nature and volume of the portfolio segments and concentrations, information about specific borrower situations, estimated collateral values, economic conditions and trends, and other factors. When all of these factors were considered, management determined that the $2.5 million negative provision for loan losses and resulting $7.1 million allowance were appropriate as of and for the year ended December 31, 2014.

Allocations of the allowance are made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Management continually analyzes portfolio risk to refine the process of effective risk identification and measurement for determination of what it believes is an adequate allowance for loan losses. Relative to conditions faced by the Bank as recently as one-year ago, combined with successive improving to stable quarterly levels of nonperforming loans, further stabilization of real estate values securing certain problem credits, continued shrinkage in the overall loan portfolio, and continued improvement in our rolling 12 quarter loss history, the allowance for loan loss calculation and analysis at December 31, 2014 supported our determination of the overall level of the allowance and related provision expense relative to prior periods. Assuming these positive trends generally continue, management believes that it is reasonably likely that future negative provision expense may be required to reduce the overall level of the allowance based on the continuation of existing portfolio trends and the anticipated improvement in the rolling 12 quarter loss history as significant prior year charge offs exit the calculation. While we cannot predict or guarantee the amount or timing of any potential additional future negative provision expense, it is possible any such negative provision expense could contribute substantially to earnings and enhance book value per share.

Given the significant portion of our loans that are secured by real estate, our portfolio continues to be sensitive to the weakened economic conditions in southeast Michigan and the Bank's market area, and is especially impacted by depressed real estate values. In response, each quarter our portfolio management practices continue to analyze and quantify risk within all segments of our portfolio to ensure effective problem loan identification procedures. Our practice is to obtain updated appraisals on criticized loans secured by real estate and apply appropriate discounting practices based on perceived declines in market value.

Although updated appraisals received during more recent quarters indicated that property values for collateral on our impaired loans continue to be depressed, the appraisals did not reflect the extent of value erosion relative to that experienced in prior quarters. However, at present, the weak Michigan economy and elevated unemployment levels continue to soften signs of economic recovery in our market area. Consequently, we have continued to allocate reserves for these risk and uncertainties, resulting in reserves above normal levels.

If the economy weakens further and/or real estate values decline further, nonperforming loans may increase in subsequent quarters. Due to the uncertainty of future economic conditions and the decline in real estate values, the provision for loan losses for 2015 may continue to be impacted by the

Bank's concentration in real estate secured loans. While we have considered these factors when determining the level of reserves, it is difficult to accurately predict the future economic events, especially in the current environment.

The allowance consists of specific and general components. The specific component relates to loans that are classified as nonaccrual or renegotiated. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan are 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 used to reflect changes in the portfolio's collectability not captured by historical loss data.

The methodology for measuring the appropriate level of allowance and related provision for loan losses relies on several key elements, which include specific allowances for loans considered impaired, general allowances for non-impaired commercial loans based on our internal loan grading system, and general allocations based on historical trends for homogeneous loan groups with similar risk characteristics.

The general allowance allocated to non-impaired commercial loans was based on the internal risk grade of such loans and their assigned portfolio segment, as primarily determined based on underlying collateral; and, if real estate secured, the type of real estate. Each risk grade within a portfolio is assigned a loss allocation factor. The higher a risk grade, the greater the assigned loss allocation percentage. Accordingly, changes in the risk grades of loans affect the amount of the allowance allocation.

Our loss factors are determined based on our actual loss history by portfolio segment and loan grade and are adjusted for significant qualitative factors that, in management's judgment, affect the collectability of the portfolio at the analysis date. We use a rolling 12 quarter net loss history as the base for our computation which is weighted to give emphasis to more recent quarters.

Groups of homogeneous noncommercial loans, such as residential real estate loans, home equity and home equity lines of credit, and consumer loans receive allowance allocations based on the loan type, primarily determined based on historical loss experience rather than by risk grade. These allocations are adjusted for consideration of general economic and business conditions, credit quality and delinquency trends, collateral values, and recent loss experience for these similar pools of loans.

Although management evaluates the adequacy of the allowance for loan losses based on information known at a given point in time, as facts and circumstances change, the provision and resulting allowance may also change. While we believe that our allowance for loan loss analysis has identified all probable losses inherent in the portfolio at December 31, 2014, there can be no assurance that all losses have been identified or that the amount of the allowance is sufficient.

The following sets forth loan balances and summarizes the changes in the allowance for loan losses and reserve for unfunded credit commitments, which is part of the Corporation's critical accounting policies, for each of the years ended December 31:

| | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| **Loans:** | | | (in thousands) | | |
| Average daily balance of loans for the year | $ 161,065 | $ 170,434 | $ 194,804 | $ 223,665 | $ 252,314 |
| Amount of loans outstanding at end of year | 160,046 | 165,115 | 180,191 | 208,844 | 235,938 |
| **Components:** | | | | | |
| **Allowance for loan losses** | | | | | |
| Balance, beginning of year | $ 9,214 | $ 11,769 | $ 12,690 | $ 13,970 | $ 18,665 |
| Loans charged off: | | | | | |
| Commercial | 244 | 1,072 | 3,778 | 7,362 | 10,751 |
| Consumer | 109 | 126 | 169 | 527 | 558 |
| Real estate mortgage | 121 | 7 | 86 | 417 | 574 |
| Total charge offs | 474 | 1,205 | 4,033 | 8,306 | 11,883 |
| Recoveries to loans previously charged off: | | | | | |
| Commercial | 737 | 702 | 1,677 | 618 | 1,029 |
| Consumer | 97 | 154 | 104 | 163 | 178 |
| Real estate mortgage | 35 | 44 | 6 | 45 | 6 |
| Total recoveries | 869 | 900 | 1,787 | 826 | 1,213 |
| Net loans charged off | (395) | 305 | 2,246 | 7,480 | 10,670 |
| Additions (reductions) to allowance charged to operations | (2,500) | (2,250) | 1,325 | 6,200 | 5,975 |
| Balance, end of year | 7,109 | 9,214 | 11,769 | 12,690 | 13,970 |
| **Reserve for unfunded credit commitments** | | | | | |
| Balance, beginning of year | 300 | 300 | 300 | 300 | 300 |
| Additions (reductions) to reserve charged to operations | - | - | - | - | - |
| Balance, end of year | 300 | 300 | 300 | 300 | 300 |
| **Total allowance for loan losses and reserve for unfunded credit commitments** | $ 7,409 | $ 9,514 | $ 12,069 | $ 12,990 | $ 14,270 |
| **Ratios:** | | | | | |
| Net loans charged off to average loans outstanding | -0.25% | 0.18% | 1.15% | 3.34% | 4.23% |
| Allowance for loan losses to loans outstanding | 4.44% | 5.58% | 6.53% | 6.08% | 5.92% |

The following shows charge offs by the type of loan collateral and percentage composition as of December 31:

| Charge offs | 2014 Amount | 2014 Percent | 2013 Amount | 2013 Percent | 2012 Amount | 2012 Percent | 2011 Amount | 2011 Percent | 2010 Amount | 2010 Percent |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | (dollars in thousands) | | | | | |
| Secured by real estate | | | | | | | | | | |
| Residential first mortgage | $ 141 | 29.8% | $ 55 | 4.6% | $ 517 | 12.8% | $ 1,401 | 16.9% | $ 868 | 7.3% |
| Residential home equity/other junior liens | 29 | 6.1% | 32 | 2.6% | 172 | 4.3% | 615 | 7.4% | 395 | 3.3% |
| Construction and land development and farmland | 5 | 1.1% | 20 | 1.7% | 481 | 11.9% | 1,436 | 17.3% | 4,547 | 38.3% |
| Commercial real estate | 122 | 25.7% | 827 | 68.7% | 2,385 | 59.1% | 4,070 | 49.0% | 5,376 | 45.2% |
| Commercial | 95 | 20.0% | 166 | 13.7% | 355 | 8.8% | 628 | 7.5% | 465 | 3.9% |
| Consumer and Other | 82 | 17.3% | 105 | 8.7% | 123 | 3.1% | 156 | 1.9% | 232 | 2.0% |
| Total charge offs | $ 474 | 100.0% | $ 1,205 | 100.0% | $ 4,033 | 100.0% | $ 8,306 | 100.0% | $ 11,883 | 100.0% |

The following presents the portion of the allowance for loan losses and unfunded commitments applicable to each loan category and the percent of loans and the percent of the credit commitments in each category to total loans and total credit commitments, as of December 31:

| | 2014 Amount | 2014 Percent | 2013 Amount | 2013 Percent | 2012 Amount | 2012 Percent | 2011 Amount | 2011 Percent | 2010 Amount | 2010 Percent |
|---|---|---|---|---|---|---|---|---|---|---|
| **Allowance for loan losses** | | | | | (dollars in thousands) | | | | | |
| Commercial | $ 6,271 | 82.7% | $ 8,554 | 82.9% | $ 10,616 | 84.4% | $ 10,720 | 85.9% | $ 11,604 | 86.0% |
| Consumer | 469 | 11.0% | 374 | 9.8% | 440 | 8.1% | 1,129 | 7.0% | 1,032 | 7.1% |
| Real estate mortgage | 369 | 6.3% | 286 | 7.3% | 713 | 7.5% | 841 | 7.1% | 1,334 | 6.9% |
| Total | $ 7,109 | 100.0% | $ 9,214 | 100.0% | $ 11,769 | 100.0% | $ 12,690 | 100.0% | $ 13,970 | 100.0% |
| **Unfunded commitments** | | | | | | | | | | |
| Commercial | $ 191 | 59.6% | $ 223 | 59.6% | $ 204 | 50.7% | $ 106 | 58.6% | $ 95 | 57.1% |
| Consumer | 109 | 40.4% | 77 | 40.4% | 96 | 49.3% | 194 | 41.4% | 205 | 42.9% |
| Real estate mortgage | - | - | - | - | - | - | - | - | - | - |
| Total | $ 300 | 100.0% | $ 300 | 100.0% | $ 300 | 100.0% | $ 300 | 100.0% | $ 300 | 100.0% |

**Deposits**

Deposits totaled $290.4 million at December 31, 2014, an increase of $5.1 million (1.8%) from December 31, 2013. Year-end deposit balances may fluctuate, therefore it is often more meaningful to analyze changes in average balances. Average deposits decreased $374,000 (0.1%) in 2014 compared to 2013. Average demand deposit balances increased $1.7 million (1.8%) while average NOW, savings and money market deposit account (MMDA) balances, as a group, increased $5.0 million (4.4%). During 2014, the Bank experienced an influx of non-interest bearing demand balances primarily from our business customers. Average certificates of deposit (CD's) decreased $7.0 million (8.7%) in 2014 due to the Bank's management of CD renewal rates and limited special rates offered to single-service customers.

During 2013, average deposits increased $4.6 million (1.6%) over 2012 levels. Average demand deposit balances increased $5.4 million (6.2%) while average NOW, savings, and MMDA balances, as a group, increased $6.7 million (6.2%). Average certificates of deposit decreased $7.5 million (8.5%) due to the Bank's management of CD renewal rates and limited special rates offered to single-service customers.

The following sets forth average deposit balances and the weighted average rates paid thereon for the years ended December 31:

| | 2014 Average Balance | 2014 Rate | 2013 Average Balance | 2013 Rate | 2012 Average Balance | 2012 Rate |
|---|---|---|---|---|---|---|
| | | | (dollars in thousands) | | | |
| Non-interest bearing demand | $ 94,280 | 0.00% | $ 92,590 | 0.00% | $ 87,180 | 0.00% |
| NOW | 30,988 | 0.03% | 30,602 | 0.02% | 29,181 | 0.02% |
| Savings | 46,726 | 0.02% | 42,684 | 0.02% | 41,622 | 0.02% |
| MMDA | 41,078 | 0.27% | 40,548 | 0.42% | 36,348 | 0.47% |
| Time deposits | 73,865 | 0.78% | 80,887 | 0.91% | 88,359 | 1.03% |
| Total | $ 286,937 | 0.36% | $ 287,311 | 0.32% | $ 282,690 | 0.39% |

The majority of the Bank's deposits are from core customer sources, representing long-term relationships with local personal, business, and public customers. In some financial institutions, the presence of interest bearing certificates greater than $100,000 indicates reliance upon purchased funds. However, large certificates in the Bank's portfolio consist primarily of core deposits of local customers. The average balance of brokered certificates was $154,000 and $1.1 million in 2014 and 2013, respectively. There were no brokered deposits outstanding at December 31, 2014. At December 31, 2013, brokered deposits totaled $1.1 million, none of which exceeded $100,000.

See Note 8, "Time Certificates of Deposits" in Notes to Consolidated Financial Statements for the maturities of negotiated rate time deposits of $100,000 or more outstanding at December 31, 2014 and 2013.

**Capital**

The Corporation's capital at year-end 2014 totaled $31.1 million, a $6.0 million (24.1%) increase compared to capital of $25.1 million at December 31, 2013, and $7.4 million at December 31, 2012. The increase in capital during 2014 resulted from net income of $3.1 million, completion of a rights offering in March 2014 which raised $1.5 million of equity from the issuance and sale of common stock, and appreciation in the available for sale investment portfolio of $1.5 million. The significant increase in capital at December 31, 2013 resulted primarily from completion of the Corporation's private placement transaction in December 2013, which raised approximately $16.5 million of additional equity, net of offering costs, from the issuance of Series B Preferred Shares. In addition, 2013 net income of $3.0 million, partially offset by $1.8 million of unrealized net loss in the available for sale investment portfolio, contributed to the Corporation's improved capital position at December 31, 2013.

Banking regulators have established various ratios of capital to assets to assess a financial institution's soundness. Tier 1 capital is equal to shareholders' equity adjusted for unrealized gains or losses accumulated in other comprehensive income while Tier 2 capital also includes a portion of the allowance for loan losses. At December 31, 2014, the following capital standards for institutions are required by regulatory agencies. The leverage ratio, which divides Tier 1 capital by quarterly average assets, must be 4% for an institution to be considered adequately capitalized. The Bank's leverage ratio was 9.34% at year-end 2014. Tier 1 risk-based capital, which includes some off balance sheet items in assets and weights assets by risk, must be 4% for an institution to be considered adequately capitalized. The Bank's Tier 1 risk-based capital ratio was 15.18% at year-end 2014. Total risk-based capital, which includes Tier 1 and Tier 2 capital, must be 8% for an institution to be considered adequately capitalized. The Bank's total risk-based capital ratio was 16.46% at year-end 2014.

The following lists various Bank capital ratios at December 31:

| | **Minimum Regulatory Ratio for Well Capitalized** | **Minimum Regulatory Ratio for Adequately Capitalized** | **Bank Ratios** | | |
|---|---|---|---|---|---|
| | | | **2014** | **2013** | **2012** |
| Average equity to average asset ratio | - | - | 8.65% | 3.36% | 2.45% |
| Tier 1 leverage ratio | 5.00% | 4.00% | 9.34% | 8.67% | 2.58% |
| Tier 1 risk-based capital | 6.00% | 4.00% | 15.18% | 13.27% | 3.71% |
| Total risk-based capital | 10.00% | 8.00% | 16.46% | 14.57% | 5.02% |

Beginning January 1, 2015, the Bank is subject to the New Capital Rules Under Basel III described above. The 2.5% capital conservation buffer is being phased in over a four-year period beginning in 2016. We believe that the Bank currently exceeds all the capital ratio requirements of the New Capital Rules.

As a result of the Consent Order against the Bank, the Bank is subject to higher minimum capital ratios than those shown above. Specifically, the Consent Order requires the Bank to maintain a Total risk-based capital ratio of 11% and a Tier 1 leverage ratio of 8.5%. Completion of the aforementioned capital raise transactions enabled the Corporation to take action to support the Bank. Namely, using proceeds from these transactions, the Corporation contributed $15.4 million and $550,000 of additional capital into the Bank in December 2013 and March 2014, respectively. These capital infusions into the Bank by the Corporation have enabled the Bank to achieve and maintain the minimum regulatory capital ratios imposed under the Consent Order since December 31, 2013. Consequently, the Bank's actual ratios have been in compliance with the minimum ratios for a well-capitalized institution since December 31, 2013. However, because the Bank is subject to the Consent Order, it does not meet the regulatory determination of a well-capitalized institution. As such, the Bank is considered "adequately capitalized" for purposes of the OCC's Prompt Corrective Action ("PCA") enforcement powers. The Bank's capital category is determined solely for purposes of applying PCA; the capital category may not constitute an accurate representation of the Bank's overall financial condition or prospects. See Item 1, Business, Supervision and Regulation above for additional details.

Despite completion of the aforementioned capital raise transactions and the subsequent restoration of the Bank's regulatory capital ratios to minimum levels imposed by the Consent Order, there is no assurance that the Bank will be able to maintain these capital ratios throughout 2015 or beyond. At December 31, 2014, net proceeds remaining from these earlier capital raise transactions at the holding company level totaled approximately $1.4 million and are available to the Corporation to fund holding company operating expenses and/or potential future contribution to the Bank, if necessary. If these funds are not sufficient to maintain the minimum capital ratios required of the Bank by the Consent Order and we are not able to raise additional capital or take other steps to increase the Bank's capital ratios, it is possible the OCC will take additional regulatory enforcement action against our Bank or require the Bank to remain subject to the Consent Order for an extended period of time. Moreover, the performance of our existing loan portfolio is, in many respects, dependent on external factors such as our borrowers' ability to repay their loan obligations and the value of collateral securing those obligations, which in turn depend on macro and micro economic conditions including the pace of economic recovery in southeast Michigan. If our loan portfolio performs worse than we currently expect, we may not have sufficient capital to maintain the minimum capital ratios required under the Consent Order.

As described elsewhere in this Form 10-K, we have established our allowance for loan losses at a level we currently believe, based on the data available to us, is sufficient to absorb expected losses in our loan portfolio. However, this process involves a very significant degree of judgment, is based on numerous different assumptions that are difficult to make and, by its nature, is inherently uncertain. Management's future plans in response to the Bank's regulatory classification and the need to overcome current economic challenges are described more fully in Note 2 of the consolidated financial statements included in this Annual Report of the Corporation's 2014 Form 10-K filing.

The Corporation's ability to pay dividends is subject to various regulatory and state law requirements. In the third quarter of 2008, the Corporation suspended, indefinitely, the payment of dividends due to the Bank's inability to pay dividends to the holding company and insufficient cash at the holding company to pay the dividends. The Corporation and the Bank are still restricted from paying any dividends, and we don't anticipate that either the Corporation or the Bank will pay any dividends in the foreseeable future.

**Liquidity and Funds Management**

Liquidity is managed to ensure stable, reliable and cost-effective sources of funds to satisfy demand for credit, deposit withdrawals and investment opportunities. Liquidity risk is the risk of the Corporation being unable to meet current and future financial obligations in a timely manner. To manage liquidity risk the Corporation relies primarily on a large, stable core deposit base, excess on-balance sheet cash positions and a readily marketable available for sale investment portfolio. Additionally, the Corporation has access to certain wholesale funding sources (as discussed below) to manage unexpected liquidity needs.

The Corporation identifies, measures and monitors its liquidity profile. The profile is evaluated daily, weekly and monthly by analyzing the composition of all funding sources, reviewing projected liquidity commitments by future month and identifying sources and uses of funds. A contingency funding plan is also prepared that details the potential erosion of funds in the event of a systemic financial market crisis or different levels of institution-specific stress. In addition, the overall management of the Corporation's liquidity position is integrated into retail deposit pricing policies to ensure a stable core deposit base.

Asset liquidity for financial institutions typically consists of cash and cash equivalents, certificates of deposits and investment securities available for sale. These categories totaled $158.5 million at year-end 2014 or about 49.1% of total assets. This compares to $145.7 million or about 46.7% of total assets at year-end 2013. Liquidity is important for financial institutions because of their need to meet loan funding commitments and depositor withdrawal requests. Liquidity can vary significantly on a daily basis based on customer activity.

The core deposit base is the primary source of the Corporation's liquidity. Management monitors rates at other financial institutions in the area to ascertain that its rates are competitive in the market. Management also attempts to offer a wide variety of products to meet the needs of its customers. The make-up of the Bank's "Large Certificates", which are generally considered to be more volatile and sensitive to changes in rates, consists principally of local depositors known to the Bank. The Bank had Large Certificates totaling approximately $26.5 million and $29.1 million at December 31, 2014 and December 31, 2013, respectively. In February 2014, the Bank paid off $1.1 million of brokered deposits that were outstanding at December 31, 2013. No brokered deposits existed at December 31, 2014. Due to the Bank's classification as Adequately Capitalized for PCA purposes, it may not renew or issue additional brokered deposits without prior approval of the Federal Deposit Insurance Corporation ("FDIC"). See "Capital" section of this Management's Discussion and Analysis for further details.

Of the Corporation's available liquidity at December 31, 2014 and 2013 noted above, investment securities with a fair value of approximately $52.6 million and $59.0 million respectively, were pledged for borrowing availability on a line of credit from the Federal Home Loan Bank of Indianapolis, to secure public deposits, or for other purposes as required or permitted by law.

The Corporation also has available unused wholesale sources of liquidity, including borrowing availability from the Federal Home Loan Bank of Indianapolis (FHLBI) and through the discount window of the Federal Reserve Bank of Chicago. In the past, the Corporation has also issued certificates of deposit through brokers.

The Corporation's liquidity could be adversely affected by both direct and indirect circumstances. An example of a direct event would be restrictions imposed by regulators due to factors such as deterioration in asset quality, a large charge to earnings, a decline in profitability or other financial measures. Examples of indirect events unrelated to the Corporation that could have an effect on the Corporation's access to liquidity would be terrorism or war, natural disasters, political events, or the default or bankruptcy of a major corporation, mutual fund or hedge fund. Similarly, market speculation or rumors about the Corporation or the banking industry in general may adversely affect the cost and availability of normal funding sources.

The Corporation maintains a liquidity contingency plan that outlines the process for addressing a potential liquidity crisis. The plan provides for an evaluation of funding sources under various market conditions. It also assigns specific roles and responsibilities for effectively managing liquidity though a problem period.

It is Bank management's intention to handle unexpected liquidity needs through its cash and cash equivalents, FHLBI borrowings, or Federal Reserve discount borrowings. At December 31, 2014, the Bank had a $21.8 million line of credit available at the FHLBI for which the Bank has pledged investment securities and certain commercial and consumer loans secured by residential real estate as collateral. The Bank also had a $4.0 million line of credit available at the Federal Reserve for which the Bank has pledged certain commercial loans as collateral. At December 31, 2014, the Bank had no borrowings outstanding against these lines of credit. In addition, during 2014, the Bank had no short-term borrowings on these lines of credit, or from other sources, for liquidity needs or other purposes.

Although the Bank has established these lines of credit, because of its regulatory status, any borrowing requests are subject to review (i.e., for purpose and repayment ability) and approval by the FHLBI and Federal Reserve, respectively. Consequently, full borrowing availability under these existing lines may be restricted at the respective lender's discretion and terms may be limited or restricted. However, in the event the Bank would need additional funding and be unable to access either line of credit facility, management could act to remove the pledge of investment securities presently securing a portion of the FHLBI line of credit, thereby allowing such securities to be liquidated to provide further liquidity. If necessary, the Bank could also satisfy unexpected liquidity needs through liquidation of unpledged securities.

**Contractual Obligations and Commitments**

The following lists significant fixed and determinable contractual obligations to third parties as of December 31, 2014:

| | Within One Year | One to Three Years | Three to Five Years (in thousands) | Over Five Years | Total |
|---|---|---|---|---|---|
| Deposits without a stated maturity [(1)] | $ 222,157 | $ - | $ - | $ - | $ 222,157 |
| Consumer and brokered certificates of deposits[(2)] | 38,994 | 21,951 | 7,410 | - | 68,355 |
| Operating leases [(3)] | 79 | 69 | 57 | - | 205 |
| Purchase obligations [(4)] | 637 | 478 | 152 | - | 1,267 |

(1) Excludes interest.

(2) Includes interest on both fixed and variable rate obligations. The interest rate for variable rate obligations is based upon interest rates in effect at December 31, 2014. Future changes in market interest rates could materially affect the contractual amounts to be paid for variable rate obligations; there were no variable rate obligations outstanding at December 31, 2014.

(3) See Note 12, "Leases," in Notes to Consolidated Financial Statements.

(4) Purchase obligations relate to certain contractual payments for services provided for information technology and data processing.

The following lists significant commitments by maturity date as of December 31, 2014:

| | Within | One to | Three to (in thousands) | Over | Total |
|---|---|---|---|---|---|
| Commercial loans | $ 10,878 | $ 1 | $ 228 | $ 1,988 | $ 13,095 |
| Consumer loans | 2,165 | 99 | 106 | 6,111 | 8,481 |
| Standby letters of credit | 10 | - | - | - | 10 |

Commitments to extend credit, including loan commitments, standby letters of credit, and commercial letters of credit do not necessarily represent future cash requirements, in that these commitments often expire without being drawn upon.

**Quantitative and Qualitative Disclosures about Market Risk**

The current economic outlook and its potential impact on the Bank and current interest rate forecasts are reviewed monthly to determine the potential impact on the Corporation's performance. Actual results are compared to budget in terms of growth and income. A yield and cost analysis is done to monitor interest margin. Various ratios are monitored including capital ratios and liquidity. Also, the quality of the loan portfolio is reviewed in light of the current allowance for loan losses, and the Bank's exposure to market risk is reviewed.

Interest rate risk is the potential for economic losses due to future rate changes and can be reflected as a loss of future net interest income and/or a loss of current market values. The Corporation's Asset/Liability Management Committee's (ALCO) objective is to measure the effect of interest rate risk on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income. Tools used by management include the standard GAP report which reflects the repricing schedule for various asset and liability categories and an interest rate shock simulation report. The Bank has no market risk sensitive instruments held for trading purposes. However, the Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers including commitments to extend credit and letters of credit. A commitment or letter of credit is not recorded as an asset until the instrument is exercised (see Note 18, "Financial Instruments with Off-Balance-Sheet Risk" in Notes to Consolidated Financial Statements).

The following shows the scheduled maturity and repricing of the Corporation's interest sensitive term assets and liabilities as well as the expected retention terms of non-maturity deposit accounts as of December 31, 2014:

| | 0-3 Months | 4-12 Months | 1-5 Years (in thousands) | 5+ Years | Total |
|---|---|---|---|---|---|
| Assets: | | | | | |
| Loans | $ 45,323 | $ 54,137 | $ 60,034 | $ 552 | $ 160,046 |
| Securities | 5,832 | 17,353 | 65,117 | 45,013 | 133,315 |
| Short term investments | 198 | - | - | - | 198 |
| Total assets | $ 51,353 | $ 71,490 | $ 125,151 | $ 45,565 | $ 293,559 |
| Liabilities: | | | | | |
| NOW, savings, and MMDA | $ 3,501 | $ 10,503 | $ 56,010 | $ 49,885 | $ 119,899 |
| Time deposits | 11,233 | 27,682 | 29,307 | - | 68,222 |
| Total liabilities | $ 14,734 | $ 38,185 | $ 85,317 | $ 49,885 | $ 188,121 |
| Rate sensitivity GAP: | | | | | |
| GAP for period | $ 36,619 | $ 33,305 | $ 39,834 | $ (4,320) | |
| Cumulative GAP | 36,619 | 69,924 | 109,758 | 105,438 | |
| December 31, 2014 cumulative sensitive ratio | 3.49 | 2.32 | 1.79 | 1.56 | |
| December 31, 2013 cumulative sensitive ratio | 2.94 | 1.73 | 1.41 | 1.22 | |

Core non-maturity deposits such as NOW, savings and MMDA are an important stable source of funding and represent significant value to the Corporation. Although these deposits may re-price earlier than what is shown in the preceding table, they are generally less rate sensitive than other non-core funding sources. Allocations for our core non-maturity deposits are made to time periods based on a core deposit study which was performed by a third-party specialist based on the Corporation's historical experience.

In the GAP table above, the short term (one year and less) cumulative interest rate sensitivity is 232% asset sensitive at year end and was 173% asset sensitive for the previous year.

Because of the Bank's asset sensitive position, if market interest rates increase, this positive GAP position indicates that the interest margin would be positively affected. However, GAP analysis is limited and may not provide an accurate indication of the impact of general interest rate movements on the net interest margin since repricing of various categories of assets and liabilities is subject to the Bank's needs, competitive pressures, and the needs of the Bank's customers. In addition, various assets and liabilities indicated as repricing within the same period may in fact reprice at different times within the period and at different rate indices. Due to these inherent limitations in the GAP analysis, the Corporation also utilizes simulation modeling, which measures the impact of upward and downward movements of interest rates on interest margin and indicates that a 100 basis point decrease in interest rates would reduce net interest income by approximately 2.8% in the first year, while a 200 basis point increase in interest rates would increase net interest income by approximately 6.7% in the first year. This is influenced by the assumptions regarding how quickly and to what extent liabilities will reprice with a change in interest rates.

**Fair Value of Financial Instruments**

We use fair value measurements to record adjustments to certain financial instruments and to determine fair value disclosures. Investment securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record other assets at fair value on a nonrecurring basis, such as loans held for investment. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets. See Note 21, "Fair Value Measurements", in Notes to Consolidated Financial Statements for further information about the extent to which fair value is used to measure assets, the valuation methodologies used, and its impact on earnings.

Fair value represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A three-level hierarchy exists for disclosures of assets or liabilities recorded at fair value. The classification of assets within the hierarchy is based on whether the inputs to the valuation methodology used for measurement are observable or unobservable. Observable inputs reflect market-derived data or market-based information obtained from independent sources, while unobservable inputs reflect our estimates about market data. The three levels of the fair value hierarchy are as follows:

Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets. Level 1 instruments include securities traded in active markets, such as the New York Stock Exchange, as well as U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter 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, such as matrix pricing, for which all significant assumptions are observable in the market. Level 2 instruments generally include U.S. government and agency securities, U.S. government and agency mortgage-backed securities, municipal bonds and preferred stocks.

Level 3 – Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect our own estimates of assumptions market participants would use in pricing the asset or liability. Valuation techniques include use of discounted cash flow models and similar techniques.

For assets recorded at fair value, it is management's intention to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. When available, quoted market prices are used to measure fair value. If market prices are not available, fair value measurement is based on models that use primarily market-based or independently-sourced market parameters, including interest rate yield curves, prepayment speeds, and option volatilities. Substantially all of our asset valuations use either of the foregoing methodologies, collectively Level 1 and Level 2 measurements, to determine fair value adjustments recorded to our financial statements. However, in certain cases, when market observable inputs for model-based valuation techniques may not be available, we are required to make judgments about assumptions market participants would use in estimating the fair value of the asset or liability.

The degree of management judgment involved in determining the fair value of a financial instrument is dependent upon the availability of quoted market prices or observable market parameters. For assets that trade actively and have quoted market prices or observable market parameters, there is minimal subjectivity involved in measuring fair value. When observable market prices and parameters are not fully available, management judgment is necessary to estimate fair value. In addition, changes in market conditions may reduce the availability of quoted prices or observable data. For example, reduced liquidity in the capital markets or changes in secondary market activities could result in observable market inputs becoming unavailable. When significant adjustments are required to available observable inputs, it may be appropriate to utilize an estimate based primarily on unobservable inputs. When an active market for a security does not exist, the use of management estimates that incorporate current market participant expectations of future cash flows, and include appropriate risk premiums, is acceptable.

At December 31, 2014, $132.2 million or 40.9% of total assets consisted of assets recorded at fair value on a recurring basis. Assets for which fair values were measured using significant Level 3 inputs represented 0.9% of these assets (0.4% of total assets). The remaining assets measured at fair value on a recurring basis were measured using valuation methodologies involving market-based or market-derived information, which are Level 2 measurements, determined mainly with the assistance of independent pricing services.

Our asset valued on a recurring basis using Level 3 measurements was a non-government agency collateralized mortgage obligation (CMO). This asset remains classified as a Level 3 measurement because significant inputs to the valuation are unobservable, largely due to reduced levels of market liquidity. The nature of the underlying collateral securing this asset and information regarding the inputs and assumptions used in estimating its fair value are discussed further in Note 3, "Investment Securities" in Notes to Consolidated Financial Statements.

**RESULTS OF OPERATIONS**

The Corporation reported net income of $3.0 million in both 2014 and 2013. Net income totaled $329,000 in 2012.

The ratio of net income (loss) to average shareholders' equity and to average total assets, for the years ended December 31 follows:

| | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| Net income (loss) as a percent of: | | | | | |
| Average common equity | 10.70% | 29.41% | 4.79% | -40.81% | -29.25% |
| Average total assets | 0.96% | 0.99% | 0.11% | -1.21% | -1.26% |

**Net Interest Income**

Net interest income is the difference between interest earned on loans, securities and other earning assets and interest paid on deposits and borrowed funds. In the following tables, the interest earned on investments and loans is expressed on a fully taxable equivalent (FTE) basis. Tax exempt interest is increased to an amount comparable to interest subject to federal income taxes in order to properly evaluate the effective yields earned on earning assets. The tax equivalent adjustment is based on a federal income tax rate of 34%.

The Federal Reserve Bank target federal funds rate has remained 0.25% since December 2008. This continued and current rate environment had a favorable impact on our net interest margin during 2010 and 2009, which partially offset the adverse impact of declining levels of average interest earning assets and lower yields. However, since 2011, the current rate environment has had an unfavorable net impact on our net interest margin as earning asset yields decreased by a greater factor than yields paid on our deposits.

The following yield analysis shows that the Corporation's net interest margin decreased 41 basis points in 2014 primarily as a result of a 53 basis point decrease in yield on earning assets, partially offset by a decrease in the cost of interest bearing deposits of 12 basis points. In 2013, the interest margin decreased 4 basis points as a result of a 10 basis point decrease in yield on earning assets, partially offset by an 8 basis point decrease in the cost of interest bearing deposits.

The following shows the daily average balances for major categories of interest earning assets and interest bearing liabilities, interest earned (on a taxable equivalent basis) or paid, and the effective rate or yield, for the years ended December 31:

**Yield Analysis of Consolidated Average Assets and Liabilities**

| | 2014 | | | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Average Balance | Interest | Yield/ Rate | Average Balance | Interest | Yield/ Rate | Average Balance | Interest | Yield/ Rate |
| **Assets:** | (in thousands) | | | | | | (in thousands) | | |
| *Interest earning assets:* | | | | | | | | | |
| Short term investments | $ 198 | $ 0.5 | 0.23% | $ 197 | $ 0.5 | 0.23% | $ 197 | $ 0.5 | 0.23% |
| Securities: Taxable | 117,795 | 1,910.4 | 1.62% | 77,921 | 1,100.3 | 1.41% | 62,017 | 1,025.4 | 1.65% |
| Tax-exempt [(1)] | 929 | 55.7 | 6.00% | 1,033 | 61.7 | 5.98% | 1,142 | 69.9 | 6.12% |
| Commercial loans [(2)(3)] | 133,499 | 7,250.7 | 5.43% | 142,261 | 8,166.3 | 5.74% | 166,596 | 8,795.1 | 5.28% |
| Consumer loans [(2)(3)] | 16,316 | 717.1 | 4.40% | 15,312 | 726.7 | 4.75% | 14,166 | 716.3 | 5.06% |
| Mortgage loans [(2)(3)] | 11,169 | 366.2 | 3.28% | 12,742 | 438.7 | 3.44% | 14,042 | 507.3 | 3.61% |
| Total earning assets and total interest income | 279,906 | $ 10,300.6 | 3.68% | 249,466 | $ 10,494.2 | 4.21% | 258,160 | $ 11,114.5 | 4.31% |
| Cash and due from banks | 35,660 | | | 49,406 | | | 33,330 | | |
| All other assets | 10,255 | | | 10,888 | | | 12,362 | | |
| Allowance for loan losses | (8,803) | | | (10,006) | | | (12,273) | | |
| Total assets | $ 317,018 | | | $ 299,754 | | | $ 291,579 | | |
| **Liabilities and Shareholders' Equity:** | | | | | | | | | |
| *Interest bearing deposits:* | | | | | | | | | |
| NOW | $ 30,988 | $ 8.1 | 0.03% | $ 30,602 | $ 6.7 | 0.02% | $ 29,181 | $ 6.2 | 0.02% |
| Savings | 46,726 | 9.5 | 0.02% | 42,684 | 8.7 | 0.02% | 41,622 | 9.5 | 0.02% |
| MMDA | 41,078 | 111.8 | 0.27% | 40,548 | 170.9 | 0.42% | 36,348 | 169.2 | 0.47% |
| Time deposits | 73,865 | 573.1 | 0.78% | 80,887 | 738.9 | 0.91% | 88,359 | 907.2 | 1.03% |
| Total interest bearing liabilities and total interest expense | 192,657 | 702.5 | 0.36% | 194,721 | 925.2 | 0.48% | 195,510 | 1,092.1 | 0.56% |
| Noninterest bearing deposits | 94,280 | | | 92,590 | | | 87,180 | | |
| All other liabilities | 1,584 | | | 2,333 | | | 2,026 | | |
| Shareholders' equity | 28,497 | | | 10,110 | | | 6,863 | | |
| Total liabilities and shareholders' equity | $ 317,018 | | | $ 299,754 | | | $ 291,579 | | |
| Interest spread | | | 3.32% | | | 3.73% | | | 3.75% |
| Net interest income-FTE | | $ 9,598.1 | | | $ 9,569.0 | | | $ 10,022.4 | |
| Net interest margin | | | 3.43% | | | 3.84% | | | 3.88% |

(1) Average yields in the above table have been adjusted to a tax-equivalent basis using a 34% tax rate and exclude the effect of any unrealized market value adjustments included in other comprehensive income recorded under ASC Topic 320, *Investments – Debt and Equity Securities*.

(2) For purposes of the computation above, average non-accruing loans of $9.3 million in 2014, $11.2 million in 2013, and $19.9 million in 2012 are included in the average daily balance.

(3) Interest on loans includes origination fees totaling $108,000 in 2014, $128,000 in 2013, and $70,000 in 2012.

Tax equivalent interest income in each of the three years includes loan origination fees. A substantial portion of such fees is deferred for recognition in future periods.

The following sets forth the effects of volume and rate changes on net interest income on a taxable equivalent basis. The change in interest due to changes in both volume and rate has been allocated to the change due to volume and the change due to rate in proportion to the relationship of the absolute dollar amounts of the change in each:

| | Year ended December 31, 2014 compared to Year ended December 31, 2013 | | | Year ended December 31, 2013 compared Year ended December 31, 2012 | | |
|---|---|---|---|---|---|---|
| | Amount of Increase (Decrease) Due to Change in (in thousands) | | | | | |
| | Volume | Average Rate | Total Amount of Increase/ (Decrease) | Volume | Average Rate | Total Amount of Increase/ (Decrease) |
| **Interest Income:** | | | | | | |
| Short term investments | $ - | $ - | $ - | $ - | $ - | $ - |
| Securities: | | | | | | |
| Taxable | 563 | 247 | 810 | 263 | (188) | 75 |
| Tax exempt | (6) | - | (6) | (7) | (1) | (8) |
| Loans | (510) | (488) | (998) | (1,274) | 587 | (687) |
| Total interest income | $ 47 | $ (241) | $ (194) | $ (1,018) | $ 398 | $ (620) |
| **Interest Expense:** | | | | | | |
| Interest bearing deposits: | | | | | | |
| NOW, savings & MMDA | $ 8 | $ (65) | $ (57) | $ 12 | $ (10) | $ 2 |
| Time deposits | (64) | (102) | (166) | (77) | (92) | (169) |
| Total interest expense | $ (56) | $ (167) | $ (223) | $ (65) | $ (102) | $ (167) |
| **Net interest income (FTE)** | $ 103 | $ (74) | $ 29 | $ (953) | $ 500 | $ (453) |

Tax equivalent net interest income increased $29,000 in 2014. The increase was the result of a $223,000 decrease in interest expense partially offset by a $194,000 decrease in interest income. The decrease in interest income is attributable to a decrease of 53 basis points in the interest rate earned on assets offset by an increase in average earning assets of $30.4 million during the year. The decrease in interest expense is due to the decrease in average interest bearing liabilities of $2.1 million combined with a decrease in rates paid of 12 basis points.

Tax equivalent loan interest income was $998,000 lower in 2014 than the previous year. The decrease resulted from lower average balances of $9.3 million in 2014 and a decrease of 30 basis points in the interest rate on loans. Commercial loan yields in 2014 and 2013 were supported by the accretion of interest income recognized under the level yield method for certain loans previously on nonaccrual status and from interest income recognized on payoffs of existing and former nonaccrual loans. Although reduced from 2013 levels, both the amount and percentage of nonperforming loans relative to performing loans continued to negatively impact loan interest income during 2014. In 2013, tax equivalent loan interest was $687,000 lower than the previous year due to a decrease in average balances of $24.5 million, partially offset by an increase of 34 basis points in the interest rate on loans.

Income on taxable securities increased $810,000 in 2014 due to an increase in average balances of $39.8 million and an increase in yield of 21 basis points. Tax equivalent income on tax-exempt bonds decreased $6,000 from 2014 due to a decrease of $104,000 in average balances partially offset by an increase of 2 basis points in yield. In 2013, income on taxable securities increased $75,000 due to an increase in average balances of $15.9 million, partially offset by a decrease in yield of 24 basis points. Tax equivalent income on tax-exempt bonds decreased $8,000 in 2013 due to a decrease of $109,000 in average balances combined with a 14 basis point decrease in yield.

In 2014, the interest rate cost for NOW, savings, and MMDA accounts decreased $57,000 due to a decrease of 5 basis points in the rate paid, partially offset by an increase in average balances of $5.0 million. Interest on time deposits decreased $166,000 as a result of a decrease in average balances of $7.0 million combined with a decrease in interest rate paid of 13 basis points. In 2013, the interest cost for NOW, savings and MMDA accounts increased $1,000 due to an increase in average balances of $6.7 million, partially offset by a 1 basis point rate reduction. Interest on time deposits decreased $168,000 due to a decrease in average balances of $7.5 million combined with a decrease in interest rate of 12 basis points.

During 2014, net interest margin (tax equivalent basis) fell from 3.84% reported for the year ended December 31, 2013 to 3.43% reported for the year ended December 31, 2014.

In 2013, tax equivalent net interest income decreased $453,000. The decrease was the result of a $620,000 decrease in interest income partially offset by a $167,000 decrease in interest expense. The decrease in interest income is attributable to a decrease in average earning assets of $8.7 million during the year and a decrease of 10 basis points in the interest rate earned on assets. The decrease in interest expense is due to the decrease in average interest bearing deposits of $789,000 combined with a decrease in rates paid of 8 basis points.

The following shows the composition of average earning assets and interest paying liabilities for the years ended December 31:

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| As a percent of average earning assets: | | | |
| Loans | 57.51% | 68.27% | 75.46% |
| Securities | 42.42% | 31.65% | 24.46% |
| Short term investments | 0.07% | 0.08% | 0.08% |
| Average earning assets | 100.00% | 100.00% | 100.00% |
| NOW, savings, & MMDA | 42.44% | 45.63% | 41.51% |
| Time deposits | 26.39% | 32.42% | 34.23% |
| Average interest bearing liabilities | 68.83% | 78.05% | 75.74% |
| Earning asset ratio | 88.29% | 83.22% | 88.54% |
| Free-funds ratio | 31.17% | 21.95% | 24.26% |

**Provision for Loan Losses**

The Bank recognized negative provision expense of $2.5 million in 2014, negative provision expense of $2.3 million in 2013, and $1.3 million of provision expense in 2013. In general, the 2014 negative provision expense reflects continuation of favorable asset quality trends in the loan portfolio as marked by declining levels of existing and newly identified nonperforming loans and further stabilization in real estate values for certain problem credits, relative to conditions faced by the Bank in recent years. In addition, consistent with the improved portfolio trends, the continued improvement in our rolling 12 quarter loss history correlates with the current overall level of allowance and related provision expense relative to the prior comparative periods. Also, the continued decline in outstanding loan balances has served to reduce the required level of loan loss reserves maintained by the Bank as general reserve allocations. Absent unforeseen further deterioration in the economy and based on the present trends in the loan portfolio and the anticipated continued improvement in our loss history as significant prior year charge offs exit the rolling 12 quarter look back period, it is reasonably likely that future negative provision expense will be necessary to maintain the directional consistency of the overall level of the allowance with the actual performance of the loan portfolio. While we cannot predict or guarantee the amount or timing of any potential additional future negative provision expense, it is possible any such negative provision expense could contribute substantially to earnings and enhance book value per share.

At year-end 2014, the ratio of the allowance for loan loss to total loans was 4.44%, compared to 5.58% at year-end 2013 and 6.53% at year-end 2012. Additional discussion regarding the provision for loan losses and the related allowance can be found under “Loans” in this Item 7.

**Noninterest Income**

Noninterest income totaled $2.4 million during 2014 compared to $2.9 million and $3.3 million during 2013 and 2012, respectively.

| | December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| | | (in thousands) | |
| Service charges and fees on deposits | $ 1,034 | $ 1,368 | $ 1,537 |
| Other fees | 1,246 | 1,217 | 1,236 |
| Trust income | 107 | 148 | 178 |
| Gain (loss) on available for sale securities | 2 | - | (3) |
| Gain on sale of loans | - | - | 319 |
| Other | 35 | 132 | 1 |
| Total | $ 2,424 | $ 2,865 | $ 3,268 |

Service charges on deposit accounts decreased in 2014 as compared to 2013 principally due to a decline in customer non-sufficient funds (“NSF”) occurrences and related NSF fees which resulted from the Bank’s implementation of new consumer advocacy safeguards, required by regulation, in late 2013. These safeguards have reduced the number of our overdraft customers and the frequency of overdrafts by our customers who perpetually overdraft their accounts. Other fees recognized in 2014 increased primarily due to the receipt of a significant one-time commercial loan prepayment penalty in the third quarter of 2014. Trust income decreased relative to the prior year as the trust department transferred its fiduciary managed accounts to other trustees as part of a plan to utilize a licensed independent financial advisor to provide investment products and services to the Bank’s existing wealth management clients and customers. Beginning in 2015, the Bank will begin recognizing commission revenues for products and services sold by the financial advisor to referrals made by the Bank. The amount and timing of any commission revenue is largely dependent on our customers’ acceptance and utilization of the services offered through the third-party financial advisor. Other income decreased as a result of fewer ORE properties paying rental income in 2014 compared to 2013. In 2012, the Corporation recognized gains of $319,000 on sales of the guaranteed portion of loans financed under the federal government’s SBA program.

**Noninterest Expense**

Noninterest expense totaled $11.4 million during 2014 compared to $11.6 million and 11.7 million during 2013 and 2012, respectively. The components of noninterest expense are shown below:

| | December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| | | (in thousands) | |
| Salaries and employee benefits | $ 6,041 | $ 5,369 | $ 4,962 |
| Occupancy expense | 929 | 882 | 796 |
| Equipment expense | 350 | 344 | 335 |
| Professional and service fees | 1,611 | 1,753 | 1,728 |
| Loan collection and foreclosed property expense | 208 | 327 | 661 |
| Computer service fees | 524 | 477 | 452 |
| Computer software amortization expense | 38 | 39 | 79 |
| FDIC assessment fees | 528 | 1,026 | 1,014 |
| Insurance expense | 338 | 518 | 575 |
| Printing and supplies | 170 | 173 | 176 |
| Director fees | - | - | 61 |
| Net (gain) loss on sale/writedown of OREO and repossessions | (123) | (91) | 206 |
| Other | 776 | 750 | 645 |
| Total | $ 11,390 | $ 11,567 | $ 11,690 |

The most significant component of our noninterest expense is salaries and employee benefits. For the year 2014, the increase in salaries and employee benefits resulted primarily from additional staffing in our loan and credit departments completed during the second half of 2013 and the hiring of a risk management officer in late 2013. These hires were made to ensure the Bank has appropriate personnel with sufficient experience, training and authority to execute safe and sound banking practices. Compensation expense in 2014 also increased due to reinstatement of merit adjustments that were previously suspended due to the Bank's financial and regulatory condition and reinstatement of 5% salary reductions impacting certain staff while the Bank was undercapitalized. In addition, $147,000 of performance awards related to successful recapitalization of the Corporation and progress against Consent Order requirements were accrued in 2014.

Occupancy expense increased in 2014 due to additional snow removal and salting services required at our branch locations because of record snowfall levels experienced during the winter months of 2014 and higher property tax expenses related to the Bank's branch facilities. These increases were partially offset by reduced repair and maintenance expenses incurred in 2014 relative to 2013.

Professional and service fees decreased in 2014 due to the elevated level of consulting services utilized by the Corporation during 2013 related to regulatory requirements identified in the Consent Order and general recapitalization efforts, including: expanded external loan review services, assistance with formation of a strategic plan and capital plan, independent external validations of various Bank processes, recruiting fees paid to hire an enterprise risk management officer, and legal fees related to problem loans and regulatory matters. In 2014, legal fees related to problem loans decreased as the level of problem loans continued to decline. Partially offsetting these decreases from 2013, the Bank incurred elevated legal fees and a one-time vendor contract termination charge related to dissolution of the Bank's trust department and transfer of fiduciary managed accounts to other trustees.

Loan collection and foreclosed property expense includes collection costs related to nonperforming and delinquent loans, including costs incurred to protect the Bank's interest in collateral securing problem loans prior to taking title to the property, appraisal expenses and carrying costs related to other real estate. The Bank incurred reduced OREO expense, appraisal expense and collection costs in 2014 due to fewer problem loans and the nature of certain OREO properties carried by the Bank during 2014 relative to 2013.

Computer service fees increased due to additional anti-virus software purchases and services initiated in 2014 to safeguard the Bank's network.

FDIC premium expense decreased in 2014 due to the Bank's improved capital position and risk profile, largely attributable to the $16 million of capital infusion into the Bank by the Corporation since December 2013. Although improved, the Bank's FDIC premium expense remains elevated due to noncompliance with the outstanding Consent Order. The timing or amount of any additional FDIC premium savings is dependent on various factors including the Bank's ability to maintain the minimum capital ratios required under the Consent Order and the ability to demonstrate a period of satisfactory performance with other requirements of the Consent Order, as assessed by the OCC.

Insurance expense decreased in 2014 due to modifications made to the scope of the Corporation's D&O liability coverage in light of the Bank's improved capital and regulatory condition subsequent to the Corporation's successful recapitalization.

Net gain on the sale/write-down of OREO in 2014 resulted from valuation adjustments recorded on two properties based on current appraised values, less estimated costs to sell, and gains realized on the sale of four other OREO properties.

**Federal Income Tax Expense (Benefit)**

Income tax expense (benefit) was $20,000, $104,000, and $(104,000) in 2014, 2013 and 2012, respectively. We maintained valuation allowances of $9.7 million, $11.2 million, and $11.5 million at year-end 2014, 2013 and 2012 respectively, due to the uncertainty of future taxable income necessary to fully realize the recorded net deferred tax asset. The Corporation's effective tax rate was 0.6%, 3.4%, and 46.2% in 2014, 2013 and 2012, respectively. Assuming our core earnings continue to improve and following eventual termination of the Consent Order (assuming that occurs), reinstatement of the Corporation's net deferred tax asset will be closely evaluated to determine the portion considered realizable based on projected taxable income. While we cannot predict or guarantee the amount or timing of any tax benefit to be recognized upon reinstatement of the net deferred tax asset, any such reinstatement could contribute substantially to earnings and enhance book value per share. For further information, see Note 10, “Federal Income Taxes,” in Notes to Consolidated Financial Statements.

**Critical Accounting Policies**

Our accounting and reporting policies are in accordance with accounting principles generally accepted within the United States of America and conform to general practices within the banking industry. The preparation of our consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Material estimates that are particularly susceptible to significant change in the near term relate to the valuation of investment securities, determination of the allowance for loan losses and accounting for income taxes, and actual results could differ from those estimates. Management has reviewed these critical accounting policies with the Audit Committee of our Board of Directors.

<u>Valuation of Investment Securities</u>

See Notes 1(c), 3 and 21 in Notes to Consolidated Financial Statements for a discussion of our policies for valuing investment securities. Other-than-temporary impairment (OTTI) analyses are conducted on a quarterly basis or more frequently if a potential loss-triggering event occurs. Our evaluation considers various qualitative and quantitative factors regarding each investment category, including if investment securities were U.S. Government issued, the credit rating on the securities, credit outlook, payment status and financial condition, the length of time a security has been in a loss position, the size of the loss position and other meaningful information. In addition, with respect to the valuation of our Level 3, non-government agency CMO security, management regularly completes a cash flow analysis with the assistance of a third party specialist. The analysis considers assumptions regarding voluntary prepayment speed, default rate, and loss severity using the CMO’s original yield as the discount rate.

For debt securities, we distinguish between the credit and noncredit components of an OTTI event. The credit component of an OTTI charge is the difference between the present value of the cash flows expected to be collected and the amortized cost basis of the debt security. If we do not intend to sell the security and it is more likely than not that we will not have to sell the security before the anticipated recovery of the remaining amortized cost basis, the credit component of the OTTI charge is recognized in earnings and the remaining portion in other comprehensive income. If either of the above criteria is met, the entire difference between the amortized cost and fair value is recognized in earnings.

<u>Allowance for Loan Losses</u>

Our methodology for determining the allowance and related provision for loan losses and reserve for unfunded credit commitments is described above in “Financial Condition – Loans.” In particular, this area of accounting requires a significant amount of judgment because a multitude of factors can influence the ultimate collection of a loan or other type of credit. Should the factors noted above and as described in Note 1, “Summary of Significant Accounting Policies,” in Notes to Consolidated Financial Statements, differ from our assumptions (for example, an increase in past due loans, deterioration of the economy), our allowance for loan losses would likely be adversely impacted. It is extremely difficult to precisely measure the amount of losses that may be inherent in our loan portfolio. We attempt to accurately quantify the necessary allowance and related provision for loan losses, but there can be no assurance that our modeling process will successfully identify all of the losses inherent in our loan portfolio. As a result, we could record future provisions for loan losses that may be significantly different from the levels that we have recorded.

<u>Accounting for Income Taxes</u>

We account for income taxes using the asset and liability method which results in two components of income tax expense, current and deferred. (Income taxes are also discussed in more detail in Note 10, “Income Taxes,” in Notes to Consolidated Financial Statements). Accrued income taxes represent the net estimated amount currently due to or to be received from taxing authorities. In estimating accrued income taxes, management assesses the relative merits and risks of the appropriate tax treatment of transactions taking into account statutory, judicial and regulatory guidance in the context of our tax position. Deferred tax assets and liabilities represent differences between when a tax benefit or expense is recognized for financial reporting purposes and on our tax return. Deferred tax assets are periodically assessed for recoverability. We record a valuation allowance if we believe, based on available evidence, that it is “more likely than not” that the future tax assets recognized will not be realized before their expiration. The amount of the deferred tax asset recognized and considered realizable could be reduced if projected taxable income is not achieved due to various factors such as unfavorable business conditions. If projected taxable income is not expected to be achieved, we record a valuation allowance to reduce our future tax assets to the amount that we believe can be realized in our future tax returns.

It is our policy to evaluate the realizability of deferred tax assets related to unrealized losses on available for sale debt securities separately from our other deferred tax assets when we have the intent and ability to hold the security to recovery (maturity, if necessary). Because the future taxable income implicit in the recovery of the basis of available for sale debt securities for financial reporting purposes will offset the deductions underlying the deferred tax asset, a valuation allowance would generally not be necessary, even in cases where a valuation allowance might be necessary related to our other deferred tax assets.

Deferred tax assets and liabilities are calculated based on tax rates expected to be in effect in future periods. Previously recorded tax assets and liabilities are adjusted when the expected date of the future event is revised based upon current information. We may record a liability for unrecognized tax benefits related to uncertain tax positions taken on our tax returns for which there is less than a 50% likelihood of being recognized upon a tax examination. Interest and penalties, to the extent applicable, are recorded in income tax expense.

**Impact of New Accounting Standards**

See Note 26, “New Accounting Standards,” in Notes to Consolidated Financial Statements for discussion of new accounting standards and their impact.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

Included in Management’s Discussion and Analysis of Financial Condition and Results of Operations.

**Item 8. Financial Statements and Supplementary Data.**

**BDO USA, LLP**
Accountants and Consultants

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## Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
FNBH Bancorp, Inc.
Howell, Michigan

We have audited the accompanying consolidated balance sheets of FNBH Bancorp, Inc. as of December 31, 2014 and 2013, and the related consolidated statements of operations, comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2014. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Corporation is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 financial position of FNBH Bancorp, Inc. at December 31, 2014 and 2013, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO USA, LLP

Grand Rapids, Michigan
March 31, 2015

**FNBH Bancorp, Inc.**
**Consolidated Balance Sheets**

| | December 31, 2014 | December 31, 2013 |
|---|---|---|
| | (in thousands, except share amounts) | |
| **Assets** | | |
| Cash and due from banks | $ 26,138 | $ 77,827 |
| Short term investments | 198 | 198 |
| **Total cash and cash equivalents** | 26,336 | 78,025 |
| Investment securities: | | |
| Investment securities available for sale, at fair value | 132,175 | 67,680 |
| FHLBI and FRB stock, at cost | 1,140 | 779 |
| **Total investment securities** | 133,315 | 68,459 |
| Loans held for investment: | | |
| Commercial | 132,382 | 136,864 |
| Consumer | 17,593 | 16,231 |
| Real estate mortgage | 10,071 | 12,020 |
| **Total loans held for investment** | 160,046 | 165,115 |
| Less allowance for loan losses | (7,109) | (9,214) |
| **Net loans held for investment** | 152,937 | 155,901 |
| Premises and equipment, net | 7,366 | 7,395 |
| Other real estate owned, held for sale | 1,174 | 480 |
| Accrued interest and other assets | 1,698 | 2,030 |
| **Total assets** | $ 322,826 | $ 312,290 |
| **Liabilities and Shareholders' Equity** | | |
| **Liabilities** | | |
| Deposits: | | |
| Demand (non-interest bearing) | $ 102,258 | $ 93,953 |
| NOW | 31,652 | 29,937 |
| Savings and money market | 88,247 | 82,518 |
| Time deposits | 68,222 | 77,782 |
| Brokered certificates of deposit | - | 1,123 |
| **Total deposits** | 290,379 | 285,313 |
| Other borrowings | - | 16 |
| Accrued interest, taxes, and other liabilities | 1,303 | 1,855 |
| **Total liabilities** | 291,682 | 287,184 |
| **Shareholders' Equity** | | |
| Preferred stock, no par value. | | |
| Series A - Authorized 10,000 shares; no shares issued and outstanding | - | - |
| Series B - Authorized 20,000 shares; no shares issued and outstanding at December 31, 2014 and 17,510 shares issued and outstanding at December 31, 2013 | - | 16,520 |
| Common stock, no par value. Authorized 40,000,000 shares at December 31, 2014 and 11,000,000 at December 31, 2013; 27,770,143 shares issured and outstanding at December 31, 2014 and 457,115 shares issued and outstanding at December 31, 2013 | 25,449 | 7,321 |
| Retained earnings | 5,528 | 2,478 |
| Deferred directors' compensation | 224 | 342 |
| Accumulated other comprehensive income (loss) | (57) | (1,555) |
| **Total shareholders' equity** | 31,144 | 25,106 |
| **Total liabilities and shareholders' equity** | $ 322,826 | $ 312,290 |

See accompanying notes to consolidated financial statements.

**FNBH BANCORP, INC. AND SUBSIDIARIES**
**Consolidated Statements of Operations**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| | (in thousands, except per share amounts) | | |
| Interest and dividend income: | | | |
| Interest and fees on loans | $ 8,286 | $ 9,311 | $ 9,990 |
| Interest and dividends on securities: | | | |
| Taxable | 1,850 | 1,066 | 998 |
| Tax-exempt | 43 | 47 | 48 |
| Other securities | 55 | 28 | 26 |
| Interest on short term investments | 5 | 3 | 2 |
| Total interst and dividend income | 10,239 | 10,455 | 11,064 |
| Interest expense | 703 | 925 | 1,092 |
| Net interest income | 9,536 | 9,530 | 9,972 |
| Provision for loan losses | (2,500) | (2,250) | 1,325 |
| Net interest income after provison for loan losses | 12,036 | 11,780 | 8,647 |
| Noninterest income: | | | |
| Service charges and other fee income | 2,280 | 2,585 | 2,773 |
| Trust income | 107 | 148 | 178 |
| Net gain (loss) on available for sale securities | 2 | - | (3) |
| Gain on sale of loans | - | - | 319 |
| Other | 35 | 132 | 1 |
| Total noninterest income | 2,424 | 2,865 | 3,268 |
| Noninterest expense: | | | |
| Salaries and employee benefits | 6,041 | 5,369 | 4,962 |
| Net occupancy expense | 929 | 882 | 796 |
| Equipment expense | 350 | 344 | 335 |
| Professional and service fees | 1,611 | 1,753 | 1,728 |
| Loan collection and foreclosed property expenses | 208 | 327 | 661 |
| Computer service fees | 524 | 477 | 452 |
| Computer software amortization expense | 38 | 39 | 79 |
| FDIC assessment fees | 528 | 1,026 | 1,014 |
| Insurance | 338 | 518 | 575 |
| Printing and supplies | 170 | 173 | 176 |
| Director fees | - | - | 61 |
| Net (gain) loss on sale/writedown of OREO and repossessions | (123) | (91) | 206 |
| Other | 776 | 750 | 645 |
| Total noninterest expense | 11,390 | 11,567 | 11,690 |
| Income before federal income taxes | 3,070 | 3,078 | 225 |
| Federal income tax expense (benefit) | 20 | 104 | (104) |
| Net income | $ 3,050 | $ 2,974 | $ 329 |
| Per share statistics: | | | |
| Basic and diluted EPS | $ 0.11 | $ 1.57 | $ 0.72 |
| Weighted-average common shares outstanding | 17,496,622 | 457,435 | 457,416 |
| Weighted-average common stock equivalent preferred shares outstanding, as converted | 9,731,574 | 1,439,178 | - |
| Total basic and diluted shares | 27,228,196 | 1,896,613 | 457,416 |

See accompanying notes to consolidated financial statements.

**FNBH BANCORP, INC. AND SUBSIDIARIES**
**Consolidated Statements of Comprehensive Income**

| | Year Ending December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| | | (in thousands) | |
| Net income | $ 3,050 | $ 2,974 | $ 329 |
| Other comprehensive income (loss) | | | |
| Net change in unrealized gain (loss) on securities available for sale | 1,500 | (1,757) | 423 |
| Less: reclassification adjustment for (gain) loss on securities available for sale recognized in earnings | (2) | - | 3 |
| Comprehensive income | $ 4,548 | $ 1,217 | $ 755 |

See accompanying notes to consolidated financial statements.

**FNBH BANCORP, INC. AND SUBSIDIARIES**
**Consolidated Statements of Shareholders' Equity**
**December 31, 2014, 2013, and 2012**

| | Preferred Stock | Common Stock | Retained Earnings | Deferred Directors' Compensation | Accumulated Other Comprehensive Income (Loss) | Total |
|---|---|---|---|---|---|---|
| | | | (in thousands) | | | |
| Balances at January 1, 2012 | $ - | $ 7,082 | $ (825) | $ 577 | $ (224) | $ 6,610 |
| Earned portion of long term incentive plan | - | 4 | - | - | - | 4 |
| Issued 774 shares for deferred directors' fees | - | 116 | - | (116) | - | - |
| Net income | - | - | 329 | - | - | 329 |
| Other comprehensive income | - | - | - | - | 426 | 426 |
| Balances at December 31, 2012 | - | 7,202 | (496) | 461 | 202 | 7,369 |
| Issuance of preferred stock | 16,520 | - | - | - | - | 16,520 |
| Issued 784 shares for deferred directors' fees | - | 119 | - | (119) | - | - |
| Net income | - | - | 2,974 | - | - | 2,974 |
| Other comprehensive loss | - | - | - | - | (1,757) | (1,757) |
| Balances at December 31, 2013 | 16,520 | 7,321 | 2,478 | 342 | (1,555) | 25,106 |
| Issued 772 shares for deferred directors' fees | - | 118 | - | (118) | - | - |
| Issuance of common stock | - | 1,490 | - | - | - | 1,490 |
| Preferred stock converted to common stock | (16,520) | 16,520 | - | - | - | - |
| Net income | - | - | 3,050 | - | - | 3,050 |
| Other comprehensive income | - | - | - | - | 1,498 | 1,498 |
| Balances at December 31, 2014 | $ - | $ 25,449 | $ 5,528 | $ 224 | $ (57) | $ 31,144 |

See accompanying notes to consolidated financial statements.

**FNBH BANCORP, INC. AND SUBSIDIARIES**
**Consolidated Statements of Cash Flows**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| | | (in thousands) | |
| Cash flows from operating activities: | | | |
| Net income | $ 3,050 | $ 2,974 | $ 329 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | |
| Provision for loan losses | (2,500) | (2,250) | 1,325 |
| Gain on sale of loans | - | - | (319) |
| Proceeds from sale of loans originated for sale | - | - | 1,210 |
| Loans originated for sale | - | - | (231) |
| Depreciation and amortization | 479 | 454 | 463 |
| Deferred income tax expense (benefit) | - | 104 | (104) |
| Net amortization on investment securities | 1,166 | 1,071 | 901 |
| Earned portion of long term incentive plan | - | - | 4 |
| (Gain) loss on available for sale securities | (2) | - | 3 |
| Net (gain) loss on sale/writedown of OREO and repossessions | (123) | (91) | 206 |
| (Increase) decrease in accrued interest income and other assets | 310 | 378 | (340) |
| Increase (decrease) in accrued interest, taxes, and other liabilities | (552) | 183 | (86) |
| Net cash provided by operating activities | 1,828 | 2,823 | 3,361 |
| Cash flows from investing activities | | | |
| Purchases of available for sale securities | (86,416) | (20,684) | (61,540) |
| Proceeds from the sales of available for sale securities | 202 | - | 247 |
| Proceeds from maturities and calls of available for sale securities | 3,350 | 3,000 | 6,990 |
| Proceeds from mortgage-backed securities paydowns - available for sale | 18,703 | 19,658 | 13,668 |
| Purchase of FRB stock | (479) | - | - |
| Proceeds from repurchase of FHLBI stock | 118 | - | - |
| Proceeds from sale of OREO and repossessions | 670 | 3,124 | 1,535 |
| Net decrease in loans | 4,223 | 14,685 | 23,605 |
| Capital expenditures | (428) | (621) | (180) |
| Net cash provided by (used in) investing activities | (60,057) | 19,162 | (15,675) |
| Cash flows from financing activites: | | | |
| Net increase (decrease) in deposits | 5,066 | (2,369) | 4,030 |
| Common stock issued, net of offering costs | 1,490 | - | - |
| Preferred stock issued, net of offering costs | - | 16,348 | - |
| (Repayment of) proceeds from other borrowings | (16) | 40 | 88 |
| Net cash provided by financing activities | 6,540 | 14,019 | 4,118 |
| Net change in cash and cash equivalents | (51,689) | 36,004 | (8,196) |
| Cash and cash equivalents at beginning of year | 78,025 | 42,021 | 50,217 |
| Cash and cash equivalents at end of year | $ 26,336 | $ 78,025 | $ 42,021 |
| | | | |
| Supplemental disclosures: | | | |
| Interest paid | $ 727 | $ 935 | $ 1,135 |
| Loans transferred to other real estate | 1,145 | 86 | 2,142 |
| Loans charged off | 474 | 1,205 | 4,033 |
| Other borrowings exchanged for preferred stock | - | 172 | - |

See accompanying notes to consolidated financial statements.

## Notes to Consolidated Financial Statements

### 1. Summary of Significant Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates are based on information available to management at the time the estimates are made. Actual results could differ from those estimates.

***Principles of Consolidation***
The consolidated financial statements include the accounts of FNBH Bancorp, Inc. and its wholly owned subsidiaries, First National Bank in Howell ("the Bank") and H.B. Realty Co. (herein collectively the "Corporation"). All significant intercompany balances and transactions have been eliminated.

The Bank is a full-service bank offering a wide range of commercial and personal banking services. These services include checking accounts, savings accounts, certificates of deposit, commercial loans, real estate loans, installment loans, collections, night depository, safe deposit box, and wealth management services. The Bank serves primarily five communities – Howell, Brighton, Green Oak Township, Hartland, and Fowlerville – all of which are located in Livingston County, Michigan. The Bank is not dependent upon any single industry or business for its banking opportunities.

H.B. Realty Co. was established on November 26, 1997 to purchase land for a future branch site of the Bank and to hold title to other Bank real estate when it is considered prudent to do so.

The accounting and reporting policies of FNBH Bancorp, Inc. and subsidiaries (Corporation) conform to accounting principles generally accepted in the United States of America and to general practice within the banking industry. The following is a description of the more significant of these policies.

***(a) Cash and Cash Equivalents***
Cash and cash equivalents include cash on hand, demand deposits with other financial institutions and short-term securities (securities with maturities equal to or less than 90 days and federal funds sold). Cash flows are reported net for customer loan and deposit transactions, interest-bearing time deposits with other financial institutions and short-term borrowings with maturities of 90 days or less.

***(b) Investment Securities***
The Bank classifies debt and equity investments as follows:

Investment securities the Bank may not hold until maturity are accounted for as securities available for sale and are stated at fair value, with unrealized gains and losses, net of income taxes, reported as a separate component of other comprehensive income until realized. Fair value measurement for investment securities 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 present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions.

Investment securities are reviewed quarterly for possible other-than-temporary impairment (OTTI). Management's evaluation considers various qualitative and quantitative factors regarding each investment category, including if investment securities were U.S. Government issued, the credit rating on the securities, credit outlook, payment status and financial condition, the length of time a security has been in a loss position, the size of the loss position and other meaningful information. In addition, with respect to the Corporation's non-government agency CMO security, management regularly completes a cash flow analysis with the assistance of a third party specialist. The analysis considers assumptions regarding voluntary prepayment speed, default rate, and loss severity using the CMO's original yield as the discount rate.

For debt securities, the Corporation distinguishes between the credit and noncredit components of an OTTI event. The credit component of an OTTI charge is the difference between the present value of the cash flows expected to be collected and the amortized cost basis of the debt security. If the Corporation does not intend to sell the security and it is more likely than not that the Corporation will not have to sell the security before the anticipated recovery of the remaining amortized cost basis, the credit component of the OTTI charge is recognized in earnings and the remaining portion in other comprehensive income. If either of the above criteria is met, the entire difference between the amortized cost and fair value is recognized in earnings.

Gains or losses on the sale of securities are computed based on the adjusted cost of the specific security.

***(c) Loans***
Loans are classified within loans held for investment when management has the intent and ability to hold the loan for the foreseeable future, or until maturity or payoff. The foreseeable future is a management judgment which is determined based upon the type of loan, business strategies, current market conditions, balance sheet management and liquidity needs. Management's view of the foreseeable future may change based on changes in these conditions. When a decision is made to sell or securitize a loan that was not originated or initially acquired with the intent to sell or securitize, the loan is reclassified from loans held for investment into held for sale. Loans are classified as held for sale when management has the intent and ability to sell or securitize. Due to changing market conditions or other strategic initiatives, management's intent with respect to the disposition of the loan may change, and accordingly, loans previously classified as held for sale may be reclassified into loans held for investment. Loans transferred between loans held for sale and loans held for investment classifications are recorded at the lower of cost or market at the date of transfer.

Loans held for investment are carried at the principal amount outstanding net of unearned income, unamortized premiums or discounts, deferred loan origination fees and costs, the allowance for loan losses, and fair value adjustments, if any.

Interest on loans is accrued daily based on the outstanding principal balance. In general, for each loan class, the accrual of interest income is discontinued when a loan becomes 90 days past due and the borrower's capacity to repay the loan and collateral values appear insufficient. However, loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due if, in management's opinion, the borrower is unable to meet payment obligations as they become due or as required by regulatory provisions. All interest accrued but not received for all loans placed on nonaccrual is reversed from interest income. Delinquency status for all commercial and installment loans is based on the actual number of days past due as required by the contractual terms of the loan agreement.

Loan origination fees and certain direct loan origination costs are deferred and recognized as an adjustment of yield generally over the contractual life of the related loan. Net unamortized deferred loan fees amounted to $159,000 and $169,000 at December 31, 2014 and 2013, respectively.

***(d) Allowance for Loan Losses and Credit Commitments***

Some loans will not be repaid in full. Therefore, an allowance for loan losses is established based on management's periodic evaluation of the loan portfolio and reflects an amount that, in management's opinion, is adequate to absorb probable losses in the existing portfolio. In evaluating the portfolio, management takes into consideration numerous factors, including current economic conditions, prior loan loss experience, nonperforming loan levels, the composition of the loan portfolio, and management's evaluation of the collectability of specific loans, which includes analysis of the value of the underlying collateral. This overall evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. In addition, although management evaluates the adequacy of the allowance for loan losses based on information known to management at a given time, various regulatory agencies, based on the timing of their normal examination process, may require future additions to the allowance for loan losses.

The methodology for measuring the appropriate level of allowance and related provision expense for each portfolio segment relies on several key elements, which include specific allowances for loans considered impaired and general allowances for non-impaired loans, based on our internal loan grading system. General allocations, based primarily on historical trends, are provided for homogeneous groups or classes of loans with similar risk characteristics.

A rolling 12 quarter charge off history, determined by class, by risk grade, and weighted to give increased emphasis on recent quarters, is used as the basis for the computation within each portfolio segment. In addition, management considers other qualitative and environmental factors to determine whether adjustments to historical loss experience are needed to better reflect the collectability of the loan portfolio at the analysis date, especially in instances where current facts and circumstances have changed significantly enough to cause estimated credit losses to differ from historical loss experience. In determining qualitative and environmental adjustments, management considers both internal and external factors specific to each portfolio segment including, but not limited to, changes in lending policies and procedures, underwriting standards in effect when existing loans were originated, current economic conditions, and values for underlying collateral for collateral dependent loans, as examples.

Within each commercial portfolio segment, a general allowance allocation is assigned to non-impaired loans based on the internal risk grade and class of such loans, as primarily determined based on underlying collateral; and if real estate secured, the type of real estate. Each risk grade within a portfolio segment is assigned a loss allocation factor, adjusted for qualitative and environmental factors, as deemed appropriate. The higher a risk grade, the greater the assigned loss allocation percentage.

Residential real estate loans, home equity and home equity lines of credit, and consumer loans receive allowance allocations based on loan class, primarily determined based on historical loss experience rather than by risk grade. These allocations are adjusted for consideration of general economic and business conditions, credit quality and delinquency trends, collateral values, and recent loss experience for these similar pools of loans.

The Bank also maintains a reserve for losses on unfunded credit commitments and letters of credit to provide for the risk of loss inherent in these arrangements. The reserve is computed using the same methodology as that used to determine the allowance for loan losses. This reserve is reported as a liability on the balance sheet within accrued interest, taxes, and other liabilities, while the corresponding provision for these losses is recorded as a component of the provision for loan losses.

***(e) Nonperforming Assets***

Nonperforming assets are comprised of loans for which the accrual of interest has been discontinued, loans 90 days past due and still accruing, and other real estate owned, which has been acquired primarily through foreclosure and is awaiting disposition. Troubled debt restructured loans that are on accrual status and not past due 90 days or more are excluded from nonperforming loan totals.

Loans are generally placed on a nonaccrual status when principal or interest is past due 90 days or more and when, in the opinion of management, full collection of principal and interest is unlikely. At the time a loan is placed on nonaccrual status, interest previously accrued but not yet collected is charged against current interest income. Income on such loans is then recognized only to the extent that cash is received and where future collection of principal is probable. Payments on such loans are generally applied to the principal balance until qualifying to be returned to accrual status. Loans are considered for return to accrual status on an individual basis when interest and principal payments are current and future payments are reasonably assured.

TDRs represent loan modifications, including renewals, where concessions have been extended by the Bank due to financial difficulties experienced by the borrower. TDR classification generally continues (i) until the borrower demonstrates sustained payment performance under the modified terms for a minimum of six consecutive payment cycles after the restructuring date and (ii) throughout the calendar year in which the restructuring took place. In addition, if the restructured loan is renewed at a market rate of interest and is structured consistent with normal lending practices, TDR classification may be removed. TDR loans may considered for return to accrual status upon satisfaction of the timely, sustained performance requirements identified above and management's determination that future payments under the modified terms are reasonably assured.

The Bank considers a loan to be impaired when it is probable that it will be unable to collect all or part of amounts due according to the contractual terms of the loan agreement or the loan has been restructured and is classified as a troubled debt restructuring. Using an internal loan grading system, commercial purpose loans graded 7 and higher are individually evaluated for impairment if reported as nonaccrual and are greater than $100,000 or part of an aggregate relationship exceeding $100,000. Noncommercial purpose loans within the residential consumer real estate and consumer and other loan portfolios are subjected to impairment assessment upon certain triggering events such as delinquency, bankruptcy and restructuring, etc. Impairment is measured by comparing the Bank's recorded investment in the loan to the present value of expected future cash flows at the loan's effective interest rate, or, as a practical expedient, at the loan's observable market price, or the fair value of the collateral less costs to sell if the loan is collateral dependent. Interest income on impaired loans is accrued based on the principal amounts outstanding. The accrual of interest is generally discontinued when an impaired loan becomes 90 days past due.

All cash payments received on impaired nonaccrual loans are generally applied to the principal balance until qualifying to be returned to accrual status. Cash payments received on accruing impaired loans, including accruing TDRs are applied to principal and interest pursuant to the terms of the related loan agreement.

The Bank charges off all or part of loans when amounts are deemed to be uncollectible, although collection efforts may continue and future recoveries may occur. In general, when available information confirms that loans or portions thereof, other than collateral dependent loans, are uncollectible, such amounts are promptly charged-off against the allowance for loan losses. When an impaired loan is collateral dependent, any portion of the loan balance in excess of the fair value of the collateral (or fair value less cost to sell) is promptly charged-off against the allowance for loan losses.

***(f) Other Real Estate Owned***

Other real estate owned is recorded at the asset's estimated fair value, net of estimated disposal costs, at the time of foreclosure, establishing a new cost basis. Any write-downs at the time of foreclosure are charged to the allowance for loan losses. Expenses incurred in maintaining assets, adjustments to estimated disposal costs, and subsequent write-downs to reflect declines in value are charged to noninterest expense.

***(g) Transfer 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 deemed to be surrendered when (1) the assets have been 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. The Bank's transfers of financial assets are limited to commercial loan participations sold, which were insignificant for 2014, 2013, and 2012.

***(h) Premises and Equipment***

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization, computed on the straight-line method, are charged to operations over the estimated useful lives of the assets. Estimated useful lives range up to 40 years for buildings, up to 7 years for furniture and equipment and up to 15 years for land improvements. Leasehold improvements are generally depreciated over the shorter of the respective lease term or estimated useful life.

Premises and equipment are evaluated periodically for impairment when events or changes in circumstances indicate the carrying amount may not be recoverable. Impairment exists when the expected undiscounted future cash flows of a long-lived asset are less than its carrying value. In that event, the Bank recognizes a loss for the difference between the carrying amount and the estimated fair value of the asset based on a quoted market price, if applicable, or a discounted cash flow analysis. Impairment losses are recorded in other noninterest expense on the income statement.

***(i) Advertising Costs***

Advertising costs are generally expensed as incurred and approximated $95,000, $97,000 and $36,000 in 2014, 2013 and 2012, respectively.

***(j) Federal Income Taxes***

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

A valuation allowance, if needed, reduces deferred tax assets to the expected amount more likely than not that is to be realized. Realization of the Corporation's deferred tax assets is primarily dependent upon the generation of a sufficient level of future taxable income. At December 31, 2014 and 2013, management did not believe it was more likely than not that all of the deferred tax assets would be realized and, accordingly, recorded a valuation allowance of $9.7 million and $11.2 million at each respective year-end.

In preparation of income tax returns, tax positions are taken based on interpretation of federal and state income tax laws for which the outcome is uncertain. Management reviews and evaluates the status of tax positions. There were no unrecognized tax benefits during 2014, 2013 or 2012. Interest or penalties related to unrecognized tax benefits would be recorded in income tax expense. The Corporation files U.S. federal income tax returns which are subject to final examination for all years after 2010.

***(k) Stock-Based Compensation***

At December 31, 2014 and 2013, the Corporation had two stock-based compensation plans, which are described more fully in Notes 16 and 17.

***(l) Fair Value of Financial Instruments***

Fair values of financial instruments are estimated using market information and other assumptions and involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, assumptions and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or market conditions could significantly affect such estimates.

***(m) Common Stock Repurchases***

The Corporation records common stock repurchases at cost. A portion of the repurchase is charged to common stock based on the average per share dollar amount of stock outstanding, multiplied by the number of shares repurchased, with the remainder charged to retained earnings. Shares repurchased are retired. No common stock repurchases were made by the Corporation during 2014, 2013, or 2012.

***(n) Statement of Cash Flows***

For purposes of reporting cash flows, cash equivalents include amounts due from banks, federal funds sold and other short term investments with original maturities of 90 days or less.

***(o) Comprehensive Income (Loss)***

ASC Topic 220 *Comprehensive Income,* establishes standards for the reporting and display of comprehensive income and its components (such as changes in unrealized gains and losses on securities available for sale) in a financial statement that is displayed with the same prominence as other financial statements. The Corporation reports comprehensive income in a separate financial statement titled comprehensive income (loss). Comprehensive income includes net income and any changes in equity from nonowner sources that are not recorded in the income statement.

***(p) Earnings Per Share***

Basic earnings per common share is calculated by dividing net income by the weighted average number of common shares and participating securities outstanding during the period. Diluted earnings per share is the same as basic earnings per share because any additional potential common shares issuable are included in the basic earnings per share calculation. The Corporation's restricted stock awards (Note 16), which provide non-forfeitable rights to dividends or dividend equivalents, were considered a participating security and included in the number of shares outstanding for both basic and diluted earnings per share calculations.

As explained more fully in Notes 14 and 15, for purposes of computing 2014 and 2013 basic and diluted earnings per share, while the Corporation's 17,510 shares of Mandatorily Convertible Non-Cumulative Junior Participating Preferred Stock, Series B (the "Series B Preferred Shares"), were outstanding (issued on December 11, 2013 and converted into common stock on May 22, 2014), they were considered a common stock equivalent and converted to common shares at a rate reflecting the conversion price per share of common stock of $0.70.

***(q) Reclassifications***

Certain reclassifications in the prior years' financial statements have been made to conform to the current year presentation.

***(r) Operating Segment***

While the Corporation monitors revenue streams of the various products and services offered, the Corporation manages its business on the basis of one operating segment, banking, in accordance with the qualitative and quantitative criteria established by ASC Topic 280, *Segment Reporting*.

## 2. Regulatory Matters and Recovery Initiatives

***Regulatory Action***

On October 16, 2008, the Bank entered into a formal agreement with its primary federal regulator, the Office of the Comptroller of the Currency (the "OCC"). Pursuant to the agreement, the Bank agreed to take certain actions intended to address various issues that negatively impacted the Bank's financial condition and performance.

On September 24, 2009, the Bank stipulated to the issuance of a Consent Order against the Bank by the OCC. This Consent Order, which superseded the formal agreement signed in October 2008, required the Bank to take certain actions to improve its financial condition and operations, including achieving and maintaining total capital equal to 11% of risk-weighted assets and Tier 1 capital equal to at least 8.5% of adjusted total assets. The Consent Order included a number of other requirements, including the submission of an acceptable strategic plan for the Bank's operations, the development and implementation of various written plans designed to improve the Bank's management of its loan portfolio, and certain steps to manage risks associated with commercial real estate and construction and development lending.

On October 31, 2013, the Bank stipulated to the issuance by the OCC of a new Consent Order against the Bank (the "Consent Order"). This new Consent Order replaces the Consent Order issued in 2009. The new Consent Order includes essentially all of the articles included in the 2009 Consent Order. In addition, the new Consent Order contains certain new conditions and/or articles intended to enhance the Bank's risk management policies and practices; requirements to obtain certain OCC approval prior to deviating from the Bank's strategic business plan; additional requirements to ensure effective management and board composition, establishment of a formal compensation plan structure, and management of third party vendor relationships; a new article requiring the Bank to establish an affiliate transaction policy; and a new article to ensure the effectiveness of the Bank's internal audit program. The new Consent Order was filed as an exhibit to the Corporation's Form 10-Q for the quarterly period ended September 30, 2013 and the OCC has made a copy of the new Consent Order available on its website at www.occ.gov.

Importantly, the new Consent Order continues to require the Bank to achieve and maintain total capital equal to 11% of risk weighted assets and Tier 1 capital equal to at least 8.5% of adjusted total assets. On December 11, 2013, the Corporation completed a private placement transaction that resulted in gross proceeds to the Corporation of approximately $17.5 million. On December 20, 2013, the Corporation contributed $15.4 million of the net proceeds from this transaction to the capital of the Bank. As a result, as of December 31, 2013, the Bank met the minimum capital ratios required by the Consent Order. In addition, on March 27, 2014, the Corporation issued 2.3 million shares of its common stock in a rights offering registered with the SEC that generated gross proceeds to the Corporation of approximately $1.6 million. The Corporation then contributed $550,000 of these proceeds into the capital of the Bank to assist the Bank in maintaining the required minimum capital ratios at March 31, 2014. To date, no additional capital contributions from the Corporation to the Bank have been needed to maintain the required minimum capital ratios required by the Consent Order.

As noted above, the Consent Order imposes many other requirements on the Bank in addition to the minimum capital ratios. Despite achieving the required minimum capital levels, the Bank has not achieved full compliance with all of the articles of the Consent Order at December 31, 2014.

Management believes it has made substantive progress on the other Consent Order requirements through various initiatives. However, additional effort and time is necessary in order for the Bank to demonstrate adherence to, and the effectiveness of, new policies and procedures implemented to remediate deficiencies identified in the Consent Order and to achieve compliance with the other provisions of the Consent Order. The Bank continues to work diligently to meet these requirements in an effort to gain full compliance with the Consent Order.

It will be imperative for the Bank to comply with these other requirements in order to avoid further regulatory enforcement action. As long as the Bank is subject to the Consent Order, the financial performance of the Corporation is expected to be adversely impacted by higher FDIC insurance premiums paid by the Bank and ongoing costs incurred to correct the deficiencies underlying the requirements of the Consent Order.

Despite exceeding minimum regulatory standards for well-capitalized institutions at December 31, 2014, for purposes of the regulators' Prompt Corrective Action ("PCA") powers, the Bank is currently considered "adequately capitalized" due to being subject to the Consent Order. (See Note 19 for actual regulatory capital ratios at December 31, 2014.) As a result of this classification, for purposes of PCA, the Bank is subject to a number of restrictions. These include, among other things, 1) limitations on the payment of capital distributions and management fees, 2) prohibitions on the acceptance, renewal, or roll-over of any brokered deposit without prior written approval of the Federal Deposit Insurance Corporation (FDIC), and 3) restrictions on interest rates paid on deposits. The Bank's capital category is determined solely for purposes of applying PCA; the capital category may not constitute an accurate representation of the Bank's overall financial condition or prospects.

In addition to the above regulatory actions and restrictions imposed on the Bank, the Federal Reserve has imposed restrictions on the Corporation to effect its support of the Bank. Specifically, the Corporation must receive approval from the Federal Reserve before the payment of dividends, issuance of debt, or redemption of stock. Additional restrictions on the Corporation by the Federal Reserve relate to changes in the composition of the Board of Directors, the employment of senior executive officers or changes in the responsibilities of senior executive officers, and limitations on indemnification and severance payments.

Despite restoration of the Bank's regulatory capital ratios to minimum levels imposed by the Consent Order, there is no assurance that the Bank will be able to maintain these capital ratios throughout 2015 or beyond. Moreover, management and the Board of Directors' execution of various initiatives designed to fully satisfy the asset quality, risk management, and other requirements of the Consent Order will take additional time and may not prove to be sufficiently effective. As such, no assurance can be provided as to whether or when the Bank will be in full compliance with the Consent Order or whether or when the Consent Order will be lifted or terminated. Even if lifted or terminated, the Bank may still be subject to a memorandum of understanding or other enforcement action by regulators that would restrict activities or that would continue to impose greater capital requirements on the Bank. The requirements and restrictions of the Consent Order are legally enforceable and the Corporation's or Bank's failure to comply with such requirements and restrictions may subject the Corporation and the Bank to additional regulatory restrictions.

Until such time as the Consent Order is either modified or lifted, management continues to pursue initiatives to achieve full compliance with all requirements of the Consent Order in order to mitigate the impact of the related regulatory challenges. In addition, execution of such initiatives includes implementation of measures necessary to position the Bank to overcome current economic challenges.

***Recovery Plan Initiatives***

As part of a recovery plan initiated in late 2008, management and the Board of Directors have been aggressively pursuing various initiatives intended to address and satisfy deficiencies identified in the Consent Order, the most important of which was a significant recapitalization necessary to restore the Bank's capital to a level sufficient to meet the required minimum capital ratios. Other recovery plan efforts and initiatives are designed to improve the Bank's financial health and risk management practices and policies. They include aggressively reducing credit risk exposure in the loan portfolio and improving the efficiency and effectiveness of core business processes. Certain other key elements of management's continued recovery plan include, but are not limited to:

- Continued, aggressive management of the Bank's existing loan portfolio to reduce the level of classified loans, to minimize further credit losses and to maximize recoveries via negotiated payoffs, settlements and restructuring of existing problem loans;
- Continued strengthening of risk management processes and procedures via ensuring the Bank has appropriate personnel with sufficient experience, training and authority to execute safe and sound banking practices with respect to asset quality;
- Improve core profitability via gradual repositioning of balance sheet composition to increase earning assets and improve yields while ensuring the Bank maintains an acceptable risk profile and adequate capital levels; and
- Commitment to dedicate sufficient resources to address all portions of the Consent Order followed by a managed re-alignment of operating costs with a recapitalized, restructured and more efficient banking operation designed to promote balance sheet growth in an increasingly regulated and competitive business climate.

Since 2010 and continuing into 2015, management believes it has made and continues to make significant progress on various initiatives that will contribute to the Bank's recovery, including:

- Reduced nonperforming assets to $9.5 million at December 31, 2014 from $11.5 million at December 21, 2013; and from a high of $47.5 million at December 31, 2009.
- Reduced the Bank's concentration in troubled commercial real estate and land development loans to $11.8 million at December 31, 2014 from $20.9 million at December 31, 2013; and from a high of $91.3 million at December 31, 2009.
- Maintained an allowance for loan losses as a percentage of total loans of 4.44% at December 31, 2014 compared to 5.58% at December 31, 2013 and 6.53% at December 31, 2012.
- Recognized negative provision expense of $2.5 million in 2014 and negative provision expense of $2.3 million in 2013 while maintaining an allowance to nonperforming loans coverage ratio of 85.6% and 83.3% at December 31, 2014 and 2013, respectively. The Bank

recognized $15.8 million of provision expense in 2009 and reported an allowance to nonperforming loan coverage ratio of 42.7% at December 31, 2009.

- Maintained average on-balance sheet liquidity comprised of cash and due from banks balances and unencumbered available for sale investments of approximately $119.2 million and $82.1 million during 2014 and 2013, respectively. Also, maintained a contingency line of credit at the Federal Home Loan Bank of Indianapolis secured by certain investment securities and loans used to provide average borrowing availability of approximately $24.7 million and $30.5 million during 2014 and 2013, respectively.

- Reduced average cost of funds by 7 basis points in 2014, following annual prior year reductions of 6, 16, 30 and 51 basis points in 2013 through 2010, respectively, achieved via nonrenewal of high cost certificates and competitive deposit rates without experiencing core deposit runoff.

- Continued reduction in problem asset costs (e.g., commercial loan legal expense, loan and collection expense, other real estate owned expense, and appraisal expense) of approximately $174,000 and $309,000 in 2014 and 2013, respectively. The level of problem asset costs incurred in 2014 represents approximately 21% of 2009 problem asset costs.

- The Bank's 2015 budget continues to emphasize remediation of problem assets and efforts to rebuild the Bank's balance sheet, primarily through loan growth initiatives funded by on-balance-sheet cash and run-off from the investment portfolio. In general, this redistribution of the Bank's existing asset mix is expected to increase the level of interest earning assets and improve the overall yield on interest earning assets.

Management makes no assurances that the efforts, results, and/or future plans described above will improve the Bank's overall financial condition, guarantee profitability in 2015, or ensure the modification or discharge of existing regulatory enforcement actions imposed on the Bank.

**3. Securities**

Securities available for sale consist of the following:

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|---|---|---|---|---|
| | | (in thousands) | | |
| **December 31, 2014** | | | | |
| Mortgage-backed/CMO | $ 107,489 | 409 | (761) | $ 107,137 |
| US Agency | 23,108 | 28 | (6) | 23,130 |
| Obligations of state and political subdivisions | 1,586 | 19 | - | 1,605 |
| Preferred stock[1] | 49 | 254 | - | 303 |
| Total available for sale | $ 132,232 | $ 710 | $ (767) | $ 132,175 |
| | | | | |
| **December 31, 2013** | | | | |
| Mortgage-backed/CMO | $ 67,392 | $ 84 | $ (2,307) | $ 65,169 |
| Obligations of state and political subdivisions | 1,794 | 7 | (7) | 1,794 |
| Preferred stock[1] | 49 | 668 | - | 717 |
| Total available for sale | $ 69,235 | $ 759 | $ (2,314) | $ 67,680 |

[1] Represents preferred stocks issued by Freddie Mac and Fannie Mae

Securities are reviewed quarterly for possible other-than-temporary impairment (OTTI) based on guidance included in ASC Topic 320, *Investments–Debt and Equity Instruments*. This guidance requires an entity to assess whether it intends to sell, or whether it is more likely than not that it will be required to sell, a security in an unrealized loss position before the recovery of the security's amortized cost basis. If either of these criteria is met, the entire difference between the amortized cost and fair value is recognized in earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment recognized in earnings is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income.

Management's review of the securities portfolio for the existence of OTTI considers various qualitative and quantitative factors regarding each investment category, including if the securities were U.S. Government issued, the credit rating on the securities, credit outlook, payment status and financial condition, the length of time the security has been in a loss position, the size of the loss position and other meaningful information.

The Corporation had nine Agency CMO securities which have been impaired for more the twelve months at December 31, 2014 and two Agency CMO securities which were impaired for more than twelve months at December 31, 2013.

The Corporation makes a quarterly assessment of OTTI on its non-government agency collateralized mortgage obligation (CMO) security primarily based on a quarterly cash flow analysis performed by an independent third-party specialist. The evaluation includes a comparison of the present value of the expected cash flows to previous estimates to determine whether adverse changes in cash flows resulted during the period. The analysis considers attributes of the security, such as its super tranche position, and specific loan level collateral underlying the security. A summary of the par value, book value, carrying value (fair value) and unrealized loss for the security is presented below:

| | December 31, | | | |
|---|---|---|---|---|
| | 2014 | | 2013 | |
| | Amount | % of Par | Amount | % of Par |
| | (dollars in thousands) | | | |
| Par value | $ 1,269 | 100.00% | $ 1,632 | 100.00% |
| Book value | 1,129 | 88.97% | 1,454 | 89.09% |
| Carrying value | 1,195 | 94.17% | 1,454 | 89.09% |
| Unrealized loss | - | 0.00% | - | 0.00% |

Certain key attributes of the underlying loans supporting the security included the following:

| | December 31, | |
|---|---|---|
| | 2014 | 2013 |
| Weighted average remaining credit score (based on original FICO) | 737 | 737 |
| Primary location of underlying loans: | | |
| California | 69% | 70% |
| Florida | 4% | 3% |
| Other | 27% | 27% |
| Delinquency status of underlying loans: | | |
| Past due 30-59 days | 3.28% | 1.44% |
| Past due 60-89 days | 0.88% | 3.44% |
| Past due 90 days or more | 5.80% | 6.01% |
| In process of foreclosure | 7.30% | 3.78% |
| Held as other real estate owned | 0.89% | 0.00% |

The specialist calculates an estimate of the fair value of the security's cash flows using an INTEX valuation model, subject to certain assumptions regarding collateral related cash flows such as expected prepayment rates, default rates, loss severity estimates, and discount rates as key valuation inputs.

| | December 31, | |
|---|---|---|
| | 2014 | 2013 |
| Voluntary repayment rate (CRR) | 15.97% | 14.27% |
| Default rates: | | |
| Within next 24 months | 7.77% | 6.56% |
| Decreasing to (by month 37) | 3.68% | 3.55% |
| Decreasing to (by month 200 at December 31, 2014 and by month 212 at December 31, 2013) | 0.00% | 0.00% |
| Loss severity rates: | | |
| Initial loss upon default (Year 1) | 47.20% | 45.08% |
| Per annum decrease (Years 2 - 11) | 3.50% | 3.50% |
| Floor (Year 12) | 23.00% | 23.00% |
| Discount rate [1]: | 5.50% | 5.50% |
| Remaining credit support provided by other collateral pools of underlying loans within the security: | 0.04% | 0.00% |

[1] Intended to reflect estimated uncertainty and liquidity premiums, after adjustment for estimated credit loss cash flows.

The prepayment assumptions used within the model consider borrowers' incentive to prepay based on market interest rates and borrowers' ability to prepay based on underlying assumptions for borrowers' ability to qualify for a new loan based on their credit and appraised property value, by location. As such, prepayment speeds decrease as credit quality and home prices deteriorate, reflecting a diminished ability to refinance.

In addition, collateral cash flow assumptions utilize a valuation technique under a "Liquidation Scenario" whereby loans are evaluated by delinquency and are assigned probability of default and loss factors deemed appropriate in the current economic environment. The liquidation scenarios assume that all loans 60 or more days past due migrate to default, are liquidated, and losses are realized over a period of between six and twenty four months based in part upon initial loan to value ratios and estimated changes in both historical and future property values since origination as obtained from financial data sources.

At December 31, 2014 and 2013, based on a present value at a prospective yield of future cash flows for the investment as provided by the specialist and after management's evaluation of the reasonableness of the specialist's underlying assumptions regarding Level 2 and Level 3 inputs, the Corporation concluded that the security's expected cash flows continued to support the amortized cost of the security and no additional other-than-temporary impairment had been incurred. Prior to 2010, approximately $290,000 of credit-loss OTTI charges were incurred on the security.

The following is a summary of the gross unrealized losses and fair value of securities by length of time that individual securities have been in a continuous loss position:

| | Less than 12 months | | 12 months or more | | Total | |
|---|---|---|---|---|---|---|
| | Unrealized losses | Fair Value | Unrealized losses | Fair Value | Unrealized losses | Fair Value |
| | (in thousands) | | | | | |
| **December 31, 2014** | | | | | | |
| Mortgage-backed/CMO | $ (185) | $ 28,453 | $ (576) | $ 22,141 | $ (761) | $ 50,594 |
| US Agency | (6) | 4,687 | - | - | (6) | 4,687 |
| **Total** | $ (191) | $ 33,140 | $ (576) | $ 22,141 | $ (767) | $ 55,281 |
| **December 31, 2013** | | | | | | |
| Mortgage-backed/CMO | $ (2,093) | $ 52,020 | $ (214) | $ 3,537 | $ (2,307) | $ 55,557 |
| Obligations of state and political subdivisions | (7) | 780 | - | - | (7) | 780 |
| **Total** | $ (2,100) | $ 52,800 | $ (214) | $ 3,537 | $ (2,314) | $ 56,337 |

The amortized cost and fair value of securities available for sale, by contractual maturity, follow. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | December 31, 2014 | | December 31, 2013 | |
|---|---|---|---|---|
| | Amortized Cost | Approximate Fair Value | Amortized Cost | Approximate Fair Value |
| | (in thousands) | | | |
| Maturing within one year | $ 4,276 | $ 4,278 | $ - | $ - |
| Maturing after one year but within five years | 17,587 | 17,606 | 761 | 761 |
| Maturing after five years but within ten years | 2,305 | 2,312 | 505 | 512 |
| Maturing after ten years | 575 | 842 | 577 | 1,238 |
| | $ 24,743 | $ 25,038 | $ 1,843 | $ 2,511 |
| Mortgage-backed/CMO securities | 107,489 | 107,137 | 67,392 | 65,169 |
| Totals | $ 132,232 | $ 132,175 | $ 69,235 | $ 67,680 |

Proceeds from at-par calls on securities totaled $3.3 million, $3.0 million, and $7.0 million in 2014, 2013 and 2012, respectively.

At December 31, 2014 and 2013, the Corporation did not own any investment securities issued by states and political subdivisions in which the amortized cost and fair value of such securities individually exceeded 10% of shareholders' equity.

Investment securities, with an amortized cost of approximately $53.0 million at December 31, 2014 were pledged to secure public deposits and for other purposes required or permitted by law, including approximately $19.7 million of securities pledged as collateral at the Federal Home Loan Bank of Indianapolis (FHLBI) to support potential liquidity needs of the Bank. At December 31, 2013, the amortized cost of pledged investment securities totaled $60.8 million of which $25.5 million of securities pledged as collateral at the FHLBI for contingent liquidity needs of the Bank.

The Bank owns stock in both the Federal Home Loan Bank of Indianapolis (FHLBI) and the Federal Reserve Bank (FRB), both of which are recorded at cost. The Bank is required to hold stock in the FHLBI equal to 5% of the institution's borrowing capacity with the FHLBI. The Bank's investment in FHLBI stock amounted to $617,000 at December 31, 2014 and $735,000 at December 31, 2013. The Bank's investment in FRB stock, which totaled $523,000 at December 31, 2014 and $44,000 at December 31, 2013, is a requirement for the Bank's membership in the Federal Reserve System. These investments can only be resold to, or redeemed by, the issuer. In December 2014, the FHLBI initiated repurchases of $118,000 of its stock at cost resulting in no gain or loss to the Bank.

**4. Loans**

The recorded investment in portfolio loans consists of the following:

| | December 31, 2014 | December 31, 2013 |
|---|---|---|
| | (in thousands) | |
| **Commercial** | $ 15,130 | $ 15,019 |
| **Commercial real estate:** | | |
| Construction, land development, and other land | 5,050 | 5,826 |
| Owner occupied | 47,434 | 49,012 |
| Nonowner occupied | 59,440 | 60,322 |
| **Consumer real estate:** | | |
| Commercial purpose | 5,463 | 6,886 |
| Mortgage - Residential | 11,631 | 12,955 |
| Home equity and home equity lines of credit | 9,613 | 8,991 |
| **Consumer and Other** | 6,444 | 6,273 |
| Subtotal | 160,205 | 165,284 |
| Unearned income | (159) | (169) |
| **Total Loans** | $ 160,046 | $ 165,115 |

Included in the consumer real estate loans above are residential first mortgages reported as "real estate mortgages" on the consolidated balance sheets. In addition, a portion of these consumer real estate loans include commercial purpose loans where the borrower has pledged a 1-4 family residential property as collateral. Loans also include the reclassification of demand deposit overdrafts, which amounted to $59,000 and $114,000 at December 31, 2014 and 2013, respectively.

Loans serviced for others, including commercial participations sold, are not reported as assets of the Bank and approximated $1.5 million at December 31, 2014 and $3.9 million at December 31, 2013.

**5. Allowance for Loan Losses and Credit Quality of Loans**

The Corporation separates its loan portfolio into segments to perform the calculation and analysis of the allowance for loan losses. The four segments analyzed are Commercial, Commercial Real Estate, Consumer Real Estate, and Consumer and Other. The Commercial segment includes loans to finance commercial and industrial businesses that are not secured by real estate. The Commercial Real Estate segment includes: i) construction real estate loans to finance construction and land development and/or loans secured by vacant land and ii) commercial real estate loans secured by non-farm, non-residential real estate which are further classified as either owner occupied or non-owner occupied based on the underlying collateral type. The Consumer Real Estate segment includes (commercial and non-commercial purpose) loans that are secured by 1 – 4 family residential real estate properties, including first mortgages on residential properties and home equity loans and lines of credit that are secured by first or second liens on residential properties. The Consumer and Other segment includes all loans not included in any other segment. These are primarily loans to consumers for household, family, and other personal expenditures, such as autos, boats, and recreational vehicles.

Activity in the allowance for loan losses by portfolio segment is a follows:

| | Commercial | Commercial Real Estate | Consumer Real Estate | Consumer and Other | Total |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| **2014** | | | | | |
| Allowance for loan losses: | | | | | |
| Beginning balance | $ 633 | $ 7,180 | $ 1,215 | $ 186 | $ 9,214 |
| Charge offs | (95) | (127) | (170) | (82) | (474) |
| Recoveries | 147 | 334 | 316 | 72 | 869 |
| Provision | (270) | (2,016) | (277) | 63 | (2,500) |
| Ending balance | $ 415 | $ 5,371 | $ 1,084 | $ 239 | $ 7,109 |
| **2013** | | | | | |
| Allowance for loan losses: | | | | | |
| Beginning balance | $ 908 | $ 8,682 | $ 2,036 | $ 143 | $ 11,769 |
| Charge offs | (177) | (836) | (87) | (105) | (1,205) |
| Recoveries | 212 | 224 | 363 | 101 | 900 |
| Provision | (310) | (890) | (1,097) | 47 | (2,250) |
| Ending balance | $ 633 | $ 7,180 | $ 1,215 | $ 186 | $ 9,214 |

The following presents the balance in allowance for loan losses and loan balances by portfolio segment based on impairment method:

| | Commercial | Commercial Real Estate | Consumer Real Estate | Consumer and Other | Total |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| **2014** | | | | | |
| Allowance for loan losses: | | | | | |
| Individually evaluated for impairment | $ 1 | $ 1,681 | $ 5 | $ - | $ 1,687 |
| Collectively evaluated for impairment | 414 | 3,690 | 1,079 | 239 | 5,422 |
| Total allowance for loan losses | $ 415 | $ 5,371 | $ 1,084 | $ 239 | $ 7,109 |
| Recorded investment in loans: | | | | | |
| Individually evaluated for impairment | $ 234 | $ 11,324 | $ 1,014 | $ - | $ 12,572 |
| Collectively evaluated for impairment | 14,896 | 100,600 | 25,693 | 6,444 | 147,633 |
| Total recorded investment in loans | $ 15,130 | $ 111,924 | $ 26,707 | $ 6,444 | $ 160,205 |
| **2013** | | | | | |
| Allowance for loan losses: | | | | | |
| Individually evaluated for impairment | $ 11 | $ 2,298 | $ 135 | $ - | $ 2,444 |
| Collectively evaluated for impairment | 622 | 4,882 | 1,080 | 186 | 6,770 |
| Total allowance for loan losses | $ 633 | $ 7,180 | $ 1,215 | $ 186 | $ 9,214 |
| Recorded investment in loans: | | | | | |
| Individually evaluated for impairment | $ 211 | $ 17,052 | $ 1,848 | $ - | $ 19,111 |
| Collectively evaluated for impairment | 14,808 | 98,108 | 26,984 | 6,273 | 146,173 |
| Total recorded investment in loans | $ 15,019 | $ 115,160 | $ 28,832 | $ 6,273 | $ 165,284 |

Management's on-going monitoring of the credit quality of the portfolio relies on an extensive credit risk monitoring process that considers several factors including: current economic conditions affecting the Bank's customers, the payment performance of individual loans and pools of homogenous loans, portfolio seasoning, changes in collateral values, and detailed reviews of specific relationships.

Our internal loan grading system assigns a risk grade to all commercial loans. This grading system is similar to those employed by banking regulators. Grades 1 through 5 are considered "pass" credits and grade 6 are considered "watch" credits and are subject to greater scrutiny. Those loans graded 7 and higher are considered substandard and are individually evaluated for impairment if reported as nonaccrual and are greater than $100,000 or part of an aggregate relationship exceeding $100,000. All commercial loans are graded at inception and reviewed, and if appropriate, re-graded at various intervals thereafter. Additionally, our commercial loan portfolio and assigned risk grades are periodically subjected to review by external loan reviewers and banking regulators. Certain of the key factors considered in assigning loan grades include: cash flows, operating performance, financial condition, collateral, industry condition, management, and the strength, liquidity and willingness of guarantors' support.

A description of the general characteristics of each risk grade follows:

- **RATING 1 (Satisfactory – Minimal Risk)** - Loans in this category are to persons or entities of unquestioned financial strength, a highly liquid financial position, with collateral that is liquid and well margined. These borrowers have performed without question on past obligations, and the Bank expects their performance to continue. Internally generated cash flow covers current maturities of long-term debt by a substantial margin.
- **RATING 2 (Satisfactory – Modest Risk)** – These loans to persons or entities with strong financial condition and above-average liquidity who have previously satisfactorily handled their obligations with the Bank. Collateral securing the Bank's debt is margined in accordance with policy guidelines. Internally-generated cash flow covers current maturities of long-term debt more than adequately.
- **RATING 3 (Satisfactory - Average)** – These are loans with average cash flow and ratios compared to peers. Usually RMA comparisons show where companies fall in the performance spectrum. Companies have consistent performance for 3 or more years.
- **RATING 4 (Satisfactory – Acceptable Risk)** – Loans to persons or entities with an average financial condition, adequate collateral margins, adequate cash flow to service long-term debt, and net worth comprised mainly of fixed assets are included in this category. These entities are minimally profitable now, with projections indicating continued profitability into the foreseeable future. Overall, these loans are basically sound.
- **RATING 5 (Satisfactory - Acceptable – Monitor)** - These loans are characterized by borrowers who have marginal, but adequate cash flow, marginal profitability, but currently have been meeting the obligations of their loan structure. However, adverse changes in the borrower's circumstances and/ or current economic conditions are more likely to impair their capacity for repayment. The borrower has in the past satisfactorily handled debts with the Bank, but may be experiencing some minor delinquency in making payments, or other signs of temporary cash flow issues. Borrower may be experiencing declining margins or other negative financial trends, despite the borrower's continued satisfactory condition and positive cash flow. Other characteristics of borrowers in this class include inadequate credit information, weakness of financial statement, or declining but positive repayment capacity. This classification includes loans to new or established borrowers with satisfactory loan structure, but where near term economic or business issues appears to remain stable and the near term projections would limit the ability for an improvement in the financial trends of the borrower.

- **RATING 6 (Special Mention - OAEM) -** Loans in this class have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. These potential weaknesses may result in a deterioration of the repayment of the loan and increase the credit risk. Special mention assets are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification. Special mention credits may include a borrower that pays the Bank on a timely basis (occasional 30 day delinquent) and may be experiencing temporary cash flow deficiencies.
- **RATING 7 (Substandard) –** A substandard loan is inadequately protected by the current sound worth and paying capacity of the borrower or of the collateral pledged, if any. Loans so classified must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans. Substandard credits may include a borrower that pays consistently past due, has significant cash flow shortages and may have a collateral shortfall that requires a specific reserve.
- **RATING 8 (Doubtful) -** This risk rating class has all of the weaknesses inherent in the substandard rating but with the added characteristic that the weaknesses make collection in full or liquidation, on the basis of currently known existing facts, condition, and values, highly questionable and improbable. These are poor quality loans in which neither the collateral, if any, nor the financial condition of the borrower presently ensure collectability in full within a reasonable period of time; in fact, there is permanent impairment in the collateral securing the Bank's loan. These loans are in a work-out status, must be non-accrual status and have a defined work-out strategy.

  This is a transitional risk rating class while collateral value and other factors are assessed. Loans will remain in this class for the assessment period, but in no event for more than 1 year. If there is no improvement in the Bank's position during that time, a charge-off will be taken to best reflect known asset collateral value. If the loan goes into a "Deeds in Redemption" status before 1 year, any shortfall will be recognized immediately.

The assessment of compensating factors may result in a rating plus or minus one grade from those listed above. These factors include, but are not limited to collateral, guarantors, environmental conditions, history, plan/projection reasonableness, quality of information, and payment delinquency.

The internal loan grading system is applied to the residential real estate portion of our consumer loan portfolio upon certain triggering events (e.g., delinquency, bankruptcy, restructuring, etc.). However, large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment and are not separately identified for impairment disclosures. The primary risk element for the residential real estate portion of consumer loans is the timeliness of borrowers' scheduled payments. We rely primarily on our internal reporting system to monitor past due loans and have internal policies and procedures to pursue collection and protect our collateral interests in order to mitigate losses.

Our monitoring of credit quality is further denoted by classification of loans as nonperforming, which reflects loans where the accrual of interest has been discontinued and loans that are past due 90 days or more and still accruing interest. Nonperforming loans include troubled debt restructured loans (as discussed below) that are on nonaccrual status or past due 90 days or more. Troubled debt restructured loans that are accruing interest and not past due 90 days or more are excluded from nonperforming loans.

The following presents the recorded investment in loans by risk grade and a summary of nonperforming loans, by class of loan:

| | Not Rated | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | Total | Nonperforming |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | (in thousands) | | | | | |
| **December 31, 2014** | | | | | | | | | | | |
| **Commercial** | $ - | $ 239 | $ 44 | $ 3,294 | $ 4,959 | $ 6,139 | $ 194 | $ 261 | $ - | $ 15,130 | $ 233 |
| **Commercial Real Estate:** | | | | | | | | | | | |
| Construction, land development, and other land | - | - | - | - | 1,072 | 1,796 | 377 | 366 | 1,439 | 5,050 | 1,740 |
| Owner occupied | - | - | 415 | 4,949 | 23,632 | 15,906 | 496 | 2,036 | - | 47,434 | 965 |
| Nonowner occupied | - | - | 337 | 4,035 | 20,287 | 27,741 | 4,685 | 2,355 | - | 59,440 | 2,148 |
| **Consumer real estate:** | | | | | | | | | | | |
| Commercial purpose | - | - | - | 55 | 1,172 | 2,575 | 654 | 1,007 | - | 5,463 | 517 |
| Mortgage - Residential | 4,589 | - | - | - | - | 4,381 | - | 2,661 | - | 11,631 | 2,497 |
| Home equity and home equity lines of credit | 8,314 | - | - | - | - | 986 | - | 313 | - | 9,613 | 137 |
| **Consumer and Other** | 6,038 | - | - | - | - | 285 | - | 121 | - | 6,444 | 71 |
| **Total** | $18,941 | $ 239 | $ 796 | $12,333 | $ 51,122 | $59,809 | $6,406 | $ 9,120 | $1,439 | $ 160,205 | $ 8,308 |

| | Not Rated | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | Total | Nonperforming |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | (in thousands) | | | | | |
| **December 31, 2013** | | | | | | | | | | | |
| **Commercial** | $ 114 | $ 479 | $ 17 | $ 2,680 | $ 5,057 | $ 5,901 | $ 607 | $ 164 | $ - | $ 15,019 | $ 12 |
| **Commercial Real Estate:** | | | | | | | | | | | |
| Construction, land development, and other land | - | - | - | - | 1,840 | 1,745 | 165 | 602 | 1,474 | 5,826 | 1,849 |
| Owner occupied | 32 | - | 720 | 3,132 | 20,987 | 16,172 | 2,916 | 5,053 | - | 49,012 | 2,580 |
| Nonowner occupied | - | - | 393 | 1,340 | 19,057 | 28,865 | 4,735 | 5,932 | - | 60,322 | 3,623 |
| **Consumer real estate:** | | | | | | | | | | | |
| Commercial purpose | - | - | - | 221 | 1,712 | 3,399 | 760 | 794 | - | 6,886 | 663 |
| Mortgage - Residential | 5,490 | - | - | - | - | 4,349 | - | 3,116 | - | 12,955 | 1,853 |
| Home equity and home equity lines of credit | 4,164 | 3,502 | - | - | - | 770 | - | 555 | - | 8,991 | 363 |
| **Consumer and Other** | 5,839 | - | - | - | - | 307 | - | 127 | - | 6,273 | 124 |
| **Total** | $ 15,639 | $ 3,981 | $ 1,130 | $ 7,373 | $ 48,653 | $ 61,508 | $ 9,183 | $ 16,343 | $ 1,474 | $ 165,284 | $ 11,067 |

Loans are considered past due when contractually required principal or interest has not been received. The amount classified as past due is the entire principal balance outstanding of the loan, not just the amount of payments that are past due.

An aging analysis of the recorded investment in past due loans, segregated by class of loans follows:

| | Loans Past Due | | | | | | 90+ Days |
|---|---|---|---|---|---|---|---|
| | 30-59 Days | 60-89 Days | 90+ Days | Total | Current | Total | Past Due and Accruing |
| | | | | (in thousands) | | | |
| **December 31, 2014** | | | | | | | |
| **Commercial** | $ - | $ - | $ - | $ - | $ 15,130 | $ 15,130 | $ - |
| **Commercial real estate:** | | | | | | | |
| Construction, land development, and other land | - | 105 | 43 | 148 | 4,902 | 5,050 | - |
| Owner occupied | 24 | - | 20 | 44 | 47,390 | 47,434 | - |
| Nonowner occupied | 174 | - | 97 | 271 | 59,169 | 59,440 | - |
| **Consumer real estate:** | | | | | | | |
| Commercial purpose | - | 112 | 191 | 303 | 5,160 | 5,463 | - |
| Mortgage - Residential | 868 | 521 | 375 | 1,764 | 9,867 | 11,631 | 4 |
| Home equity and home equity lines of credit | 2 | - | - | 2 | 9,611 | 9,613 | - |
| **Consumer and Other** | 33 | 6 | - | 39 | 6,405 | 6,444 | - |
| **Total** | $ 1,101 | $ 744 | $ 726 | $ 2,571 | $ 157,634 | $ 160,205 | $ 4 |
| | | | | | | | |
| **December 31, 2013** | | | | | | | |
| **Commercial** | $ - | $ - | $ - | $ - | $ 15,019 | $ 15,019 | $ - |
| **Commercial real estate:** | | | | | | | |
| Construction, land development, and other land | - | - | 68 | 68 | 5,758 | 5,826 | - |
| Owner occupied | 153 | 155 | 843 | 1,151 | 47,861 | 49,012 | - |
| Nonowner occupied | 627 | 312 | 241 | 1,180 | 59,142 | 60,322 | - |
| **Consumer real estate:** | | | | | | | |
| Commercial purpose | 103 | - | 123 | 226 | 6,660 | 6,886 | - |
| Mortgage - Residential | 77 | 851 | 104 | 1,032 | 11,923 | 12,955 | - |
| Home equity and home equity lines of credit | 75 | 37 | - | 112 | 8,879 | 8,991 | - |
| **Consumer and Other** | 55 | 9 | - | 64 | 6,209 | 6,273 | - |
| **Total** | $ 1,090 | $ 1,364 | $ 1,379 | $ 3,833 | $ 161,451 | $ 165,284 | $ - |

Loans are placed on nonaccrual when, in the opinion of management, the collection of additional interest is doubtful. Loans are generally placed on nonaccrual upon becoming ninety days past due. However, loans may be placed on nonaccrual regardless of whether or not they are past due. All cash received on nonaccrual loans is applied to the principal balance. Loans are considered for return to accrual status on an individual basis when all principal and interest amounts contractually due are brought and future payments reasonably assured.

The following is a summary of the recorded investment in nonaccrual loans, by class of loan:

| | December 31, 2014 | December 31, 2013 |
|---|---|---|
| | (in thousands) | |
| **Commercial** | $ 233 | $ 12 |
| **Commercial real estate:** | | |
| Construction, land development, and other land | 1,692 | 1,849 |
| Owner occupied | 965 | 2,580 |
| Nonowner occupied | 2,148 | 3,623 |
| **Consumer real estate:** | | |
| Commercial purpose | 517 | 663 |
| Mortgage - Residential | 2,497 | 1,853 |
| Home equity and home equity lines of credit | 137 | 363 |
| **Consumer and Other** | 119 | 124 |
| **Total** | $ 8,308 | $ 11,067 |

The following presents information pertaining to impaired loans and related valuation allowance allocations by class of loan:

| | December 31, 2014 | | | December 31, 2013 | | |
|---|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Valuation Allowance | Recorded Investment | Unpaid Principal Balance | Valuation Allowance |
| | (in thousands) | | | | | |
| **With an allowance recorded:** | | | | | | |
| **Commercial** | $ 30 | $ 32 | $ 1 | $ 198 | $ 224 | $ 11 |
| **Commercial real estate:** | | | | | | |
| Construction, land development, and other land | 2,144 | 4,411 | 1,567 | 2,368 | 4,664 | 1,649 |
| Owner occupied | 1,182 | 1,483 | 111 | 3,467 | 3,799 | 297 |
| Nonowner occupied | 97 | 104 | 4 | 5,107 | 5,470 | 352 |
| **Consumer real estate:** | | | | | | |
| Commercial purpose | 94 | 100 | 4 | 1,185 | 1,316 | 135 |
| Mortgage - Residential | - | - | - | - | - | - |
| Home equity and home equity lines of credit | - | - | - | - | - | - |
| **Consumer and Other** | - | - | - | - | - | - |
| **Total** | 3,547 | 6,130 | 1,687 | 12,325 | 15,473 | 2,444 |
| **With no related allowance recorded:** | | | | | | |
| **Commercial** | 203 | 209 | - | 13 | 14 | - |
| **Commercial real estate:** | | | | | | |
| Construction, land development, and other land | 317 | 451 | - | 306 | 416 | - |
| Owner occupied | 1,368 | 1,605 | - | 2,556 | 3,517 | - |
| Nonowner occupied | 6,216 | 6,673 | - | 3,248 | 3,871 | - |
| **Consumer real estate:** | | | | | | |
| Commercial purpose | 921 | 1,024 | - | 663 | 1,261 | - |
| Mortgage - Residential | - | - | - | - | - | - |
| Home equity and home equity lines of credit | - | - | - | - | - | - |
| **Consumer and Other** | - | - | - | - | - | - |
| **Total** | 9,025 | 9,962 | - | 6,786 | 9,079 | - |
| **Total:** | | | | | | |
| **Commercial** | 233 | 241 | 1 | 211 | 238 | 11 |
| **Commercial real estate:** | | | | | | |
| Construction, land development, and other land | 2,461 | 4,862 | 1,567 | 2,674 | 5,080 | 1,649 |
| Owner occupied | 2,550 | 3,088 | 111 | 6,023 | 7,316 | 297 |
| Nonowner occupied | 6,313 | 6,777 | 4 | 8,355 | 9,341 | 352 |
| **Consumer real estate:** | | | | | | |
| Commercial purpose | 1,015 | 1,124 | 4 | 1,848 | 2,577 | 135 |
| Mortgage - Residential | - | - | - | - | - | - |
| Home equity and home equity lines of credit | - | - | - | - | - | - |
| **Consumer and Other** | - | - | - | - | - | - |
| **Total Impaired Loans** | $ 12,572 | $ 16,092 | $ 1,687 | $ 19,111 | $ 24,552 | $ 2,444 |

The following presents information pertaining to the recorded investment in impaired loans as follows:

| | December 31, 2014 | | December 31, 2013 | |
|---|---|---|---|---|
| | Average Outstanding Balance | Interest Income Recognized | Average Outstanding Balance | Interest Income Recognized |
| | (in thousands) | | | |
| **Commercial** | $ 256 | $ 2 | $ 230 | $ 15 |
| **Commercial real estate:** | | | | |
| Construction, land development, and other land | 2,522 | 41 | 2,925 | 64 |
| Owner occupied | 2,658 | 164 | 7,005 | 318 |
| Nonowner occupied | 6,374 | 243 | 8,415 | 314 |
| **Consumer real estate:** | | | | |
| Commercial purpose | 878 | 46 | 1,947 | 74 |
| Mortgage - Residential | - | - | - | - |
| Home equity and home equity lines of credit | 113 | - | - | - |
| **Consumer and Other** | - | - | - | - |
| **Total** | $ 12,801 | $ 496 | $ 20,522 | $ 785 |

For loans where impairment is measured based on the present value of expected future cash flows, subsequent changes in present value and related allowance adjustments resulting from the passage of time are accounted for within the provision for loan losses rather than interest income.

**Troubled Debt Restructurings**

The Corporation may agree to modify the terms of a loan to improve its ability to collect amounts due. The modified terms are intended to enable customers to mitigate the risk of foreclosure by creating a payment structure that provides for continued loan payment requirements based on their current cash flow ability. Modifications, including renewals, where concessions are made by the Bank and result from the debtor's financial difficulties are considered troubled debt restructurings (TDRs).

Loan modifications are considered TDRs when the modification includes terms outside of normal lending practices (i.e., concessions) to a borrower who is experiencing financial difficulties.

Typical concessions granted include, but are not limited to:

1. Agreeing to interest rates below prevailing market rates for debt with similar risk characteristics
2. Extending the amortization period beyond typical lending guidelines for debt with similar risk characteristics
3. Forbearance of principal
4. Forbearance of accrued interest

To determine if a borrower is experiencing financial difficulties, the Corporation considers if:

1. The borrower is currently in default on any other of their debt
2. It is likely that the borrower would default on any of their debt if the concession was not granted
3. The borrower's cash flow was sufficient to service all of their debt if the concession was not granted
4. The borrower has declared, or is in the process of declaring bankruptcy
5. The borrower is a going concern (if the entity is a business)

The following summarizes troubled debt restructurings:

| | December 31, 2014 | | | December 31, 2013 | | |
|---|---|---|---|---|---|---|
| | Outstanding Recorded Investment | | | Outstanding Recorded Investment | | |
| | Accruing | Nonaccrual | Total | Accruing | Nonaccrual | Total |
| | (in thousands) | | | | | |
| **Commercial** | $ - | $ 104 | $ 104 | $ 199 | $ 13 | $ 212 |
| **Commercial real estate:** | | | | | | |
| Construction, land development, and other land | 769 | 1,512 | 2,281 | 826 | 1,662 | 2,488 |
| Owner occupied | 1,586 | 907 | 2,493 | 3,442 | 2,202 | 5,644 |
| Nonowner occupied | 4,165 | 566 | 4,731 | 4,732 | 2,281 | 7,013 |
| **Consumer real estate:** | | | | | | |
| Commercial purpose | 497 | 153 | 650 | 1,185 | 502 | 1,687 |
| Mortgage - Residential | 808 | 1,002 | 1,810 | 940 | 823 | 1,763 |
| Home equity and home equity lines of credit | 54 | 8 | 62 | 58 | 250 | 308 |
| **Consumer and Other** | 5 | 37 | 42 | 6 | 61 | 67 |
| **Total** | $ 7,884 | $ 4,289 | $ 12,173 | $ 11,388 | $ 7,794 | $ 19,182 |

Troubled debt restructured loans may qualify for return to accrual status if the borrower complies with the revised terms and conditions and has demonstrated sustained payment performance consistent with the modified terms for a minimum of six consecutive payment cycles after the restructuring date. In addition, the collection of future payments must be reasonably assured.

The following presents information regarding existing loans that were restructured, resulting in the loan being classified as a troubled debt restructuring:

| | Loans Restructured in 2014 | | | Loans Restructured in 2013 | | |
|---|---|---|---|---|---|---|
| | Number of Loans | Pre-Modification Recorded Investment | Post-Modification Recorded Investment | Number of Loans | Pre-Modification Recorded Investment | Post-Modification Recorded Investment |
| | (dollars in thousands) | | | | | |
| **Commercial** | - | $ - | $ - | 1 | $ 46 | $ 46 |
| **Commercial real estate:** | | | | | | |
| Construction, land development, and other land | 1 | 43 | 43 | - | - | - |
| Owner occupied | 3 | 237 | 237 | 1 | 390 | 390 |
| Nonowner occupied | 2 | 500 | 500 | 1 | 105 | 105 |
| **Consumer real estate:** | | | | | | |
| Commercial purpose | 2 | 170 | 170 | 2 | 166 | 166 |
| Mortgage - Residential | 1 | 62 | 62 | - | - | - |
| Home equity and home equity lines of credit | - | - | - | - | - | - |
| **Consumer and Other** | 1 | 25 | 25 | - | - | - |
| **Total** | 10 | $ 1,037 | $ 1,037 | 5 | $ 707 | $ 707 |

During the year ended December 31, 2014, the Corporation had five TDR loans with a recorded investment of $242,000 that defaulted within 12 months of restructuring. During the year ended December 31, 2013, the Corporation had four TDR loans with a recorded investment of $567,000 that defaulted within 12 months of restructuring. A loan is considered to be in payment default generally once it is 90 days contractually past due under the modified terms.

The following summarizes the nature of concessions granted by the Corporation to borrowers experiencing financial difficulties which resulted in troubled debt restructurings:

| | Non-Market Interest Rate | | Extension of Amortization Period | | Non-Market Interest Rate and Extension of Amortization Period | |
|---|---|---|---|---|---|---|
| | Number of Loans | Pre-Modification Recorded Investment | Number of Loans | Pre-Modification Recorded Investment | Number of Loans | Pre-Modification Recorded Investment |
| | (dollars in thousands) | | | | | |
| **December 31, 2014** | | | | | | |
| **Commercial** | - | $ - | - | $ - | - | $ - |
| **Commercial real estate:** | | | | | | |
| Construction, land development, and other land | - | - | 1 | 43 | - | - |
| Owner occupied | - | - | 3 | 237 | - | - |
| Nonowner occupied | - | - | 2 | 500 | - | - |
| **Consumer real estate:** | | | | | | |
| Commercial purpose | - | - | 2 | 170 | - | - |
| Mortgage - Residential | 1 | 62 | - | - | - | - |
| Home equity and home equity lines of credit | - | - | - | - | - | - |
| **Consumer and Other** | - | - | 1 | 25 | - | - |
| Total | 1 | $ 62 | 9 | $ 975 | - | $ - |
| **December 31, 2013** | | | | | | |
| **Commercial** | - | $ - | 1 | $ 46 | - | $ - |
| **Commercial real estate:** | | | | | | |
| Construction, land development, and other land | - | - | - | - | - | - |
| Owner occupied | - | - | - | - | 1 | 390 |
| Nonowner occupied | - | - | 1 | 105 | - | - |
| **Consumer real estate:** | | | | | | |
| Commercial purpose | - | - | 2 | 166 | - | - |
| Mortgage - Residential | - | - | - | - | - | - |
| Home equity and home equity lines of credit | - | - | - | - | - | - |
| **Consumer and Other** | - | - | - | - | - | - |
| Total | - | $ - | 4 | $ 317 | 1 | $ 390 |

During the years ended December 31, 2014 and 2013, non-market interest rate restructurings included pre-modification recorded investments of $62,000 and $390,000 respectively, related to performing loans that were renewed at either their existing contractual rates or non-market interest rates. Because these performing loans were graded substandard and the modified rates were not market rates for similar loans, these renewals are considered troubled debt restructurings.

## 6. Premises and Equipment

A summary of premises and equipment, and related accumulated depreciation and amortization follows:

| | December 31, 2014 | December 31, 2013 |
|---|---|---|
| | (in thousands) | |
| Land and land improvements | $ 2,882 | $ 2,875 |
| Premises | 10,199 | 9,938 |
| Furniture and equipment | 3,634 | 3,660 |
| | 16,715 | 16,473 |
| Less accumulated depreciation and amortization | (9,349) | (9,078) |
| Premises and equipment, net | $ 7,366 | $ 7,395 |

## 7. Other Real Estate Owned

At December 31, 2014, the Bank owned 5 foreclosed properties with a carrying value of $1.2 million. As of December 31, 2013, the Bank owned 5 foreclosed properties with a carrying value of $480,000. During 2014, OREO additions included four commercial real estate properties and two residential properties totaling approximately $1.3 million. Cost basis, as determined at the time of transfer into OREO based on current appraisals less estimated selling costs, included approximately $140,000 of fair value adjustments recognized as $96,000 of recoveries and $44,000 of valuation adjustments. OREO activity in 2014 also included the sale of four properties for $670,000 which generated gains of $79,000. In 2013 and 2012, net gain (loss) of $91,000 and $(206,000), respectively, was recognized on OREO sales/write-downs. The net gain (loss) on sale/write-down of other real estate is included in noninterest expense.

## 8. Time Certificates of Deposit

The scheduled maturities of time deposits, including brokered certificates of deposit, with a remaining term of more than one year at December 31, 2014 and 2013 were:

| | 2014 | 2013 |
|---|---|---|
| | (in thousands) | |
| 2015 | $ - | $ - |
| 2016 | 17,115 | 12,607 |
| 2017 | 4,785 | 2,645 |
| 2018 | 6,574 | 3,101 |
| 2019 and thereafter | 833 | 2,737 |
| Total | $ 29,307 | $ 21,090 |

Included in time deposits are certificates of deposit in amounts of $100,000 or more. These certificates and their remaining maturities at December 31, 2014 and 2013 are as follows:

| | 2014 | 2013 |
|---|---|---|
| | (in thousands) | |
| Three months or less | $ 3,706 | $ 5,079 |
| Three through six months | 2,453 | 5,011 |
| Six through twelve months | 7,460 | 10,572 |
| Over twelve months | 12,887 | 8,391 |
| Total | $ 26,506 | $ 29,053 |

Interest expense attributable to time deposits in amounts of $100,000 or more amounted to approximately $237,000, $287,000, and $363,000 in 2014, 2013, and 2012, respectively.

## 9. Other Borrowings

The Bank maintains a line-of-credit with the Federal Home Loan Bank of Indianapolis (“FHLBI”) which provides maximum borrowing capacity of $21.8 million as of December 31, 2014. The line is secured by unencumbered qualified mortgage and home equity loans with outstanding balances of $7.9 million and unencumbered investment securities with a fair value of $19.5 million.

The Bank also maintains a line-of-credit at the Federal Reserve discount window secured by specific pledges of eligible commercial loans totaling $5.2 million. At December 31, 2014, the lendable collateral value of such loans totaled $4.0 million.

Due to the Bank’s regulatory condition, borrowing availability under these lines-of-credit is subject to approval by the FHLBI and Federal Reserve, respectively, and terms may be limited or restricted.

No advances were drawn on either the FHLBI or Federal Reserve discount window lines of credit during 2014, 2013 or 2012, except for certain overnight test borrowings. Consequently, any related interest expense incurred on FHLBI and Federal Reserve discount window borrowings during 2014, 2013 and 2012 (if any) was immaterial. No advances were outstanding on these lines of credit at December 31, 2014, 2013, and 2012.

The Board of Directors and a member of executive management had previously extended $188,000 of unsecured non-interest bearing loans to FNBH Bancorp, Inc. to fund operating expenses of the Corporation. In conjunction with the Corporation's December 2013 private placement transaction,

$172,000 of the loans were repaid in connection with the Corporation's issuance of the Series B Preferred Shares. The remaining $16,000 was repaid by the Corporation in 2014.

**10. Federal Income Taxes**

Federal income tax expense (benefit) consists of:

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | | (in thousands) | |
| Current | $ 20 | $ - | $ - |
| Deferred | - | 104 | (104) |
| Total federal income tax expense (benefit) | $ 20 | $ 104 | $ (104) |

Federal income tax expense (benefit) differed from the amounts computed by applying the U.S. Federal income tax rate of 34% to pretax income as a result of the following:

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | | (in thousands) | |
| Computed "expected" tax expense (benefit) | $ 1,044 | $ 1,047 | $ 76 |
| Increase (reduction) in tax resulting from: | | | |
| Tax-exempt interest and dividends, net | (45) | (28) | (35) |
| Change in valuation allowance | (965) | (893) | (157) |
| Other, net | (14) | (22) | 12 |
| Total federal income tax expense (benefit) | $ 20 | $ 104 | $ (104) |

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are presented below:

| | December 31, | |
|---|---|---|
| | 2014 | 2013 |
| | (in thousands) | |
| Deferred tax assets: | | |
| Allowance for loan losses | $ 1,113 | $ 1,465 |
| Net operating loss carryforward | 7,370 | 7,922 |
| AMT credit carryforward | 32 | - |
| Other-than-temporary impairment on securities available for sale | 769 | 769 |
| Premises and equipment | 277 | 309 |
| Deferred directors' fees | 76 | 116 |
| Reserve for other real estate owned | 9 | 53 |
| Supplemental retirement plan | - | 42 |
| Unrealized loss on securites available for sale | 19 | 529 |
| Other | 137 | 66 |
| Total gross deferred tax assets | 9,802 | 11,271 |
| Deferred tax liabilities: | | |
| Deferred loan fees | (59) | (54) |
| Unrealized gain on securites available for sale | - | - |
| Other | (66) | (65) |
| Total gross deferred tax liabilities | (125) | (119) |
| Net deferred tax asset before valuation allowance | 9,677 | 11,152 |
| Valuation allowance | (9,677) | (11,152) |
| Net deferred tax asset | $ - | $ - |

Deferred tax assets are subject to periodic asset realization tests. Management believes the above valuation allowances are required at December 31, 2014 and 2013, due to the uncertainty of future taxable income necessary to fully realize the recorded net deferred tax asset.

It is the Corporation's policy to evaluate the realizability of deferred tax assets related to unrealized losses on available for sale debt securities separately from its other deferred tax assets when it has the intent and ability to hold the security to recovery (maturity, if necessary). Because the future taxable income implicit in the recovery of the basis of available for sale debt securities for financial reporting purposes will offset the deductions underlying the deferred tax asset, a valuation allowance would generally not be necessary, even in cases where a valuation allowance might be necessary related to the Corporation's other deferred tax assets.

At December 31, 2014, the Corporation had a net operating loss carryforward of approximately $21.7 million that expires beginning in 2028 if not previously utilized.

**11. Related Party Transactions**

Certain directors and executive officers, including their immediate families and companies in which they are principal owners, were loan customers of the Bank during 2014 and 2013. Deposits from such individuals and their related interests totaled approximately $1.3 million and $839,000 at

December 31, 2014 and December 31, 2013, respectively. Loans were made to such individuals in the ordinary course of business, in accordance with the Bank's normal lending policies, including the interest rate charged and collateralization, and do not represent more than a normal credit risk.

Loans to related parties are summarized below for the periods indicated:

| | December 31, | | | |
|---|---|---|---|---|
| | 2014 | | 2013 | |
| | (in thousands) | | | |
| Balance at beginning of year | $ | 180 | $ | 211 |
| New loans and related parties | | 45 | | 30 |
| Loan repayments | | (50) | | (61) |
| Balance at end of year | $ | 175 | $ | 180 |

**12. Leases**

The Bank has a noncancelable operating lease that provides for renewal options. Future minimum lease payments under the noncancelable lease as of December 31, 2014, are as follows:

Year ending December 31 (in thousands):

| | | |
|---|---|---|
| 2015 | $ | 79 |
| 2016 | | 69 |
| 2017 | | 57 |
| Total lease payments | $ | 205 |

Rental expense charged to operations in 2014, 2013 and 2012 amounted to approximately $85,000, $92,000 and $88,000, respectively, including amounts paid under short term, cancelable leases.

**13. Retirement Plan**

The Bank sponsors a defined contribution money purchase thrift plan covering all employees 21 years of age or older who have completed one year of service as defined in the plan agreement. Plan expenses recognized for discretionary employer contributions equal to 50% of an employee's contribution, limited to 3% of the employee's base compensation or the maximum amount permitted by the Internal Revenue Code. totaled $100,800, $75,000, and $0 in 2014, 2013 and 2012, respectively. No employer contributions were made to the plan during 2012 due to the Bank's financial condition.

**14. Shareholders' Equity**

On December 11, 2013, the Corporation closed a private placement offering to accredited investors and issued 17,510 shares of its Mandatorily Convertible Non-Cumulative Junior Participating Preferred Stock, Series B (the "Series B Preferred Shares"). The transaction generated gross proceeds to the Corporation of approximately $17.5 million and provided additional equity of approximately $16.5 million after related offering costs. At that time, shares of preferred stock were offered in the private placement instead of common stock because the Corporation did not have a sufficient number of authorized common shares to raise the desired amount of capital needed from the private placement.

On March 27, 2014, the Corporation completed the issuance and sale of new shares of common stock to shareholders of record on January 8, 2014 pursuant to a rights offering that was registered with the SEC. The Corporation issued a total of approximately 2.3 million common shares in the rights offering. The rights offering generated gross proceeds of approximately $1.6 million and provided additional equity to the Corporation of approximately $1.5 million, after offering costs.

At the Corporation's annual shareholder meeting held on May 22, 2014, shareholders voted to amend the Corporation's Restated Articles of Incorporation to increase the amount of authorized shares of common stock from 11 million to 40 million shares. The increase in authorized common shares triggered the mandatory conversion of the Series B Preferred Shares to common stock, pursuant to the Certificate of Designation of the Series B Shares, filed as Exhibit 3.1 to the Corporation's Current Report on Form 8-K filed on December 6, 2013. As a result, effective May 22, 2014, the 17,510 issued and outstanding shares of Series B Preferred Shares were converted into 25,014,256 shares of common stock at a rate of $0.70 per share of common stock.

Prior to the conversion into common stock, the terms of the Series B Preferred Shares were substantially identical to the terms applicable to the outstanding common stock with respect to dividends, distributions, voting, and all other matters.

Given the parity of the rights and limitations and the lack of preferences of the Series B Preferred Shares relative to the Corporation's common stock, the Series B Preferred Shares were, for all purposes, considered a common stock equivalent while they were outstanding.

Because the sale of the Series B Preferred Shares was not registered under federal securities laws pursuant to an exemption from such registration requirements, the related shares of common stock issued upon conversion of the Series B Preferred Shares are also not registered under federal securities laws.

**15. Net Income per Common Share**

Basic earnings per common share are based on the weighted average number of common shares and participating securities outstanding during the period. Diluted earnings per share are the same as basic earnings per share because any additional potential common shares issuable are included in the basic earnings per share calculation. On January 1, 2009, the Corporation adopted new guidance impacting ASC Topic 260, *Earnings Per Share*, related to determining whether instruments granted in a share-based payment transaction are participating securities. This guidance requires that unvested stock awards which contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid (referred to as "participating securities”), be included in the number of shares outstanding for both basic and diluted earnings per share calculations. Our unvested restricted stock under the Long-Term Incentive Plan (see Note 16) was considered a participating security. In the event of a net loss, the participating securities are excluded from the calculation of both basic and diluted earnings per share.

For purposes of determining basic and diluted net income per share for 2014 and 2013, while the Corporation’s 17,510 shares of Series B Preferred Shares were outstanding (issued on December 11, 2013 and converted into common stock on May 22, 2014), the shares were considered a common stock equivalent and converted to common shares at a rate reflecting a price per share of common stock of $0.70.

The following presents basic and diluted net income per share:

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| | (dollars in thousands, except per share amounts) | | |
| Weighted average basic and diluted common shares outstanding | 17,496,622 | 457,435 | 457,416 |
| Weighted average common stock equivalent preferred shares outstanding, as converted | 9,731,574 | 1,439,178 | - |
| Total weighted average basic and diluted shares outstanding | 27,228,196 | 1,896,613 | 457,416 |
| Net income available to shareholders | $ 3,050 | $ 2,974 | $ 329 |
| Basic and diluted net income per share | $ 0.11 | $ 1.57 | $ 0.72 |

### 16. Long Term Incentive Plan

Under the Long Term Incentive Plan (the “LTIP”), the Corporation had the authority to grant stock options and restricted stock as compensation to key employees. Such authority expired April 22, 2008. The Corporation did not award any stock options under the LTIP. The restricted shares granted under the LTIP had a five-year vesting period. The awards were recorded at fair value on the grant date and amortized into salary expense over the vesting period.

At December 31, 2012, all restricted shares granted under the LTIP had vested and there was no unrecognized compensation cost related to nonvested stock awards. The total fair value of the awards which vested during the year ended December 31, 2012 was $4,000.

### 17. Directors’ Stock Fee Plan

Each director of the Corporation who is not an officer or employee of any subsidiary of the Corporation is eligible to participate in the Compensation Plan for Nonemployee Directors. Nonemployee directors may elect to participate in this plan in lieu of all or a portion of fees payable to them as directors (“plan fees”). The plan fees consist of both a fixed and variable component. The fixed component equals the per-meeting fee paid for attendance at board meetings of both the Bank and the Corporation and any committees of their respective boards. The variable component of the plan is equal to the total fixed fees paid to a specific director for services performed during the preceding calendar year, multiplied by bonus amounts (expressed as the percentage of base compensation payable to officers of the Bank for the preceding calendar year under the Bank’s Incentive Bonus Plan). Expenses related to both fixed and variable fees are recorded as noninterest expense in the year incurred regardless of payment method.

Fixed directors’ fees may be paid in cash, to a current stock purchase account, to a deferred cash investment account, or to a deferred stock account according to each eligible director’s payment election. Current stock is issued quarterly based on the average fair market value of the stock for the preceding quarter. When deferred stock is elected, payments are credited to a deferred stock account for each participating director, and stock units are computed quarterly based on the average fair market value of the stock for the preceding quarter. When dividends are declared, they are computed based on the stock units available in each director’s deferred account, are reinvested in stock units and charged to expense. The units are converted to shares and issued to participating directors upon retirement. As of December 31, 2014, there were approximately 1,279 shares earned and available for distribution in the fixed-fee deferred stock accounts.

Variable directors’ fees may be paid to a current stock purchase account or to a deferred stock account. Current stock is issued based on the average fair market value of the stock for the preceding quarter. Deferred stock units are computed for directors electing to use a deferred stock account, and dividends are reinvested throughout the year as declared. As of December 31, 2014, there were 268 shares earned and available for distribution in the variable-fee deferred stock accounts.

Effective October 2012, all director fee compensation was suspended as a result of the financial condition and regulatory actions taken against the Corporation and the Bank. There were no compensation costs related to directors’ fees included in noninterest expense in 2014, 2013 or 2012.

### 18. Financial Instruments with Off-Balance-Sheet Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments are loan commitments to extend credit and letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amounts recognized in the consolidated balance sheets.

The Bank’s exposure to credit loss in the event of the nonperformance by the other party to the financial instruments for loan commitments to extend credit and letters of credit is represented by the contractual amounts of these instruments. The Bank uses the same credit policies in making credit commitments as it does for on-balance-sheet loans.

Financial instruments whose contract amounts represent credit risk are as follows:

| | December 31, 2014 | December 31, 2013 |
|---|---|---|
| | (in thousands) | |
| Commercial | $ 10,118 | $ 9,144 |
| Commercial real estate | 2,977 | 1,247 |
| Consumer real estate | 5,729 | 4,410 |
| Consumer and Other | 2,752 | 2,648 |
| Total credit commitments | $ 21,576 | $ 17,449 |

Loan 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. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable; inventory; property, plant, and equipment; residential real estate; and income-producing commercial properties. Market risk may arise if interest rates move adversely subsequent to the extension of commitments.

As of December 31, 2014 and 2013, the Bank had outstanding irrevocable standby letters of credit, which carry a maximum potential commitment of approximately $10,000, respectively. These letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The majority of these letters of credit are short term guarantees of one year or less, although some have maturities which extend as long as two years. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The Bank primarily holds real estate as collateral supporting those commitments for which collateral is deemed necessary. The extent of collateral held on those commitments at December 31, 2014 and 2013, where there is collateral, is in excess of the committed amount. A letter of credit is not recorded on the balance sheet until a customer fails to perform.

## 19. Capital

The Corporation and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can result in the initiation of certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct, material effect on the Corporation'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 assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Corporation's and the Bank's capital classification are also subject to qualitative judgments by regulators with regard to components, risk weightings, and other factors.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) required that the federal regulatory agencies adopt regulations defining five capital tiers for banks:

| | Total Risk-Based Capital Ratio | Tier 1 Risk-Based Capital Ratio | Leverage Ratio |
|---|---|---|---|
| Well capitalized | 10% or above | 6% or above | 5% or above |
| Adequately capitalized | 8% or above | 4% or above | 4% or above |
| Undercapitalized | Less than 8% | Less than 4% | Less than 4% |
| Significantly undercapitalized | Less than 6% | Less than 3% | Less than 3% |
| Critically undercapitalized | - | - | A ratio of tangible equity to total assets of 2% or less |

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and Tier 1 capital (as defined) to average assets (as defined). The Corporation's and the Bank's actual capital amounts and ratios are presented in the following table:

| As of December 31, 2014 | Actual Amount | Actual Ratio | Minimum for Capital Adequacy Purposes Amount | Minimum for Capital Adequacy Purposes Ratio | To be Well Capitalized Under Prompt Corrective Action Provision Amount | To be Well Capitalized Under Prompt Corrective Action Provision Ratio |
|---|---|---|---|---|---|---|
| | | | (dollars in thousands) | | | |
| Total Capital (to risk weighted assets) | | | | | | |
| Bank | $ 32,346 | 16.46% | $ 15,721 | 8.00% | $ 19,651 | 10.00% |
| FNBH Bancorp | 33,722 | 17.14% | 15,743 | 8.00% | N/A | N/A |
| Tier 1 Capital (to risk weighted assets) | | | | | | |
| Bank | 29,828 | 15.18% | 7,860 | 4.00% | 11,791 | 6.00% |
| FNBH Bancorp | 31,201 | 15.86% | 7,872 | 4.00% | N/A | N/A |
| Tier 1 Capital (to average assets) | | | | | | |
| Bank | 29,828 | 9.34% | 12,780 | 4.00% | 15,975 | 5.00% |
| FNBH Bancorp | 31,201 | 9.72% | 12,835 | 4.00% | N/A | N/A |
| **As of December 31, 2013** | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Total Capital (to risk weighted assets) | | | | | | |
| Bank | $ 28,593 | 14.57% | $ 18,705 | 8.00% | $ 19,631 | 10.00% |
| FNBH Bancorp | 29,204 | 14.86% | 15,724 | 8.00% | N/A | N/A |
| Tier 1 Capital (to risk weighted assets) | | | | | | |
| Bank | 26,052 | 13.27% | 7,852 | 4.00% | 11,779 | 6.00% |
| FNBH Bancorp | 26,660 | 13.56% | 7,862 | 4.00% | N/A | N/A |
| Tier 1 Capital (to average assets) | | | | | | |
| Bank | 26,052 | 8.67% | 12,021 | 4.00% | 15,026 | 5.00% |
| FNBH Bancorp | 26,660 | 8.82% | 12,097 | 4.00% | N/A | N/A |

The OCC has established the following minimum capital standards for national banks: a leverage requirement consisting of a minimum ratio of Tier 1 capital to total average assets of 3% for the most highly-rated banks, with minimum requirements of 4% to 5% for all others, and a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8%, at least one-half of which must be Tier 1 capital. Tier 1 capital consists principally of shareholders' equity. These capital requirements are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions. Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions.

As a result of a new Consent Order issued to the Bank by the OCC on October 31, 2013, the Bank continues to be subject to higher minimum capital ratios than those shown above. Specifically, the Consent Order requires the Bank to maintain a Total risk-based capital ratio of 11% and a Tier 1 leverage ratio of 8.5%. As shown above, the Bank's actual ratios were in compliance with the minimum ratios for a well-capitalized institution as of December 31, 2014 and 2013. However, because the Bank is subject to the Consent Order, it does not meet the regulatory determination of a well-capitalized institution. As such, the Bank is considered "adequately capitalized" for purposes of the OCC's Prompt Corrective Action ("PCA") enforcement powers. The Bank's capital category is determined solely for purposes of applying PCA; the capital category may not constitute an accurate representation of the Bank's overall financial condition or prospects.

On July 3, 2013, the FDIC Board of Directors approved the Regulatory Capital Interim Final Rule, implementing Basel III. This rule redefines Tier 1 capital as two components (Common Equity Tier 1 and Additional Tier 1), creates a new capital ratio (Common Equity Tier 1 Risk-based Capital Ratio) and implements a capital conservation buffer. It also revises the prompt corrective action thresholds and makes changes to risk weights for certain assets and off-balance-sheet exposures. Banks are required to transition into the new rule beginning on January 1, 2015, with some requirements of the new rule phased in over a longer period. Based on the Bank's capital levels and balance sheet composition at December 31, 2014, implementation of the new rule is not expected to have a material impact on the Bank's capital needs in the near term. However, the implementation of these standards could have an adverse impact on our financial position and future earnings due to, among other things, the increased minimum Tier 1 capital ratio requirements that will be implemented. The ultimate impact of these new rules on the Corporation and the Bank is still being reviewed.

The Corporation's ability to pay dividends is subject to various regulatory and state law requirements. Due to the Bank's regulatory condition, the Bank cannot pay a dividend to the Corporation without the prior approval of the OCC. The Corporation does not anticipate the Bank providing any dividends to the Corporation through at least 2015. The Corporation suspended, indefinitely, the payment of dividends to its shareholders in the third quarter of 2008 due to the Bank's inability to pay dividends to the holding company and insufficient cash at the holding company to pay the dividends. The Corporation does not anticipate resuming dividend payments to its shareholders in the near future.

In addition, as a result of the condition of the Corporation, the Corporation is required to receive prior approval from the Federal Reserve before the payment of dividends, issuance of debt, or redemption of stock. Additional restrictions imposed on the Corporation by the Federal Reserve relate to changes in the composition of the Board of Directors, the employment of senior executive officers or changes in the responsibilities of senior executive officers, and limitations on indemnification and severance payments.

**20. Contingent Liabilities**

The Corporation is subject to various claims and legal proceedings arising out of the normal course of business, none of which, in the opinion of management, based on the advice of legal counsel, is expected to have a material effect on the Corporation's financial position or results of operations.

## 21. Fair Value Measurements

ASC Topic 820 defines fair value and establishes a consistent framework for measuring fair value and expands disclosure requirements for fair value measurements. Fair values represent the estimated price that would be received from selling an asset or paid to transfer a liability, otherwise known as an "exit price". The three levels of inputs that may be used to measure fair value are as follows:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be derived from or corroborated by observable market data by correlation or other means.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The following is a description of the Corporation's valuation methodologies used to measure and disclose the fair values of its financial assets and liabilities on a recurring basis:

*Securities available for sale.* Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based on quoted prices, if available (Level 1). If quoted prices are not available, fair values are measured using independent pricing models such as matrix pricing models (Level 2). Matrix pricing is a mathematical technique widely used in the financial industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. Level 2 securities include U.S. government and agency securities, other U.S. government and agency mortgage-backed securities, municipal bonds and preferred stock securities. Level 3 securities include private collateralized mortgage obligations. The fair value measurement of our only Level 3 security, a non-investment grade, non-government agency CMO, and details regarding significant inputs and assumptions used in estimating its fair value, is detailed in Note 3, Securities.

Fair value of assets measured on a recurring basis:

| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| | | (in thousands) | | |
| **December 31, 2014** | | | | |
| Mortgage-backed/CMO | $ 107,137 | $ - | $ 105,942 | $ 1,195 |
| U.S. agency | 23,130 | - | 23,130 | - |
| Obligations of state and political subdivisions | 1,605 | - | 1,605 | - |
| Preferred stock | 303 | - | 303 | - |
| Total investment securities available for sale | $ 132,175 | $ - | $ 130,980 | $ 1,195 |
| **December 31, 2013** | | | | |
| Mortgage-backed/CMO | $ 65,169 | $ - | $ 63,715 | $ 1,454 |
| Obligations of state and political subdivisions | 1,794 | - | 1,794 | - |
| Preferred stock | 717 | - | 717 | - |
| Total investment securities available for sale | $ 67,680 | $ - | $ 66,226 | $ 1,454 |

The reconciliation of the beginning and ending balances of the asset classified by the Corporation within Level 3 of the valuation hierarchy is as follows:

| | 2014 Fair Value Measurement Using Significant Unobservable Inputs (Level 3) | 2013 Fair Value Measurement Using Significant Unobservable Inputs (Level 3) |
|---|---|---|
| Fair value of non-government agency CMO security, beginning of year(1) | $ 1,454 | $ 2,018 |
| Total gains (losses) realized/unrealized: | | |
| Included in earnings(2) | - | - |
| Included in other comprehensive income (2) | 66 | 79 |
| Purchases, issuances, and other settlements | (325) | (643) |
| Transfers into Level 3 | - | - |
| Fair value of non-government agency CMO security, end of year | $ 1,195 | $ 1,454 |
| Total amount of losses for the year included in earnings attributable to the change in unrealized losses relating to assets still held at end of year | $ - | $ - |

(1) Non-government agency CMO security classified as available for sale is valued using internal valuation models and pricing information from third parties.

(2) Realized gains (losses), including unrealized losses deemed other-than-temporary, are reported in noninterest income. Unrealized gains (losses) are reported in accumulated other comprehensive income (loss).

The following is a description of the Corporation's valuation methodologies used to measure and disclose the fair values of its financial assets and liabilities on a non-recurring basis:

*Loans*. The Corporation does not record loans at fair value on a recurring basis. However, from time to time, the Corporation records nonrecurring fair value adjustments to collateral dependent loans to reflect partial write-downs or specific reserves that are based on the observable market price or current appraised value of the collateral. These loans are reported in the nonrecurring table below at initial recognition of impairment and on an ongoing basis until recovery or charge off. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the impaired loan as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the impaired loan as nonrecurring Level 3.

*Other real estate owned.* Real estate acquired through foreclosure or deed-in-lieu is adjusted to fair value less costs to sell upon transfer of the loan to other real estate owned, usually based on an appraisal of the property. Subsequently, other real estate owned is carried at the lower of carrying value or fair value, less cost to sell. A valuation based on a current appraisal or by a broker's opinion is considered a Level 2 fair value. If management determines the fair value of the property is further impaired below the appraised value and there is no observable market price, the Corporation records the property as nonrecurring Level 3.

Fair value of assets on a non-recurring basis:

| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| | | (in thousands) | | |
| **December 31, 2014** | | | | |
| Impaired loans [1] | $ 10,885 | $ - | $ - | $ 10,885 |
| Other real estate owned | $ 1,174 | $ - | $ - | $ 1,174 |
| **December 31, 2013** | | | | |
| Impaired loans [1] | $ 16,667 | $ - | $ - | $ 16,667 |
| Other real estate owned | $ 480 | $ - | $ - | $ 480 |

(1) Represents carrying value and related write-downs and specific reserves pertaining to collateral dependent loans for which adjustments are based on the appraised value of the collateral or by other unobservable inputs.

## 22. Fair Value of Financial Instruments

Fair value disclosures require fair-value information about financial instruments for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair-value estimates cannot be substantiated by comparison to independent markets and, in many cases, cannot be realized in immediate settlement of the instrument.

Fair-value methods and assumptions for the Corporation's financial instruments are as follows:

***Cash and cash equivalents*** – The carrying amounts reported in the consolidated balance sheet for cash and short term investments reasonably approximate those assets' fair values.

***Investment securities*** – Fair values for investment securities are determined as discussed above.

***FHLBI and FRB stock*** – The carrying amounts reported in the consolidated balance sheet for FHLBI and FRB stock reasonably approximate those assets' fair values.

***Loans*** – For variable-rate loans that reprice frequently, fair values are generally based on carrying values, adjusted for credit risk. The fair value of fixed-rate loans is estimated by discounting future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

***Accrued interest income*** – The carrying amount of accrued interest income is a reasonable estimate of fair value.

***Deposit liabilities*** – The fair value of deposits with no stated maturity, such as demand deposit, NOW, savings, and money market accounts, is equal to the amount payable on demand. The fair value of certificates of deposit is estimated using rates currently offered for wholesale funds with similar remaining maturities.

***Other borrowings*** – The carrying amount of other borrowings is a reasonable estimate of fair value.

***Accrued interest payable*** – The carrying amount of accrued interest payable is a reasonable estimate of fair value.

***Off-balance-sheet instruments*** – The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of commitments to extend credit, including letters of credit, is estimated to approximate their aggregate book balance and is not considered material and therefore not included in the following table.

| | Level in Fair Value Hierarchy | December 31, 2014 Carrying Value | December 31, 2014 Fair Value | December 31, 2013 Carrying Value | December 31, 2013 Fair Value |
|---|---|---|---|---|---|
| | | (in thousands) | | | |
| Financial assets: | | | | | |
| Cash and cash equivalents | Level 1 | $ 26,138 | $ 26,138 | $ 77,827 | $ 77,827 |
| Short term investments | Level 2 | 198 | 198 | 198 | 198 |
| Investment and mortgage-backed securities | Level 2 | 130,980 | 130,980 | 66,226 | 66,226 |
| Non-government agency CMO security | Level 3 | 1,195 | 1,195 | 1,454 | 1,454 |
| FHLBI and FRB stock | Level 2 | 1,140 | 1,140 | 779 | 779 |
| Loans, net | Level 3 | 152,937 | 153,284 | 155,901 | 156,793 |
| Accrued interest income | Level 2 | 683 | 683 | 573 | 573 |
| Financial liabilities: | | | | | |
| Deposits | Level 2 | $ 290,379 | $ 284,225 | $ 285,313 | $ 280,549 |
| Other borrowings | Level 2 | - | - | 16 | 16 |
| Accrued interest expense | Level 2 | 59 | 59 | 83 | 83 |

***Limitations***

Fair-value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discounts that could result from offering for sale at one time the Corporation's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Corporation's financial instruments, fair-value estimates are based on judgments regarding future loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment, and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

### 23. Dividend Restrictions

On a parent company-only basis, the Corporation's only source of funds is dividends paid by the Bank. The ability of the Bank to pay dividends is subject to limitations under various laws and regulations and to prudent and sound banking principles. The Bank may not declare a dividend without the approval of the Office of the Comptroller of the Currency (OCC) unless the total of its net profits for the year combined with its retained profits of the two preceding years exceed the total dividends in a calendar year. Under these provisions and based upon the Bank's current regulatory condition, there is no ability to pay dividends at December 31, 2014, without the prior approval of the OCC.

### 24. Condensed Financial Information – Parent Company Only

The condensed balance sheets at December 31, 2014 and 2013, and the condensed statements of operations and cash flows for the years ended December 31, 2014, 2013 and 2012, of FNBH Bancorp, Inc. follow:

| Condensed Balance Sheets | December 31 2014 | December 31 2013 |
|---|---|---|
| | (in thousands) | |
| Assets: | | |
| Cash | $ 1,368 | $ 1,036 |
| Investment in subsidiaries: | | |
| First National Bank in Howell | 29,771 | 24,498 |
| H.B. Realty Co. | 1 | 1 |
| Other assets | 5 | 30 |
| Total assets | $ 31,145 | $ 25,565 |
| Liabilities and Shareholders' Equity: | | |
| Other borrowings | $ - | $ 16 |
| Other liabilities | 1 | 443 |
| Shareholders' equity | 31,144 | 25,106 |
| Total liabilities and shareholders' equity | $ 31,145 | $ 25,565 |

| Condensed Statements of Operations | Year ended December 31 2014 | 2013 | 2012 |
|---|---|---|---|
| | | (in thousands) | |
| Operating income: | | | |
| Dividends from subsidiaries | $ - | $ - | $ - |
| Miscellaneous income | - | 4 | - |
| Total operating income | - | 4 | - |
| Operating expenses: | | | |
| Interest expense-other borrowings | - | - | - |
| Administrative and other expenses | 134 | 55 | 168 |
| Total operating expenses | 134 | 55 | 168 |
| Loss before equity in undistributed net loss of subsidiaries | (134) | (51) | (168) |
| Equity in undistributed net income of subsidiaries and dividends declared from subsidiaries | 3,184 | 3,025 | 497 |
| Net income | $ 3,050 | $ 2,974 | $ 329 |
| Comprehensive income | $ 4,548 | $ 1,217 | $ 755 |

| Condensed Statements of Cash Flows | Year ended December 31 | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| | | (in thousands) | |
| Cash flows from operating activities: | | | |
| Net income | $ 3,050 | $ 2,974 | $ 329 |
| Adjustments to reconcile net income to net cash used in operating activies: | | | |
| Earned portion of long term incentive plan | - | - | 4 |
| (Increase) decrease in other assets | 25 | (29) | (1) |
| Increase (decrease) in other liabilities | (442) | 216 | 38 |
| Equity in undistributed net income of subsidiaries and dividends declared from subsidiaries | (3,184) | (3,025) | (497) |
| Net cash from operating activities | (551) | 136 | (127) |
| Cash flows from investing activities | (591) | (15,488) | 35 |
| Cash flows from financing activities: | | | |
| Common stock issued | 1,490 | - | - |
| Preferred stock issued | - | 16,520 | - |
| (Repayment of) proceeds from other borrowings | (16) | (132) | 88 |
| Net cash from financing activities | 1,474 | 16,388 | 88 |
| Net increase (decrease) in cash | 332 | 1,036 | (4) |
| Cash at beginning of year | 1,036 | - | 4 |
| Cash at end of year | $ 1,368 | $ 1,036 | $ - |

## 25. Quarterly Financial Data - Unaudited

The following table presents summarized quarterly data for each of the two years ended December 31:

| | March 31 | June 30 | September 30 | December 31 |
|---|---|---|---|---|
| **Quarters ended in 2014** | | (in thousands) | | |
| Selected operations data: | | | | |
| Interest and dividend income | $ 2,493 | $ 2,670 | $ 2,589 | $ 2,487 |
| Net interest income | 2,285 | 2,493 | 2,421 | 2,337 |
| Provision for loan losses | - | - | (2,500) | - |
| Income before federal income taxes | 54 | 106 | 2,538 | 372 |
| Net income | 49 | 106 | 2,538 | 357 |
| Basic and diluted net income per share | $ - | $ - | $ 0.09 | $ 0.01 |
| Cash dividends per share | $ - | $ - | $ - | $ - |
| | | | | |
| **Quarters ended in 2013** | | | | |
| Selected operations data: | | | | |
| Interest and dividend income | $ 2,746 | $ 2,574 | $ 2,621 | $ 2,514 |
| Net interest income | 2,511 | 2,343 | 2,389 | 2,287 |
| Provision for loan losses | (2,250) | - | - | - |
| Income (loss) before federal income taxes | 2,448 | 361 | 237 | 32 |
| Net income (loss) | 2,490 | 215 | 237 | 32 |
| Basic and diluted net income (loss) per share (1) | $ 5.44 | $ 0.47 | $ 0.52 | $ 0.01 |
| Cash dividends per share | $ - | $ - | $ - | $ - |

(1) Per share data for the quarterly periods ended December 31, 2013, March 31, 2014 and June 30, 2014 includes 17,510 shares of Series B Preferred Shares issued on December 11, 2013 converted to common shares at a rate reflecting a price per common share of $0.70.

## 26. New Accounting Standards

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists, Income Taxes (Topic 740)*. This ASU amends existing guidance so that an unrecognized tax benefit, or a portion thereof, be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. However, to the extent that a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date to settle any additional income taxes that would result from disallowance of a tax position, or the tax law does not require the entity to use, and the entity does not intend to use the deferred tax asset for such purpose, then the unrecognized tax benefit should be presented as a liability. This ASU became effective for the Corporation on January 1, 2014, and did not have a material impact on the Corporation’s consolidated operating results or financial condition.

FASB issued Accounting Standards Update (ASU) No. 2014-04, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40) – Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* The amendments are intended to clarify when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate recognized. The amendments clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either: *(a)* the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure; or *(b)* the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additional disclosures are required. The amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2014. The impact of adoption of this ASU by the Corporation is not expected to be material.

FASB issued ASU 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 205): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.* The amendments in the Update change the requirements for reporting discontinued operations. A discontinued operation may include a component of an entity or a group of components of an entity, or a business or nonprofit activity. A disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operation if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. The amendments in this Update require an entity to present for each comparative period, the assets and liabilities of a disposal group that included a discontinued operation separately in the asset and liability sections, respectively, of the statement of financial position. This Update also requires additional disclosures about discontinued operations including pretax profit or loss, and any ongoing involvement with the discontinued operation. The amendments are effective for the annual periods and interim periods within those annual periods beginning December 15, 2014. The impact of adoption of this ASU by the Corporation is not expected to be material.

FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606).* The amendments in this Update create a new topic in the *FASB Accounting Standards Codification®* (ASC or Codification), Topic 606. In addition to superseding and replacing nearly all existing U.S. GAAP revenue recognition guidance, including industry-specific guidance, ASC 606 establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, ASU 2014-09 adds a new Subtopic to the Codification, ASC 340-40, *Other Assets and Deferred Costs: Contracts with Customers*, to provide guidance on costs related to obtaining a contract with a customer and costs incurred in fulfilling a contract with a customer that are not in the scope of another ASC Topic. The new guidance does not apply to certain contracts within the scope of other ASC Topics, such as lease contracts, insurance contracts, financing arrangements, financial instruments, guarantee other than product or service warranties, and nonmonetary exchanges between entities in the same line of business to facilitate sales to customers. The amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2016. The impact of adoption of this ASU by the Corporation is not expected to be material.

FASB issued ASU 2014-14, *Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure.* This update requires creditors to reclassify loans that are within the scope of the ASU to "other receivables" upon foreclosure, rather than reclassifying them to other real estate owned. The separate other receivable recorded upon foreclosure is to be measured based on the amount of the loan balance (principal and interest) the creditor expects to recover from the guarantor. The new guidance is effective for the public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The impact of the adoption of the ASU by the Corporation is not expected to be material.

**Recent Legislative Developments**

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law. Uncertainty remains as to the ultimate impact of this law, which could have a material adverse impact either on the financial services industry as a whole or on the Corporation's and Bank's business, results of operations and financial condition. This federal law contains a number of provisions that could affect the Corporation and the Bank. For example, the law:

- Made national banks (such as the Bank) and their subsidiaries subject to a number of state laws that were previously preempted by federal laws;
- Imposed new restrictions on how mortgage brokers and loan originators may be compensated;
- Established a new federal consumer protection agency, the Consumer Financial Protection Bureau (CFPB), that has broad authority to develop and implement rules regarding most consumer financial products;
- Created new rules affecting corporate governance and executive compensation at all publicly traded companies (such as the Corporation);
- Broadened the base for FDIC insurance assessments and made other changes to federal deposit insurance, including permanently increasing FDIC deposit insurance coverage to $250,000; and
- Allows depository institutions to pay interest on business checking accounts

The Dodd-Frank Act and regulations being issued as a result of the Dodd-Frank Act have had, and we expect will continue to have, a significant impact on the banking industry, including our organization.

On April 5, 2012, the Jumpstart Our Business Startups Act (JOBS Act) was signed into law. The JOBS Act is intended to stimulate economic growth by helping smaller and emerging growth companies access the U.S. capital markets. It amends various provisions of, and adds new sections to, the Securities Act of 1933 and the Securities Exchange Act of 1934, as well as provisions of the Sarbanes-Oxley Act of 2002. The SEC has been directed to issue rules implementing certain JOBS Act amendments. For bank holding companies, the JOBS Act increases the statutory threshold for deregistration under the Securities Exchange Act of 1934 from 300 shareholders to 1,200 shareholders of record.

In December 2010, the Basel Committee on Banking Supervision, an international forum for cooperation on banking supervisory matters, announced the "Basel III" capital rules, which set new capital requirements for banking organizations. In July 2013, the Federal Reserve and the OCC each approved final rules that establish an integrated regulatory capital framework implementing the Basel III regulatory capital reforms in the U.S. These new rules impose higher capital requirements and more restrictive leverage and liquidity ratios than those currently in place. The new capital requirements become effective for banks beginning January 1, 2015 and include additional components that will be phased in over a four-year period beginning in 2016. Based on the Bank's capital levels and balance sheet composition at December 31, 2014, implementation of the new rule is not expected to have a material impact on the Bank's capital needs in the near term. However, the implementation of these standards could have an adverse impact on our financial position and future earnings due to, among other things, the increased minimum Tier 1 capital ratio requirements that will be implemented. The ultimate impact of these new rules on the Corporation and the Bank is still being reviewed.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None.

**Item 9A. Controls and Procedures.**

1. Evaluation of Disclosure Controls and Procedures. As of the end of the period covered by this report, the Corporation's Chief Executive Officer and Chief Financial Officer, with the participation of management, carried out an evaluation of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based on that evaluation the Chief Executive Officer and Chief Financial Officer have concluded that the Corporation's disclosure controls were effective at December 31, 2014 to ensure that information required to be disclosed in its reports that the Corporation files or submits to the Securities and Exchange Commission under the Exchange Act is recorded, processed, summarized and reported on a timely basis.

2. Management's Annual Report on Internal Control Over Financial Reporting. The Corporation's management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Exchange Act Rules 13a-15(f) and 15d-15(f), for the Corporation. The Corporation's internal control system was designed to provide reasonable assurance to the Corporation regarding the preparation and fair presentation of published financial statements. The Corporation's management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control – Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Based on this assessment and those criteria, the Corporation's management concluded that, as of December 31, 2014, the Corporation's internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Corporation have been detected.

During the fourth quarter ended December 31, 2014, there were no changes in the Corporation's Internal Control Over Financial Reporting that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

This report by management over the Corporation's internal control over financial reporting was not subject to attestation by the Corporation's independent registered public accounting firm pursuant to applicable SEC rules. As a result, no such attestation report has been included in this report.

| | |
|---|---|
| /s/ Ronald L. Long | /s/ Mark J. Huber |
| Ronald L. Long<br>President & Chief Executive Officer | Mark J. Huber<br>Chief Financial Officer |

**Item 9B. Other Information.**

None

## PART III

**Item 10. Directors, Executive Officers and Corporate Governance.**

**Directors**

The information set forth under the captions "Information About Directors and Director Nominees" and "Section 16(a) Beneficial Ownership Reporting Compliance" in our definitive proxy statement, to be filed with the SEC relating to the 2015 Annual Meeting of Shareholders, is incorporated herein by reference.

**Executive Officers**

The information called for by this item is contained in Part I of this Form 10-K Report.

We have adopted a Code of Ethics for our chief executive officer and senior financial officers. A copy of our Code of Ethics is available upon request by writing to the Corporation's Chief Financial Officer at 101 East Grand River, Howell, Michigan 48843 and is available on our website at www.fnbh.com.

**Corporate Governance**

The information with respect to Corporate Governance set forth under the caption "Corporate Governance and Board Matters" in our definitive proxy statement, to be filed with the SEC relating to the 2015 Annual Meeting of Shareholders, is incorporated herein by reference.

**Item 11. Executive Compensation.**

The information set forth under the captions "Executive Compensation" and "Director Compensation" in our definitive proxy statement, to be filed with the SEC relating to the 2015 Annual Meeting of Shareholders, is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters.**

The information set forth under the caption "Ownership of Common Stock" in the Corporation's definitive proxy statement, to be filed with the SEC relating to the 2015 Annual Meeting of Shareholders, is incorporated herein by reference.

The following information is provided as of December 31, 2014:

| Plan Category | Number of securities to be issued upon exercise of outstanding options, warrants, and rights | Weighted – average exercise price of outstanding options, warrants, and rights | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|---|---|---|---|
| | (a) | (b) | (c) |
| Equity compensation plans approved by shareholders | 0 | 0 | 2,293 [(1)(2)] |
| Equity compensation plans not approved by shareholders | None | None | None |

(1) Available under the Compensation Plan for Nonemployee Directors
(2) Amounts are adjusted to reflect the 1-for-7 reverse stock split effective October 3, 2011.

**Item 13. Certain Relationships and Related Transactions, and Director Independence.**

The information set forth under the captions "Related Party Transactions" and "Corporate Governance and Board Matters" in our definitive proxy statement, to be filed with the SEC relating to the 2015 Annual Meeting of Shareholders, is incorporated herein by reference.

**Item 14. Principal Accountant Fees and Services**.

The information set forth under the caption "Disclosure of Fees Paid to Our Independent Registered Public Accounting Firm" in our definitive proxy statement, to be filed with the SEC relating to the 2015 Annual Meeting of Shareholders, is incorporated herein by reference.

## PART IV

**Item 15. Exhibits and Financial Statement Schedules.**

(a) Documents filed as part of this report on Form 10-K.

1. Financial Statements

   The financial statements are set forth under Item 8 of this report on 10-K.

2. Financial Statement Schedules

   Not applicable.

3. Exhibits (Numbered in accordance with Item 601 of Regulation S-K)

   The Exhibit Index is located on the final page of this report on Form 10-K.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, dated March 31, 2015.

**FNBH BANCORP, INC.**

| | |
|---|---|
| */s/* Ronald L. Long | Ronald L. Long, President and Chief Executive Officer<br>(Principal Executive Officer) |
| */s/* Mark J. Huber | Mark J. Huber, Chief Financial Officer<br>(Principal Financial and Accounting Officer) |

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated. Each director of the Registrant, whose signature appears below, hereby appoints Ronald L. Long and Mark J. Huber, and each of them severally, as his or her attorney-in-fact, to sign in his or her name and on his or her behalf, as a director of the Registrant, and to file with the SEC any and all Amendments to this Report on Form 10-K.

| | Signature | Date |
|---|---|---|
| Philip C. Utter, Chairman of the Board | */s/* Philip C. Utter | March 31, 2015 |
| Stanley B. Dickson, Jr., Vice Chairman of the Board | */s/* Stanley B. Dickson, Jr. | March 31, 2015 |
| Ronald L. Long, Director, President, and Chief Executive Officer (Principal Executive Officer) | */s/* Ronald L. Long | March 31, 2015 |
| Timothy H. Corrigan, Director | */s/* Timothy H. Corrigan | March 31, 2015 |
| R. Michael Yost, Director | */s/* R. Michael Yost | March 31, 2015 |
| William R. Dickson, Director | */s/* William R. Dickson | March 31, 2015 |
| Mark J. Huber, Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer) | */s/* Mark J. Huber | March 31, 2015 |

**EXHIBIT INDEX**

The following exhibits are filed herewith, indexed according to the applicable assigned number:

| Exhibit Number | |
|---|---|
| 10.1 | Retirement Agreement between FNBH Bancorp, Inc.; First National Bank in Howell; and Daniel Wollschlager dated March 17, 2015. |
| (23) | Consent of BDO USA, LLP |
| (24) | Power of Attorney (included in signature section) |
| (31.1) | Certificate of the Chief Executive Officer of FNBH Bancorp, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| (31.2) | Certificate of the Chief Financial Officer of FNBH Bancorp, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| (32.1) | Certificate of the Chief Executive Officer of FNBH Bancorp, Inc. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350). |
| (32.2) | Certificate of the Chief Financial Officer of FNBH Bancorp, Inc. pursuant to Section 906 of the Sarbanes Oxley Act of 2002 (18 U.S.C. 1350). |
| | 101.INS Instance Document |
| | 101.SCH XBRL Taxonomy Extension Schema Document |
| | 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document |
| | 101.DEF XBRL Taxonomy Extension Definition Linkbase Document |
| | 101.LAB XBRL Taxonomy Extension Label Linkbase Document |
| | 101.PREXBRL Taxonomy Extension Presentation Linkbase Document |

The following exhibits, indexed according to the applicable assigned number, were previously filed by the Registrant and are incorporated by reference in this Form 10-K Annual Report.

| Exhibit Number | | Exhibit | Original Filing Form and Date |
|---|---|---|---|
| (3.1) | | Articles of Incorporation (as restated and amended to date), including (i) the Certificate of Designation of Junior Participating Preferred Stock, Series A, filed with the State of Michigan on October 14, 2011, and (ii) the Certificate of Designation of Mandatorily Convertible Non-Cumulative Junior Participating Preferred Stock, Series B, filed with the State of Michigan on December 2, 2013 | Exhibit 3.1 to Form 10-Q filed with the SEC on November 14, 2014 |
| (3.2) | | Bylaws (as restated and amended to date) | Exhibit 3.2 to Form S-1 filed with the SEC on December 30, 2013 |
| (4.1) | | Tax Benefits Preservation Plan, dated October 14, 2011, by and between FNBH Bancorp, Inc. and American Stock Transfer & Trust Company, LLC | Exhibit 4.1 to Form 8-A filed with the SEC on October 14, 2011 |
| (10.2) | | Securities Purchase Agreement, dated June 12, 2013, by and between FNBH Bancorp, Inc. and Stanley B. Dickson, Jr. | Exhibit 10.1 to Form 10-Q filed with the SEC on August 14, 2013 |
| (10.3) | | Form of Subscription Agreement entered into between FNBH Bancorp, Inc. and various accredited investors, effective August 7, 2013 or effective December 11, 2013 | Exhibit 10.2 to Form 10-Q filed with the SEC on August 14, 2013 |
| (10.4) | * | FNBH Bancorp, Inc. Second Amended and Restated Compensation Plan for Nonemployee Directors, as amended and restated through January 1, 2009 | Exhibit 10.3 to Form S-1 filed with the SEC on December 30, 2013 |
| (10.5) | | Stipulation and Consent to the Issuance of a Consent Order by and between First National Bank in Howell and the Office of the Comptroller of the Currency, dated October | Exhibit 10.1 to Form 8-K filed with the SEC on November 6, 2013 |

| | | |
|---|---|---|
| | 31, 2013 | |
| (10.6) | Form of Indemnification Agreement entered into by and between FNBH Bancorp, Inc. and each of its directors, effective November 12, 2014 | Exhibit 10.1 to Form 10-Q filed with the SEC on November 14, 2014 |
| (10.7) | Form of Indemnification Agreement entered into by and between First National Bank in Howell and each of its directors, effective November 12, 2014 | Exhibit 10.2 to Form 10-Q filed with the SEC on November 14, 2014 |
| (21) | Subsidiaries of the Registrant | Exhibit 21.1 to Form S-1 filed with the SEC on December 30, 2013 |

*Represents a compensation plan

**EXHIBIT 10.1**

RETIREMENT AGREEMENT

This Retirement Agreement ("Agreement") is made by and between Daniel Wollschlager ("Mr. Wollschlager"), First National Bank in Howell and FNBH Bancorp ("the Bank").

WHEREAS, Mr. Wollschlager will be retiring from employment with the Bank.

WHEREAS, the Bank and Mr. Wollschlager desire that Mr. Wollschlager's services continue for a period of time prior to the end of the employment relationship in order to promote a smooth transition;

WHEREAS, the parties desire to end their relationship in an amicable manner;

NOW, THEREFORE, the parties agree as follows:

l. Retention Period. Mr. Wollschlager will remain employed with the Bank until May 4, 2015 ("Retention Period"). Mr. Wollschlager's duties during the Retention Period will be as follows. Until March 31, 2015, Mr. Wollschlager will continue to report to the Bank and will perform all of the usual duties of his role of Senior Vice President, Chief Credit Officer, and will not utilize any vacation time. Beginning April 1, 2015 and for the remainder of the Retention Period, Mr. Wollschlager will utilize his accrued eight (8) days of available vacation time under the Bank's policies, will take such additional personal days (13 hours accrued during 2015 and 48 hours carried over from 2014 yearend) and paid vacation time as may be approved by Ron Long, and will perform duties as requested by the Bank. Mr. Wollschlager will perform such duties remotely except as specifically requested by the Bank and agreed by Mr. Wollschlager.

2. Retirement from Employment. Effective at the close of business on May 4, 2015 (the "Separation Date"), Mr. Wollschlager shall retire and his employment relationship with the Bank shall be terminated. Following the Separation Date, Mr. Wollschlager will not accrue any benefits or vest in any benefits under any Company policy, plan, or procedure for any purpose except as specifically provided in this Agreement. Mr. Wollschlager shall be entitled to elect continued health coverage, if applicable, pursuant to COBRA, and shall be entitled to any vested benefits and rights Mr. Wollschlager has under the Bank's qualified retirement, savings, or stock option plans. Under terms of the existing 401k plan, Mr. Wollschlager will be eligible for an employer match for his 401k contributions made during the 2015 plan year provided that the Board elects to approve match of 2015 employee 401k contributions.

3. Separation Benefits. The Bank will pay Mr. Wollschlager the following separation benefits, provided Mr. Wollschlager remains employed through the Separation Date, enters into and complies with this Agreement, and enters into a subsequent complete release of claims in a form substantially similar to that set forth at Exhibit A:

a. Salary Continuation. The Bank will continue Mr. Wollschlager's regular salary through the Retention Period as outlined in Section 1 above.

b. Executive Management Success Reward. The Bank will pay Mr. Wollschlager the $24,555 Executive Management Success Reward as identified in the 2014 Employee Compensation Program on the same basis as if he were actively employed. The Executive Management Success Reward will be paid on the earliest date permitted by the Department of Treasury, Office of the Comptroller of the Currency, concurrent with payment of the Executive Management Success Reward to other executive management personnel.

Mr. Wollschlager acknowledges that the Separation Benefits constitute good and valuable consideration, and that they satisfy and exceed any compensation or benefits to which Mr. Wollschlager is entitled by law.

4. Release. Mr. Wollschlager forever releases the Bank and its parents, affiliates, subsidiaries, officers and directors, employees, agents, and consultants from any and all complaints, charges or causes of actions, obligations, demands, liabilities, and/or claims whatsoever that Mr. Wollschlager ever had, now has, or might have, known or unknown, as of the date Mr. Wollschlager signs this Agreement. Except as prohibited by law, this release includes, but is not limited to, any claims for compensation and/or fringe benefits, claims relating to or arising from wrongful termination, employment discrimination or retaliation under state or federal law including, without limitation, Title VII of the Civil Rights Act, the Americans with Disabilities Act, the Family and Medical Leave Act, the Age Discrimination in Employment Act, the Elliott-Larsen Civil Rights Act, the Michigan Persons with Disabilities Act, or any other federal, state, or local law, regulation or ordinance, or public policy, contract, or tort law having any bearing whatsoever on the terms and conditions of Mr. Wollschlager's employment with the Bank or Mr.

Wollschlager's separation from employment, and to any complaints or charges brought with state or federal agencies under any state, federal, or local law regulating wages, hours, notice, or any other term or condition of employment.

Mr. Wollschlager specifically understands, acknowledges, and agrees that through this Agreement Mr. Wollschlager is waiving any and all claims Mr. Wollschlager may have under the Age Discrimination in Employment Act ("ADEA") and the Older Workers' Benefit Protection Act ("OWBPA").

5. Covenant Not to Sue or Institute Charges. To the fullest extent permitted by law, Mr. Wollschlager will not institute or initiate any action, administrative action, grievance, or other suit against the Bank or any other person or entity released in Paragraph 4, with any state, federal, or local court or agency or other tribunal related to claims released through this Agreement. Nothing in this provision or Agreement shall preclude Mr. Wollschlager from seeking a judicial determination regarding the validity of this waiver with respect to any claim under the ADEA. Further, this provision shall not affect or interfere with Mr. Wollschlager's right to file a charge with the Equal Employment Opportunity Commission or participate, cooperate, or assist in an investigation or proceeding conducted by any federal or state enforcement agency; but Mr. Wollschlager knowingly and voluntarily waives the right to any form of recovery or compensation in any such action arising from or related to Mr. Wollschlager's employment with the Bank.

6. Reasonable Cooperation. Mr. Wollschlager will provide reasonable cooperation to the Bank related to any business or other issues that arose during Mr. Wollschlager's employment at the Bank for which Mr. Wollschlager had responsibility or involvement.

7. Property Return. Mr. Wollschlager will return, on or before the Separation Date, all Bank property, including, but not limited to: keys/access cards, charge card(s), documents, files, records, and/or any other non-public or confidential Company property under Mr. Wollschlager's control or in Mr. Wollschlager's possession that is nonpublic or confidential.

8. Non-Disparagement. Mr. Wollschlager will not in any way disparage, criticize, condemn, or impugn the reputation or character of the Bank or any other entity/individual released in Paragraph 4.

9. Nondisclosure of Confidential Information, Restrictive Covenants.

a. *Non-Disclosure.* Mr. Wollschlager acknowledges that, through employment with the Bank, Mr. Wollschlager obtained confidential and proprietary information concerning the Bank's (including its subsidiaries and affiliates) products, its research and development information, plans and activities, its methods, means, practices, procedures, processes, its formulas and know-how relating to design or production, its intellectual property and related legal affairs, and other business or affairs ("Confidential Information"). Mr. Wollschlager acknowledges that all such Confidential Information is the property of the Bank. Therefore, Mr. Wollschlager will not at any time disclose to any third party or use for Mr. Wollschlager's own purposes any Confidential Information without the prior written consent of the Bank, unless and to the extent that the aforementioned matters become generally known to and available for use by the public other than as a result of Mr. Wollschlager's acts or omissions to act.

b. *Non-Solicitation.* For the duration of Mr. Wollschlager's employment and for a 12 month period following the Separation Date, Mr. Wollschlager will not, directly or indirectly, on behalf of himself or any third party:

i. Employ or solicit for employment, or engage or hire any Employee (defined as any individual who is at the time of the prohibited contact, or was at any time during the twelve (12) month period prior to the Separation Date, an employee of the Bank or any of its affiliates);

ii. Solicit any Clients (defined as any person who is at the time of the prohibited contact or was at any time within the twelve (12) months preceding the Separation Date, a customer of the Bank or any affiliate of the Bank) for the provision of services similar to those offered by the Bank; or

iii. Request or encourage any Employee or Client of the Bank to discontinue, reduce, or modify his/her relationship with the Bank.

10. Agreement as Defense. This Agreement may be pled as a complete defense to any claim or entitlement arising out of the matters released in Paragraph 4 above, which Mr. Wollschlager may subsequently assert in any suit or claim against the Bank or any other person or entity released pursuant to Paragraph 4.

11. Entire Agreement. This Agreement, including any prior agreement provisions incorporated by reference in Paragraph 10, contains the entire agreement and understanding of the parties and supersedes all prior discussions, agreements, understandings, and practices of every nature between them related to the topics addressed herein, including the claims released in Paragraph 4. This Agreement may not be changed or modified, except through an agreement in writing signed by the Bank and Mr. Wollschlager.

12. Successors and Assigns. This Agreement shall be binding on and inure to the benefit of the Bank and its affiliates, successors, and assigns. This Agreement shall be binding on and inure to the benefit of Mr. Wollschlager and Mr. Wollschlager's personal representatives and heirs. Mr. Wollschlager may not assign this Agreement without the prior written consent of the Bank, provided, however, the Bank may assign this Agreement to any person or entity acquiring all or substantially all of its business (whether by sale of stock, sale of assets, merger, consolidation, or otherwise) but such assignments shall not relieve the Bank of its liabilities hereunder.

13. Waiver. The waiver of a breach of any term or provision of this Agreement shall not operate as or be construed to be a waiver of any other or subsequent breach of this Agreement.

14. Governing Law. This Agreement shall be construed and enforced in accordance with the laws of the State of Michigan.

15. Invalidity. In case any one or more of the provisions contained in this Agreement shall, for any reason, be held to be invalid, illegal, or unenforceable in any respect, such invalidity, illegality, or unenforceability shall not affect the validity of any other provision of this Agreement and such provision shall be deemed modified to the extent necessary to be made enforceable.

16. Voluntary Execution. Mr. Wollschlager acknowledges and warrants that no promise or inducement has been offered for this Agreement other than as set forth above, and that this Agreement is executed without reliance upon any other Bank statement or representation.

17. Consideration Period, ADEA Revocation. Mr. Wollschlager warrants that he is legally competent to execute this Agreement, and that he has had adequate time and opportunity to deliberate over the Agreement's terms. Mr. Wollschlager is advised by the Bank to consult with an attorney prior to signing this Agreement and prior to executing the subsequent release referenced in Paragraph 2. Mr. Wollschlager has been provided at least twenty-one (21) days to consider the Agreement prior to signing. Mr. Wollschlager has seven (7) days to revoke this Agreement once it is signed. To revoke this Agreement, Mr. Wollschlager must send a written letter revoking the Agreement within the seven (7) days provided to:

First National Bank in Howell
Attn: Ronald Long
101 E. Grand River
PO Box 800
Howell, MI 48844-0800

IN WITNESS WHEREOF, the parties have executed and delivered this Agreement as of the date and year below.

FNBH BANCORP (and the First National Bank in Howell)

Date: March 17, 2015 By: /s/Ronald L. Long

Its: CEO

Date: March 17, 2015 /s/Daniel Wollschlager

**EXHIBIT A**

In further consideration of FNBH Bancorp's (the "Bank") agreement to provide me separation benefits as set forth in my March 17, 2015 Confidential Separation Agreement and Release, I forever release the Bank and its affiliates, subsidiaries, officers and directors, employees, agents, and consultants from any and all complaints, charges or causes of actions, obligations, demands, liabilities, and/or claims whatsoever that I ever had, now have, or might have, known or unknown, arising out of my employment with the Bank, or the decision to separate that employment. Except as prohibited by law, this release includes, but is not limited to, any claims for compensation and/or fringe benefits, claims relating to or arising from wrongful termination, employment discrimination or retaliation under state or federal law including, without limitation, Title VII of the Civil Rights Act, the Americans with Disabilities Act, the Family and Medical Leave Act, the Age Discrimination in Employment Act, the Elliott-Larsen Civil Rights Act, the Michigan Persons with Disabilities Act, or any other federal, state, or local law, regulation or ordinance, or public policy, contract, or tort law having any bearing whatsoever on the terms and conditions of my employment with the Bank, and to any complaints or charges brought with state or federal agencies under any state, federal, or local law regulating wages, hours, notice, or any other term or condition of employment.

I specifically understand, acknowledge, and agree that through this release I am waiving any and all claims I may have under the Age Discrimination in Employment Act ("ADEA") and the Older Workers' Benefit Protection Act ("OWBPA").

I am legally competent to execute this release, and have had adequate time and opportunity to deliberate over its terms. I have been advised in writing to consult with an attorney prior to signing this release. I have been provided twenty-one (21) days to consider the release prior to signing and seven (7) days to revoke this release once it is signed. To revoke this release, I understand I must send a written letter of revocation within the seven (7) days provided to:

First National Bank in Howell
Ronald Long
101 E. Grand River
PO Box 800
Howell, MI 48844-0800

Date: March 17, 2015 /s/Daniel Wollschlager

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**EXHIBIT 23**

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

FNBH Bancorp, Inc.
Howell, Michigan

We hereby consent to the incorporation by reference in the Registration Statement on Form S-8 (File No. 333-46244) of FNBH Bancorp, Inc. of our report dated March 31, 2015, relating to the consolidated financial statements of FNBH Bancorp, Inc., which appear in this Annual Report on Form 10-K.

*/s/* BDO USA, LLP

Grand Rapids, Michigan
March 31, 2015

EXHIBIT 31.1

CERTIFICATE OF THE
CHIEF EXECUTIVE OFFICER OF
FNBH BANCORP, INC.

Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002:

I, Ronald L. Long, certify that:

1. I have reviewed this report on Form 10-K of FNBH Bancorp, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the Audit Committee of registrant's Board of Directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 31, 2015

*/s/* Ronald L. Long
Ronald L. Long
President and Chief Executive Officer

EXHIBIT 31.2

CERTIFICATE OF THE
CHIEF FINANCIAL OFFICER OF
FNBH BANCORP, INC.

Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002:

I, Mark J. Huber, certify that:

1. I have reviewed this report on Form 10-K of FNBH Bancorp, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the Audit Committee of registrant's Board of Directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 31, 2015

*/s/* Mark J. Huber
Mark J. Huber
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATE OF THE
CHIEF EXECUTIVE OFFICER OF
FNBH BANCORP, INC.

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350):

I, Ronald L. Long, President and Chief Executive Officer of FNBH Bancorp, Inc., certify, to the best of my knowledge and belief, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350) that:

(1) The annual report on Form 10-K for the annual period ended December 31, 2014, which this statement accompanies, fully complies with requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and;

(2) The information contained in this annual report on Form 10-K for the annual period ended December 31, 2014, fairly presents, in all material respects, the financial condition and results of operations of FNBH Bancorp, Inc.

FNBH BANCORP, INC.

Date: March 31, 2015

By: */s/* Ronald L. Long
Ronald L. Long
Its: President and Chief Executive Officer

The signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to FNBH Bancorp, Inc. and will be retained by FNBH Bancorp, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

EXHIBIT 32.2

CERTIFICATE OF THE
CHIEF FINANCIAL OFFICER OF
FNBH BANCORP, INC.

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350):

I, Mark J. Huber, Chief Financial Officer of FNBH Bancorp, Inc., certify, to the best of my knowledge and belief, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350) that:

(1) The annual report on Form 10-K for the annual period ended December 31, 2014, which this statement accompanies, fully complies with requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and;

(2) The information contained in this annual report on Form 10-K for the annual period ended December 31, 2014, fairly presents, in all material respects, the financial condition and results of operations of FNBH Bancorp, Inc.

FNBH BANCORP, INC.

Date: March 31, 2015

By: */s/* Mark J. Huber
Mark J. Huber
Its: Chief Financial Officer

The signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to FNBH Bancorp, Inc. and will be retained by FNBH Bancorp, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.