# TRI CITY BANKSHARES CORPORATION

## 2014 Annual Report
## Audited Consolidated Financial Statements

# TRI CITY BANKSHARES CORPORATION

Dear Shareholder,

Reviewing the balance sheet of Tri City Bankshares, Inc. one must focus on the fact that we are funded with $1.1 billion in core deposits at the subsidiary bank. Those deposits grew in 2014 from the businesses and neighborhoods served by our branch network. The convenience of our locations, extended hours and our loyal staff solidify the long-standing formula which provides this reliable base. With no need for wholesale borrowing or high priced deposits the Corporation enjoys funding costs which rank among the best in our peer group.

With increased liquidity, our securities portfolio has grown as it necessarily provides the alternative investments to loans. However, yields on investments in government bonds, municipal and mortgage backed securities are less than those earned on the loan portfolio. Tri City has always been a profitable bank. As we seek to maximize profits this excess position in loan alternatives directs our strategy for the future. Job number one is lending.

After ending the first quarter of 2014 with the smallest total loan portfolio since prior to the FDIC acquisition in 2009, our lenders increased the portfolio to $689 million at year end. The Director's Loan Committee, which includes four outside Directors, opted to meet weekly in 2014 to ensure that every loan opportunity is acted upon for immediate approval. Expanding the Bank's commercial loan base to all sectors and offering competitive loan products and terms to attract new business is part of the strategy. Director's oversight coupled with senior lender guidance ensures loan growth is accomplished with the same high credit standards which have always been a Tri City priority.

With the retirements in 2014 and 2013 of our President and Chief Financial Officer at the subsidiary bank we continue a successful transition to a new executive team. We are pleased that although retired from their executive roles, both Mr. Robert Orth and Mr. Scott Wilson continue as members of the Board and serve on several committees to provide their expertise to our corporate governance. President Craig Dedrick and Chief Financial Officer Frederick Klug continue to install their brand of leadership which includes added responsibility for our Chief Risk Officer Ms. Kristen Gagliano and Director of Internal Audit Mr. Greg Daniels.

Shareholders will recall a significant dividend in December 2012. This dividend required approval from the Office of the Comptroller of the Currency. A key factor in receiving regulatory approval was the Board's commitment to return to capital levels which existed before the dividend was paid. We are pleased to report the earnings recorded in 2014 completed that commitment. As a result dividends were resumed in the first quarter of 2015.

Your Corporation has a long history of maintaining capital ratios in excess of the levels required to be considered well capitalized. This philosophy is unchanged. However, new capital rules for banks which became effective January 1, 2015 have increased the capital required and added additional capital requirements to be phased-in through 2019. The Board of Directors is confident shareholders agree that maintaining a strong capital base for the Bank is a prime objective of Board oversight.

So we return our focus to job number one, growth of our loan portfolio. Your Board of Directors, Executive management, Senior loan team, all officers and employees arrive at work each day understanding success will be achieved as we provide loans to businesses and consumers in the many communities we serve. Doing so will enhance our profitability and your investment in the years to come.

Very truly yours

TRI CITY BANKSHARES CORPORATION

Ronald K. Puetz
Chairman of the Board
Chief Executive Officer

## Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion provides management's analysis of the audited consolidated financial statements of Tri City Bankshares Corporation (the "Corporation") and should be read in conjunction with those financial statements. This discussion focuses on significant factors that affected the Corporation's financial performance in 2014, with comparisons to 2013 and to 2012 where applicable. For all periods presented, the operations of Tri City National Bank (the "Bank") contributed substantially all of the Corporation's revenues and expenses. Included in the operations of the Bank are the activities of its wholly-owned subsidiaries, Tri City Capital Corporation, Inc. and Title Services of Southeast Wisconsin, Inc.

This report contains statements that may constitute forward-looking statements that speak of the Corporation's plans, goals, beliefs or expectations, refer to estimates or use similar terms. Forward-looking statements are subject to significant risks and uncertainties. The Corporation's actual results may differ materially from the results discussed in such forward-looking statements.

### Performance Summary

The Corporation posted net income of $8.7 million during 2014, a decrease of $0.2 million, or 2.3%, from 2013. Earnings per share were $0.98 during 2014 compared to $1.00 in 2013. The decrease in earnings was due to a $5.4 million decrease in non-interest income and a $0.3 million increase in operating expenses which was partially offset by a $1.4 million increase in net interest income and a $3.5 million decrease in the provision for loan losses.

The increase in net interest income was due to an increase in interest income on investments and a decrease in interest paid on deposits which was partially offset by a decrease in interest income on loans. The decrease in the provision for loan losses was primarily due to a decrease in charge-offs net of recoveries.

The decrease in non-interest income was due to a decrease in acquisition-related purchase accounting income, a reduction in mortgage lending activity and a gain of sale of branches of $2.2 million in 2013 which was partially offset by one-time income of $1.0 million related to bank owned life insurance in 2014.

The Corporation's total assets increased $71.2 million, or 6.0%, from $1,180.7 million at December 31, 2013 to $1,251.9 million at December 31, 2014. Cash and due from banks, investment securities and loans outstanding all increased year over year. The growth in the loan portfolio, although modest in 2014, is a significant development. 2014 will mark the year that management turned the page from focusing on working out troubled loans to putting additional resources towards growing the loan portfolio. Total deposits increased by $61.7 million as of December 31, 2014 compared to December 31, 2013. The increase in deposits came in all categories with the exception of certificates of deposits as depositors continued to move their funds into more liquid accounts due to the low interest rate environment.

There were no dividends paid during 2014. Shareholders will recall a significant dividend prepayment in December 2012 before tax rates increased. A key factor in receiving regulatory approval to pay that dividend was the Board's commitment to return to capital levels which existed before the dividend was paid. We are pleased to report that earnings in 2013 and 2014 have accomplished that commitment. As a result, the Board of Directors resumed dividend payments and declared a dividend of $0.12 per share payable on February 5, 2015 to shareholders as of the record date of January 26, 2015.

The Corporation has a long history of maintaining capital ratios in excess of the levels required to be considered well capitalized. This philosophy is unchanged. However, new capital rules for banks which became effective January 1, 2015 have increased the capital required for this classification and added additional capital buffer requirements to be phased-in from now through 2019.

The Board of Directors is confident shareholders agree that maintaining a strong capital base for the Bank is a prime objective of Board oversight. The Board will review earnings, on-going regulatory requirements and other factors when approving dividends, just as they have done every quarter throughout our history.

On October 23, 2009, the Bank was the successful bidder for the Bank of Elmwood ("Acquired Bank") through an FDIC-assisted purchase (the "Acquisition"). The Acquisition was the result of a competitive bidding process facilitated by the FDIC. The Bank bid negative $110.9 million and the FDIC estimated the net cost of the transaction to be $101.1 million, deemed to be the "least costly" resolution for the FDIC. The Acquisition has positively impacted the earnings performance of the Bank.

**INCOME STATEMENT ANALYSIS**

Table 1 provides average balances of interest-earning assets and interest-bearing liabilities, the interest income and expense resulting from each, and the calculated interest rates earned and paid. The table further shows net interest income, interest rate spread, and the net interest margin on a tax-equivalent basis for the years ended December 31, 2014, 2013 and 2012.

AVERAGE BALANCES AND INTEREST RATES
**(Interest rates on a tax-equivalent basis)**
**(Dollars in Thousands)**

| | 2014 | | | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Average Balance | Interest | Yield or Cost | Average Balance | Interest | Yield or Cost | Average Balance | Interest | Yield or Cost |
| ASSETS | | | | | | | | | |
| Interest earning assets: | | | | | | | | | |
| Loans[1] | $ 678,518 | $ 32,710 | 4.82% | $ 687,577 | $ 36,024 | 5.24% | $ 695,408 | $ 40,870 | 5.88 % |
| Taxable investment securities[2] | 334,105 | 7,034 | 2.11% | 290,758 | 2,946 | 1.01% | 307,775 | 3,250 | 1.06 % |
| Non taxable investment securities | 47,378 | 1,741 | 3.67% | 44,093 | 1,674 | 3.80% | 47,922 | 1,983 | 4.14 % |
| Other money market instruments | 54,576 | 136 | 0.25% | 71,138 | 177 | 0.25% | - | - | - % |
| Fed funds sold | 2,041 | 2 | 0.09% | 9,412 | 8 | 0.09% | 48,593 | 43 | 0.09 % |
| Total interest earning assets | 1,116,618 | 41,623 | 3.73% | 1,102,978 | 40,829 | 3.70% | 1,099,698 | 46,146 | 4.20 % |
| Noninterest-earning assets: | | | | | | | | | |
| Other assets | 77,068 | | | 80,374 | | | 77,681 | | |
| TOTAL ASSETS | $ 1,193,686 | | | $ 1,183,352 | | | $ 1,177,379 | | |
| LIABILITIES AND EQUITY | | | | | | | | | |
| Interest-bearing liabilities: | | | | | | | | | |
| Transaction accounts | $ 309,082 | 193 | 0.06% | $ 292,877 | 217 | 0.07% | $ 276,010 | 371 | 0.13 % |
| Money market | 224,808 | 301 | 0.13% | 224,625 | 429 | 0.19% | 214,817 | 721 | 0.34 % |
| Savings deposits | 210,527 | 73 | 0.03% | 206,389 | 89 | 0.04% | 198,957 | 283 | 0.14 % |
| Other time deposits | 124,753 | 718 | 0.58% | 154,347 | 1,180 | 0.76% | 179,323 | 1,829 | 1.02 % |
| Short-term borrowing | 22 | - | 0.00% | 15 | - | 0.00% | 1,256 | 10 | 0.80 % |
| Total interest bearing liabilities | 869,192 | 1,285 | 0.15% | 878,253 | 1,915 | 0.22% | 870,363 | 3,214 | 0.37 % |
| Noninterest bearing liabilities: | | | | | | | | | |
| Demand deposits | 195,311 | | | 184,613 | | | 171,994 | | |
| Other | 8,080 | | | 8,962 | | | 10,674 | | |
| Stockholders' equity | 121,103 | | | 111,524 | | | 124,348 | | |
| Total liabilities and stockholders' Equity | $ 1,193,686 | | | $ 1,183,352 | | | $ 1,177,379 | | |
| Net interest earnings and interest rate spread[3] | | $ 40,338 | 3.58% | | $ 38,914 | 3.48% | | $ 42,932 | 3.83 % |
| Net interest margin[4] | | | 3.61% | | | 3.53% | | | 3.90 % |

**Table 1**

1. The average loan balances and rates include non-accrual loans.
2. The interest income on tax exempt securities is computed on a tax-equivalent basis using a tax rate of 34% for all periods presented.
3. Interest rate spread represents the difference between the average yield earned on average interest-earning assets for the period and the average rate accrued on average interest-bearing liabilities for the period and is represented on a tax-equivalent basis.
4. Net interest margin represents net interest income for a period divided by average interest-earning assets for the period and is represented on a tax-equivalent basis.

The following table sets forth, for the periods indicated, a summary of the changes in interest earned on a fully tax-equivalent basis and interest paid resulting from changes in volume and rates:

**Table 2**

**NET INTEREST INCOME AND EXPENSE VOLUME AND RATE CHANGE**
**(Dollars in Thousands)**

| | 2014 Compared to 2013 Increase (Decrease) Due to | | | 2013 Compared to 2012 Increase (Decrease) Due to | | |
|---|---|---|---|---|---|---|
| | Volume | Rate(1) | Net | Volume | Rate(1) | Net |
| Interest earned on: | | | | | | |
| Loans | $ (475) | $ (2,839) | $ (3,314) | $ (460) | $ (4,386) | $ (4,846) |
| Taxable investment securities | 439 | 3,649 | 4,088 | (180) | (124) | (304) |
| Non-taxable investment | 125 | (58) | 67 | (158) | (151) | (309) |
| Other money market instruments | (41) | - | (41) | 177 | - | 177 |
| Fed funds sold | (7) | - | (7) | (35) | - | (35) |
| Total interest-earning assets | $ 41 | $ 752 | $ 793 | $ (656) | $ (4,661) | $ (5,317) |
| Interest paid on: | | | | | | |
| Transaction accounts | $ 12 | $ (36) | $ (24) | $ 23 | $ (177) | $ (154) |
| Money market | - | (128) | (128) | 33 | (325) | (292) |
| Savings deposits | 2 | (18) | (16) | 11 | (205) | (194) |
| Time deposits | (226) | (236) | (462) | (255) | (394) | (649) |
| Short-term borrowings | - | - | - | (10) | - | (10) |
| Total interest-bearing liabilities | $ (212) | $ (418) | $ (630) | $ (198) | $ (1,101) | $ (1,299) |
| Increase (decrease) in net interest income | | | $ 1,423 | | | $ (4,018) |

(1) The change in interest due to both rate and volume has been allocated to rate changes.

**Net Interest Income**

Total interest income on loans decreased $3.3 million, or 9.2%, during 2014 compared to the same period in 2013. The decrease was due to both a reduction in loan volume and the low interest rate environment. Average loans decreased $9.1 million, or 1.3%, during 2014 due primarily to the run-off of acquired loans. In addition to a decrease in loan volume, loan yields decreased 42 basis points to 4.82% during 2014 compared to 5.24% in 2013, as new and renewed loans were booked at lower interest rates than the existing portfolio. The decrease in interest income on loans was also due to a $1.3 million decrease in purchase accounting income related to the Acquisition from $2.5 million during 2013 to $1.2 million during 2014. Loan discount accretion on non-credit impaired loans is realized as the Acquired Bank's loan portfolio continues to amortize, mature, renew or pay off. Interest income on loans during 2014, excluding loan discount accretion, decreased by $2.1 million compared to same period in 2013.

The remaining interest income on earning assets includes tax equivalent interest income on taxable investment securities, nontaxable investment securities, other money market instruments and fed funds sold. As a group, interest income on a tax-equivalent basis increased $4.1 million to $8.9 million during 2014 compared to the same period in 2013. This change reflects both an increase in volume and an increase in yield. Total average investment securities increased $22.7 million to $438.1 million as of December 31, 2014 primarily due to an increase in taxable investment securities. The average tax equivalent yield increased 88 basis points to 2.03% during 2014 compared to 1.16% for the same period in 2013. The increase in the average tax equivalent yield was primarily due a decline in the high level of mortgage refinance activity during 2014 compared to 2013 which caused prepayment speeds on the investments in collateralized mortgage obligations ("CMO") and mortgage-backed securities ("MBS") to decrease and resulted in an increase in interest income due to slowing levels of premium amortization.

Interest expense during 2014 decreased $0.6 million or 32.9%, compared to the same period in 2013. The decrease in interest expense was due to both a decrease in volume and rate. Average interest-bearing liabilities decreased $9.1 million or 1.0% to $869.2 million in 2014 from $878.3 million in 2013. The decrease was due to the sale of $21.6 million in deposits associated with the Cedarburg/Grafton branch sale which was partially offset by an increase in core deposits. The average yield on interest-bearing liabilities decreased 7 basis points to 0.15% during 2014 compared to 0.22% in 2013.

Net interest income in the consolidated statements of income (which excludes the tax-equivalent adjustment) was $39.7 million during 2014, compared to $38.3 million for the same period in 2013. The tax equivalent adjustments (adjustments needed to bring tax-exempt interest to a level that would yield the same after-tax income had that income been subject to taxation using a 34% tax rate) of $0.6 million for both 2014 and 2013 resulted in a tax-equivalent net interest income of $40.3 million and $38.9 million, respectively. The tax-equivalent net interest margin for 2014 was 3.61% compared to 3.53% during 2013.

Total interest income on loans decreased $4.8 million, or 11.9%, during 2013 compared to the same period in 2012. The decrease was due to both a reduction in loan volume and the low interest rate environment. The decrease in interest income on loans was also due to a $1.6 million decrease in purchase accounting income related to the Acquisition from $4.1 million during 2012 to $2.5 million during 2013. Interest income on investment securities on a tax-equivalent basis decreased $0.5 million, or 8.9%, during 2013 compared to the same period in 2012. This change reflects both a decrease in volume and a decrease in yield. Interest expense during 2013 decreased $1.3 million or 40.4%, compared to the same period in 2012. The decrease was due to a decrease in yield which was partially offset by an increase in volume. Net interest income on a tax-equivalent basis was of $38.9 million in 2013 compared $42.9 million in 2012. The tax-equivalent net interest margin for 2013 was 3.53% compared to 3.90% during 2012.

**Provision for Loan Losses**

The provision for loans losses ("PLL") results from the assessment of qualitative and quantitative factors to determine the required allowance for loan losses ("ALL"). Factors considered are the size of the portfolio, levels of nonperforming loans, historical losses, risk inherent in certain categories of loans, concentrations of loans to certain borrowers or certain industry segments, economic trends, collateral pledged, and other factors that could affect loan losses as discussed in the paragraphs following Table 8.

The PLL represents the amount periodically added to the Bank's ALL and charged to earnings in the relevant period. The PLL for 2014 was $3.0 million, a decrease from $6.5 million in 2013 and $7.2 million in 2012. The fluctuations in the PLL reflect the charge-off activity, net of recoveries on loans previously charged off as well as the level of non-performing loans. Net charge-offs were $3.3 million in 2014, $6.3 million in 2013 and $6.0 million in 2012. Charge-offs, and the corresponding PLL, are expected to decline over time as the level of net charge-offs and problem loans decline as the economy continues to improve.

**Non-interest Income**

A summary of non-interest income for the years ended December 31, 2014, 2013 and 2012 appear in Table 3 below:

**Table 3**

**NON-INTEREST INCOME**
**(Dollars in Thousands)**

| | For the Year Ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| Service charges on deposits | $ 9,699 | $ 9,777 | $ 10,108 |
| Loan servicing income | 468 | 357 | 133 |
| Net gain on sale of loans | 456 | 1,558 | 2,569 |
| Increase in cash surrender value of life insurance | 962 | 1,010 | 837 |
| Bank owed life insurance death benefit | 1,002 | - | - |
| Gain on sale of branches | - | 2,153 | - |
| Non-accretable loan discount | 484 | 3,680 | 1,974 |
| Other income | 988 | 950 | 1,571 |
| Total non-interest income | $ 14,059 | $ 19,485 | $ 17,192 |

Total non-interest income was $14.1 million for 2014, a decrease of $5.4 million or, 27.8% from $19.5 million in 2013. The decrease was primarily due to three factors. The net gain on sale of loans decreased $1.1 million to $0.5 million in 2014 compared to $1.6 million in 2013. The decrease was due to an increase in interest rates in the summer of 2013 which meant that mortgage refinance activity was strong during the first half of 2013 but was weak during the second half of 2013 and all of 2014. In addition, non-interest income benefited from a one-time gain of $2.1 million on the sale of the Cedarburg and Grafton branches. Finally, income from the non-accretable loan discount decreased by $3.2 million from $3.7 million in 2013 to $0.5 million in 2014. The non-accretable loan discount income is related to the purchase accounting on the loans acquired in the Acquisition that were specifically identified as credit impaired which were paid or charged off during the year. In future years, non-accretable income will be dependent on the difference between future contractual payments expected to be received and the carrying amount of the loans specifically impaired. These decreases in non-interest income were offset by one-time income of $1.0 million from the death benefit on bank owned life insurance.

Total non-interest income was $19.5 million for 2013, an increase of $2.3 million or, 13.3% from $17.2 million in 2012. The increase was primarily due the one-time gain of $2.1 million on the sale of the Cedarburg and Grafton branches and an increase in non-accretable loan discount income of $1.7 million. The non-accretable loan discount income is related to the purchase accounting on the loans acquired in the Acquisition that were specifically identified as credit impaired which were paid or charged off during the year. In addition to the one-time gain on the branch sale and the non-accretable loan discount income, loan servicing income increased by $0.2 million and the cash surrender value of life insurance increased $0.2 million. The increases were offset by a decrease in the net gain on sale of loans of $1.0 million, a decrease in other income of $0.6 million and a decrease in service charge income on deposits of $0.3 million. The decrease in the net gain on sale of loans was due to an increase in mortgage rates during the year that resulted in a reduction in refinance activity in the secondary mortgage market. The decrease in other income was primarily due to a decrease in the gain on the sale of other real estate owned ("OREO"), net of carrying costs, of $0.6 million in 2013 compared to 2012.

**Non-interest Expense**

A summary of non-interest expense for the years ended December 31, 2014, 2013 and 2012 appear in Table 4 below:

**Table 4**

**NON-INTEREST EXPENSE**
**(Dollars in Thousands)**

| | For the Year Ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| Salaries and employee benefits | $ 21,493 | $ 21,406 | $ 21,407 |
| Occupancy | 4,144 | 4,093 | 3,733 |
| Furniture and equipment | 1,624 | 1,740 | 1,966 |
| Computer services | 3,115 | 2,979 | 4,075 |
| Advertising and promotional | 744 | 730 | 953 |
| Regulatory agency assessments | 1,140 | 1,273 | 1,286 |
| Office supplies | 841 | 765 | 833 |
| Core deposit intangible amortization | 173 | 230 | 310 |
| Other expenses | 5,051 | 4,777 | 5,518 |
| Total non-interest expense | $ 38,325 | $ 37,993 | $ 40,081 |

Total non-interest expense for 2014 was $38.3 million, an increase of $0.3 million or 0.9% over 2013 as management continues to make expense control a priority. Salaries and employee benefits increased slightly to $21.5 million in 2014 compared to $21.4 million in 2013 due to retirements and stable benefit costs which were offset by several new hires on the lending side. Occupancy expense remained stable at $4.1 million in both 2013 and 2014 as increased snow plowing costs during 2014 was offset by a decrease in depreciation expense due to the sale of our Cedarburg branch in November of 2013. Furniture and equipment decreased by $0.1 million in 2014 while computer services increased by $0.2 million. The increase in computer services was due to increased data processing costs related to the roll out of our mobile banking product. Advertising and promotional expense remained stable at $0.7 million for both 2013 and 2014. Costs associated with FDIC and other regulatory assessments decreased $0.1 million to $1.1 million in 2014 as the assessment rate charged by the FDIC decreased due to the improvement in our asset quality in 2014. Office supply expense increased $0.1 million during 2014 which was offset by a decrease core deposit amortization expense of $0.1 million in 2014. The core deposit amortization expense will decrease annually until it is fully amortized in 2017. Other non-interest expense increased by $0.3 million primarily due to an increase in professional fees related the hiring of a registered investment advisor to manage the investment portfolio.

Total non-interest expense for 2013 was $38.0 million, a decrease of $2.1 million or 5.2% over 2012 as management continues to make expense control a priority. Salaries and employee benefits remained stable at $21.4 million in both 2012 and 2013. Occupancy expense increased $0.3 million in 2013 compared to 2012 due to an increase in maintenance and repair expenses, utilities and property taxes. Furniture and equipment decreased by $0.2 million in 2012 while computer services decreased by $1.1 million. The decrease in computer services was due to renegotiated telecommunications and data processing contracts. Advertising and promotional expense decreased $0.2 million to $0.7 million in 2013 as the Bank focused on larger, higher exposure advertising opportunities and discontinued several outlets that produced lower returns. Both office supply expense and core deposit amortization expense decreased $0.1 million in 2013 compared to 2012. The core deposit amortization expense will decrease annually until it is fully amortized in 2017. Other non-interest expense decreased by $0.7 million due to a reduction in loan collection and the aforementioned renegotiated telecommunications contracts.

**Income Taxes**

Income tax expense was $3.8 million in 2014 compared to $4.4 million in 2013 and $4.0 million in 2012. The Corporation's effective tax rate (income tax expense divided by income before income taxes) was 30.2% in 2014 compared to 33.3% in 2013 and 33.0% in 2012. The decrease in the effective tax rate for 2014 was due to the fact that the one-time death benefit on bank owned life insurance of $1.0 million is not taxable income.

## BALANCE SHEET ANALYSIS

### Investment Securities Portfolio

The investment securities portfolio is intended to provide the Bank with liquidity, a source of stable income, and is structured to minimize the Corporation's credit exposure.

**Table 5**

| | For the Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2014 | | 2013 | | 2012 | |
| | Carrying Value | Percentage of Total | Carrying Value | Percentage of Total | Carrying Value | Percentage of Total |
| Obligations of: | | | | | | |
| States and political subdivisions (tax exempt) | $ 50,060 | 14.00% | $ 42,693 | 12.89% | $ 44,008 | 12.5% |
| States and political subdivisions (taxable) | 12,157 | 3.40% | 12,589 | 3.80% | 16,510 | 4.7% |
| U.S. government sponsored entities | 84,050 | 23.50% | 150,200 | 45.35% | 151,781 | 43.2% |
| Collateralized mortgage obligations | 104,521 | 29.22% | 41,340 | 12.48% | 43,812 | 12.5% |
| Mortgage-backed securities | 106,871 | 29.88% | 84,355 | 25.48% | 95,413 | 27.1% |
| Total investment securities | $ 357,659 | 100.00% | $ 331,177 | 100.00% | $ 351,524 | 100.00% |
| | | | | | | |
| Designated as: | | | | | | |
| Available for sale | $ 149,456 | 41.87% | $ 32,272 | 9.75% | $ - | 0.00% |
| Held to maturity | 208,203 | 58.13% | 298,905 | 90.25% | 351,524 | 100.00% |
| Total investment securities | $ 357,659 | 100.00% | $ 331,177 | 100.00% | $ 351,524 | 100.00% |

The total investment securities portfolio increased $26.5 million or 8.0% to $357.7 million at December 31, 2014 compared to $331.2 million at December 31, 2013. At December 31, 2014, the total carrying value of investment securities represented 28.6% of total assets, compared to 28.1% at December 31, 2013. The increase in the investment securities portfolio was due to additional investment purchases which were partially offset by proceeds from issuer called securities and principal payments on the collateralized mortgage obligations and mortgage-backed securities.

States and political subdivisions (tax-exempt) investment securities increased $7.4 million, or 17.3% to $50.0 million at December 31, 2014 compared to $42.7 million at December 31, 2013 as purchases of $14.1 million were partially offset by $6.7 million in call activity. States and political subdivisions (taxable) investment securities decreased $0.4 million or 3.4% to $12.2 million at December 31, 2014 compared to $12.6 million at year end 2013. Management mitigates credit quality concerns by limiting purchases to rated investments of high quality as dictated by the Bank's Investment Policy. Diversity in the municipal portfolio is maintained by limiting the amount of investment to any single debtor in the municipal category. At December 31, 2014, the Bank's securities portfolio did not contain any obligations of any single issuer that were payable by the same source of revenue or taxing authority where the aggregate carrying value of such securities exceeded 2.8% of the stockholders' equity.

Investments in U.S. government sponsored entity ("GSE") securities decreased $66.1 million to $84.1 million at December 31, 2014 compared to $150.2 million at year end 2013. The decrease was due to call activity as there were no new purchases in this investment category during 2014. Investments include three GSEs; the Federal Home Loan Bank, the Federal National Mortgage Association ("Fannie Mae"), and the Federal Home Loan Mortgage Corporation ("Freddie Mac"). Many of the GSE securities contain step-up features in which the yields are scheduled to increase in future periods. Step-up features provide the Bank the advantage of increasing yields in a rising rate environment in return for the optionality of a call feature favoring the issuer. GSEs such as Fannie Mae and Freddie Mac are not explicitly guaranteed by the U.S. government. The U.S. government has, however, provided unlimited support to both entities since 2009. The Federal Home Loan Bank has to date not required support from the U.S. Government.

Investments in CMO and MBS securities increased $85.7 million from $125.7 million at December 31, 2013 to $211.4 million at December 31, 2014. The increase in the investments in CMO and MBS securities was due to $113.9 million of purchases which was partially offset by principal prepayments of $28.2 million. Low interest rates through the first five months of 2013 resulted in elevated prepayment speeds as the underlying mortgages continued to be refinanced. As longer term interest rates began to rise in June of 2013, the mortgage refinancing boom largely ended resulting in slower prepayment speeds and slower premium amortization which had a positive effect on the investment yields. The mortgages underlying these securities are guaranteed by Fannie Mae, Freddie Mac and the Government National Mortgage Association ("Ginnie Mae").

In 2013 the Board of Directors amended the Bank's Investment Policy and voted to create an Asset/Liability and Investment Committee ("ALICO") to manage the balance sheet and oversee liquidity, contingency funding, investment strategy and monitor the Board approved limits tested by asset liability modeling. The Committee consists of the CEO and CFO of the Bank and three outside members of the Board. The Committee reports to the Board on a quarterly basis.

Since the 2009 Acquisition, the investment portfolio has increased to represent 28.5% of the Bank's assets compared to 13.5% prior to the Acquisition. The investment in loan alternatives is the result of a decreasing loan portfolio from the time of the Acquisition through the first quarter of 2014. Since the first quarter of 2014 the loan portfolio has grown resulting in year over year growth of $5.6 million. Going forward we expect the loan portfolio to continue to grow which would reduce the impact of the investment portfolio on the overall balance sheet. Given the current size of the investment portfolio, the performance of investment portfolio will continue to have a significant impact on the balance sheet and the income statement.

The amended Investment Policy authorizes the use of a registered investment advisor to manage a portion of the investment portfolio. The Board action was taken partially to address succession planning and partially due to the challenges in today's historically low rate environment. With the investment portfolio's increased impact on performance, the inclusion of a professional registered investment advisor is deemed appropriate at this time.

Historically all of the investments securities have been managed and classified as held to maturity. Beginning in the 4th quarter of 2013, management classified new purchases as available for sale. Securities classified as available for sale are those securities which the Bank has determined might be sold to meet potential liquidity needs, reposition holdings to increase returns or modify durations, or in response to changes in interest rates or other economic factors. They may or may not be held until maturity. Securities available for sale are carried at fair value.

**Loans**

Total loans were $688.6 million at December 31, 2014, an increase of $5.6 million, or 0.8%, from $683.0 million at December 31, 2013. The increase in the loan portfolio during 2014 was attributable to an increase in new loan production which was offset by portfolio amortization, payoffs and the continued reduction of the Acquired Bank's loans. An increase of $28.2 million in commercial and commercial real estate lending is the result of a reorganization of the Bank's commercial loan group and hiring of new marketing officers in both 2013 and 2014. Management will continue this effort with more marketing hires in 2015. This aggressive step is necessary because despite increased loan demand with an improving economy every competitor is seeking to expand its loan portfolio as well.

Loans originated by the Bank are generally loans to small businesses and individuals in the communities served in the Southeastern Wisconsin market. Although the legal lending limit of the Bank was $20.6 million per borrower as of December 31, 2014, most of the Bank's larger customers are borrowers with credit needs of $10 million and less and, in fact, most borrowers' credit relationships total less than $1 million. At December 31, 2014, there were five relationships in excess of $10 million with aggregate exposure totaling $64.4 million, twelve relationships between $5.0 and $10 million with aggregate exposure totaling $82.9 million and thirty eight relationships between $2.0 and $5.0 million with aggregate exposure totaling $120.9 million. Of these fifty five relationships with $268.2 million committed, the balance outstanding at December 31, 2014 was $229.3 million. The remaining $38.9 million represented unfunded liability on lines of credit to twenty eight of the borrowers.

As of October 23, 2009 (the "Acquisition Date"), the Acquired Bank's loan portfolio of $279.2 million was discounted $85.1 million to reflect the estimated fair value of the acquired loans. Between the Acquisition Date and December 31, 2014, both the Acquired Bank's loan portfolio and the associated discount have been significantly reduced as a result of activity in the Acquired Bank's loan portfolio including renewals, amortization, pay-offs, charge-offs and collateral liquidations. Thus, as of December 31, 2014 the remaining Acquired Bank's loan portfolio was $61.0 million with a discount of $15.0 million reflecting the difference between cash flows expected to be received and contractually required payments on the acquired loans. In addition, $43.8 million of the Acquired Bank's loan portfolio has been restructured or renewed into the Bank's portfolio and does not have any remaining discount. Management continues to pursue improvement in the credit quality of the acquired loans as they are renewed and integrated into the Bank's portfolio. Management believes the remaining discount will be sufficient to cover the remaining credit losses related to the acquired loans that have not yet been paid off, renewed or restructured since the Acquisition.

The following table presents information concerning the composition of the loans held for investment by the Bank at the dates indicated.

**Table 6**

## LOAN PORTFOLIO COMPOSITION
## (Dollars in Thousands)

| | For the Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2014 | | 2013 | | 2012 | |
| | Amount | % of Total | Amount | % of Total | Amount | % of Total |
| Commercial | $ 31,261 | 4.54% | $ 20,577 | 3.01% | $ 20,286 | 2.89% |
| Real estate | | | | | | |
| Construction | 26,022 | 3.78% | 29,493 | 4.32% | 40,790 | 5.79% |
| Commercial | 365,054 | 53.01% | 346,972 | 50.80% | 325,335 | 46.17% |
| Residential | 214,868 | 31.20% | 229,565 | 33.61% | 258,548 | 36.69% |
| Multifamily | 41,470 | 6.02% | 45,610 | 6.68% | 47,526 | 6.74% |
| Installment and other | 9,970 | 1.45% | 10,793 | 1.58% | 12,151 | 1.72% |
| Total loans | $ 688,645 | 100.00% | $ 683,010 | 100.00% | $ 704,636 | 100.00% |

As Table 6 indicates, commercial loans were $31.3 million at December 31, 2014, an increase of $10.7 million, or 51.9% from December 31, 2013 and comprised 4.5% of the total loan portfolio compared to $20.6 million comprising 3.0% of the loan portfolio at December 31, 2013. While commercial lending has historically been a small part of the Bank's portfolio there has been more emphasis on this segment in 2014 as the bank is building a commercial loan team in order to compete more effectively for these loans in the future. Commercial loans are collateralized by general business assets such as accounts receivable, inventory and equipment and have no real estate component.

Real estate construction loans decreased $3.5 million, or 11.8% to $26.0 million, representing 3.8% of the total loan portfolio at December 31, 2014, compared to $29.5 million or 4.3% of the total loan portfolio at December 31, 2013. The decrease from 2013 to 2014 was due primarily to continued repayment of the Bank's construction loan portfolio. Construction financing by definition is classified as such only during the development phase. When the project is complete, the outstanding balance is paid in one of several ways. In the case of residential real estate development, the sale of the spec home or lot results in payment. In the case of a commercial project, the completed building is refinanced to term debt for the developer or in some cases a new buyer. Historically, real estate construction loans have been made to developers who are well known to the Bank, have prior successful project experience and are well capitalized. Loans are made to customers in the Bank's Southeastern Wisconsin market with experience and knowledge of the local economy. As evidenced the decreasing balances from 2012 to 2014, this segment of the portfolio has been reduced as lot inventory remained available from projects begun at the peak of the market. The Bank has seen an increase in new home starts by all of the builders for whom it provides financing, but the aggregate construction volume of individual home loans is not yet adequate to replace developer pay down of the larger subdivision loans.

Commercial real estate loans increased $18.1 million, or 5.2% to $365.1 million at December 31, 2014, compared to $347.0 million at December 31, 2013. This increase marks three years of growth in commercial real estate loans. The increase is due to new business exceeding the portfolio amortization, pay-offs and elimination of nonperforming commercial real estate loans from the Acquisition. This category of loans made up the largest component of the total loan portfolio at 53.1% at December 31 2014 and 50.8% at December 31, 2013. The increase is attributable to new relationships as well as new projects with current customers which outpaced run-off from the Acquired loan portfolio. The Bank's commercial real estate lending efforts are focused on owner occupied, improved property such as office buildings, warehouses, small manufacturing operations and retail facilities. The most significant risk factor is occupancy. The fact that the Bank prefers owner occupied commercial real estate reduces that risk, provided of course, the owner's business prospers. The Bank's $20.6 million per-borrower legal lending limit would permit it to compete for activity in the middle market, but management prefers to seek small businesses as its target borrowers. Loans to such businesses are approved based on the creditworthiness, economic feasibility and cash flow abilities of the borrower. The commercial real estate portfolio increases in each of the last three years also indicates a shift in the Bank's portfolio as management emphasizes commercial over residential real estate.

The decline in the Bank's residential real estate portfolio loans has been due to changes in the marketplace. Residential real estate loans in the portfolio have historically been originated with maturities of one, two or three years. Amortization periods offered to balloon customers had been 20-25 years depending on equity and loan-to-value ratios. Prior to 2014, fixed rate financing at historically low rates caused many of our portfolio loan customers to seek long term financing in the secondary market. The Bank retained the customer and profited from the transaction in the secondary market, but the refinancing of in-house loans decreased the portfolio as a result. During 2014 residential real estate loans which include single family, 2-4 family dwellings and home equity lines of credit or "HELOCs" secured by real estate decreased $14.7 million, or 6.4% to $214.9 million comprising 31.2% of the Bank's total loan portfolio at December 31, 2014 compared to $229.6 million comprising 33.4% of the Bank's total loan portfolio at December 31, 2013. In 2014, changes mandated by the Consumer Financial Protection Bureau ("CFPB") limited the Bank's traditional residential real estate products with "QM" or Qualified Mortgage Rules all but eliminating balloon notes. Despite regulatory changes, the bank has invested in both online mortgage software and additional retail lenders in order to grow the residential real estate portfolio. Management will continue to offer consumer real estate loans with Adjustable Rate Mortgage or ARM loan products, but as stated, continued emphasis on commercial real estate and a move to compete for more commercial and industrial lending was a necessary strategic decision.

Mortgage customers seeking long term rate locks choose the secondary market products offered by the Bank where rates can be fixed for 15, 20 or 30 years. These loans are then sold and as a result, do not impact the portfolio yields nor are they a factor in interest rate risk. Loans from the Acquisition are either one-, two- or three-year balloons or Adjustable Rate Mortgages ("ARMs"). While ARMs were not the Bank's vehicle of choice for rate management prior to the creation of the CFPB, they serve the purpose of providing annual rate adjustments after an initial fixed rate period of three to five years. ARM loans from the Acquired Bank residential real estate loan portfolio have been repriced since they were acquired at the margin (2.625%) prescribed by Freddie Mac over their assigned indices. A typical ARM index is the one year U.S. Treasury note rate, which continued near historic lows during 2014. This rate hovered between 0.09% and 0.15% for most of the year, resulting in adjusted rates below 3.0% for ARM mortgage customers. Of the variable rate mortgage loans repricable, total ARM portfolio yields decreased 32 basis points to 3.78% at December 31, 2014 from 4.04% at December 31, 2013 as a result of these rate decreases.

Multi-family real estate loans decreased $4.1 million, or 9.1%, to $41.5 million, representing 6.0% of the total loan portfolio at December 31, 2014 compared to $45.6 million comprising 6.6% of the total loan portfolio at December 31, 2013. The loans in this category are collateralized by properties with more than four family dwelling units. The Bank has always been conservative in requiring borrowers to be well-qualified and to provide their personal guaranty, as well as insisting on proper debt service coverage ratios and equity sufficient to sustain reasonable debt service in the event of interest rate pressure. Loans in this category typically have maturities of 3, 4 or 5 years and are amortized over 15 to 20 years.

Installment loans decreased $0.8 million, or 7.6%, to $10.0 million at December 31, 2014 compared to $10.8 million at December 31, 2013 due to the elimination of acquired loans outpacing new business. These loans consist of auto loans, mobile home loans and unsecured consumer loans which have been decreasing at the Bank for several years. Auto loan volume decreased despite improved new car sales in 2014 because dealer incentive financing makes this non-competitive. The Bank has historically limited its exposure to mobile home loans and unsecured consumer loans. However, the Bank acquired a number of such consumer loans in the Acquisition, many of which continue to perform, despite not meeting the Bank's historical underwriting standards.

To ensure credit quality, overall credit management of portfolio loans in the Bank requires sound loan underwriting and administration, systematic monitoring of existing loans, effective loan review, early identification of problem loans, an adequate ALL and valid non-accrual and charge-off policies. As the economy weakened, loan underwriting was strengthened at the Bank by reducing delegated authority for lenders in the branch locations to ensure that appropriate standards would be met on every credit request. These precautions were extended through 2014 and deemed necessary as management believed many marketing opportunities were the result of marginally qualified borrowers, both commercial and consumer, attempting to leave their existing bank due to rate pressure and new requirements such as additional collateral or other restrictive terms.

**Other Real Estate Owned**

Real estate acquired by foreclosure or by deed in lieu of foreclosure is held for sale and is initially recorded at fair value at the date of foreclosure less estimated selling expenses, establishing a new cost basis. At the date of foreclosure, any write down to fair value less estimated selling costs is charged to the allowance for loan losses. Subsequent to foreclosure, an analysis of the valuation is performed and a valuation allowance is established as needed. Costs relating to the development and improvement of the property may be capitalized; holding period costs and subsequent changes to the valuation allowance are charged to expense.

A summary of the activity in OREO is as follows:

**Table 7**

| | For the Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2014 | | 2013 | | 2012 | |
| | Dollar Balance | Number of Properties | Dollar Balance | Number of Properties | Dollar Balance | Number of Properties |
| Beginning Balance | $ 5,709 | 22 | $ 8,545 | 31 | $ 7,351 | 67 |
| Additions | 2,920 | 42 | 10,007 | 108 | 10,167 | 79 |
| Valuation Adjustment | (108) | - | - | - | - | - |
| Sales | (3,750) | (44) | (12,843) | (117) | (8,973) | (115) |
| Ending Balance | $ 4,772 | 20 | $ 5,709 | 22 | $ 8,545 | 31 |

Both the number of properties and the total balance of OREO declined in 2014 compared to 2013. As of December 31, 2014, the Bank had 20 properties in OREO with a total balance of $4.8 million compared to 22 properties with a total balance of $5.7 million as of December 31, 2013 Management expects a decrease in OREO activity during 2015 as the foreclosure pipeline, a precursor to OREO, continues to decline.

The collection practices for the Bank are centralized in order to efficiently handle the increased levels of past dues, foreclosures and repossessions from both legacy loans and acquired loans. The Bank has three collection divisions reporting to the President of the Bank; commercial loan workouts, retail loan collection and collection of the secondary market real estate loan portfolio serviced by the Bank. The Bank's goal is to minimize the delay in liquidation. The Bank has used its own officers as the best source for identifying buyers for OREO as they know which of the Bank's existing customers are in the market for real estate. This strategy has proven successful as Bank officers have been responsible for identifying the buyers for 139 of the 276 properties sold over the last three years.

**Allowance for Loan Losses**

The loan portfolio is the primary asset subject to credit risk. Credit risk is controlled and monitored through the use of lending standards, management's strict underwriting of potential borrowers and on-going review of loan payment performance. Managing credit risk and minimizing loan losses is a high priority for management. Active asset quality administration, including early problem loan identification and timely resolution, aids in the management of credit risk and minimization of loan losses.

Table 8 summarizes the Allowance for Loan Losses ("ALL") balances at the beginning and end of each year from 2012 through 2014, changes in the ALL arising from loans charged-off and recoveries on loans previously charged-off, additions to the allowance that have been charged to expense and selected performance ratios.

**Table 8**

**SUMMARY OF ALLOWANCE FOR LOAN LOSSES**
**(Dollars in Thousands)**

| | For the Year Ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| Balance of allowance for loan losses at beginning of period | $ 12,371 | $ 12,197 | $ 11,012 |
| Total loans charged-off | (3,674) | (7,015) | (6,715) |
| Total recoveries | 406 | 707 | 700 |
| Net loans charged-off | (3,268) | (6,308) | (6,015) |
| Additions to allowance charged to expense | 3,000 | 6,482 | 7,200 |
| Balance of allowance for loan losses at end of period | $ 12,103 | $ 12,371 | $ 12,197 |
| Total loans | $ 688,645 | $ 683,010 | $ 704,636 |
| Total nonperforming loans(1) | $ 20,461 | $ 19,065 | $ 22,374 |
| Ratio of allowance for loan losses to total nonperforming loans | 59.15% | 64.89% | 54.51% |
| Ratio of nonperforming loans to total loans | 2.97% | 2.79% | 3.18% |
| Ratio of nonperforming assets to total assets | 2.14% | 2.10% | 2.51% |
| Ratio of net loans charged-off during the period to average loans outstanding | 0.48% | 0.92% | 0.86% |
| Ratio of allowance at end of year to total loans | 1.76% | 1.81% | 1.73% |

(1)This amount excludes purchased credit-impaired loans. Purchased credit-impaired loans have evidence of pre-Acquisition deterioration in credit quality. Fair value of these loans as of the Acquisition Date includes estimates of credit losses.

The ALL represents management's estimate of an amount adequate to provide for probable and inherent credit losses in the loan portfolio. To assess the adequacy of the ALL, management uses significant judgment focusing on specific reserves applied to loans that are identified for evaluation on an individual loan basis. In addition, loans are analyzed on a group basis using risk characteristics that are common to groups of similar loans. The factors that are considered include changes in the size and character of the loan portfolio, changes in the levels of impaired and nonperforming loans, historical losses in each category, the risk inherent in specific loans, concentrations of loans to specific borrowers or industries, existing economic conditions, and the fair value of underlying collateral as well as changes to the fair value of underlying collateral.

At December 31, 2014, the ALL was $12.1 million, compared to $12.4 million at December 31, 2013. As of December 31, 2014, the ratio of the ALL to total loans was 1.76% and covered 59.2% of nonperforming loans, compared to a ratio of 1.81% covering 64.9% of nonperforming loans at December 31, 2013. The decrease in the ratio of ALL to total loans during 2014 was due to both an increase in loans and a decrease in the ALL. Nonperforming loans, not including the acquired credit impaired nonperforming loans were $20.5 million, or 3.0% of total loans as of December 31, 2014 compared to $19.1 million, or 2.8% of total loans at December 31, 2013. Net charge-offs were $3.3 million and $6.3 million for 2014 and 2013, respectively. Loans charged-off are subject to continuous review and specific efforts are taken to achieve maximum recovery of principal, accrued interest and related expenses.

**Potential Problem Loans**

Management uses an internal asset classification system as a means of reporting problem and potential problem assets. At their quarterly meetings, the Board of Directors of the Bank review trends for loans classified as “Special Mention,” “Substandard” and “Doubtful” for the previous thirteen months both as a total dollar volume in each classified category and as the percent of capital each classified category represents. A Special Mention loan has potential weaknesses that deserves management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at some future date. An asset is classified Substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets classified as Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of current existing facts, conditions and values, highly questionable and improbable. Assets classified as Loss are those considered uncollectible and viewed as non-bankable assets, worthy of charge-off. Assets that do not currently expose the Bank to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses that may or may not be within the control of the customer are deemed to be Watch.

The determination as to the classification of assets and the amount of valuation allowance is subject to review by the Bank’s regulator, the Office of the Comptroller of the Currency (the “OCC”), which can order the establishment of additional general or specific loss allowances. There can be no assurance that regulators, in reviewing the Bank’s loan portfolio, will not request the Bank to materially adjust its allowance for loan losses. The OCC, in conjunction with the other federal banking agencies, has adopted an interagency policy statement on the ALL. The policy statement provides guidance for financial institutions on both the responsibilities of management for the assessment and establishment of adequate allowances and guidance for banking agency examiners to use in determining the adequacy of general valuation guidelines. Generally, the policy statement recommends that (1) institutions have effective systems and controls to identify, monitor and address asset quality problems; (2) management has analyzed all significant factors that affect the collectability of the portfolio in a reasonable manner; and (3) management has established acceptable allowance evaluation processes that meet the objectives set forth in the policy statement. Management believes it has established an adequate ALL. The Bank analyzes its process regularly, with modifications made if needed, and reports those results at quarterly meetings of the Board of Directors. Although management believes that adequate specific and general loan loss allowances have been established, actual losses are dependent upon future events and, as such, further additions to the level of specific and general loan loss allowances may become necessary.

**Deposits**

Deposits are the Bank's largest source of funds. The Bank competes in Southeastern Wisconsin with other financial institutions such as banks, thrifts and credit unions, as well as non-bank institutions, for retail and commercial deposits. The Bank continues to market its checking accounts and had continued success in 2014 with completely free checking (non-interest-bearing), several options for interest-bearing checking and for Investor Checking, a tiered product. The interest-bearing checking options offered are desirable to the Bank as low cost core deposit growth. Depositors earn interest, but the yields paid on these products are low compared to other funding costs. The following table presents the average daily balance of deposits and average rate paid on deposits for the years ended December 31, 2014, 2013 and 2012.

**Table 9**

**AVERAGE DAILY BALANCE OF DEPOSITS AND AVERAGE RATE PAID ON DEPOSITS**
**(Dollars in Thousands)**

| | 2014 | | 2013 | | 2012 | |
|---|---|---|---|---|---|---|
| | Amount | Rate | Amount | Rate | Amount | Rate |
| Noninterest-bearing demand deposits | $ 195,311 | -% | $ 184,613 | -% | $ 171,994 | -% |
| Transaction Accounts | 309,082 | 0.06% | 292,877 | 0.07% | 276,010 | 0.13% |
| Money Market Accounts | 224,808 | 0.13% | 224,625 | 0.19% | 214,817 | 0.34% |
| Savings | 210,527 | 0.03% | 206,389 | 0.04% | 198,957 | 0.14% |
| Time deposits (excluding time certificates of deposit of $100,000 or more) | 77,633 | 0.50% | 99,326 | 0.71% | 103,806 | 0.96% |
| Time deposits ($100,000 or more) | 47,120 | 0.70% | 55,021 | 0.87% | 75,517 | 1.10% |
| | $ 1,064,481 | | $ 1,062,851 | | $ 1,041,101 | |

For the year ended December 31, 2014, average daily deposits were $1,064 million, an increase of $1 million or 0.2% over $1,063 million at December 31, 2013. The Bank continued to have substantial organic deposit growth across most of the branches due to a strong product line, convenient hours and locations, online and mobile banking options, and successful marketing campaigns. Average deposits increased during 2013 despite the sale of our Cedarburg and Grafton branch locations on November 1, 2013 which included the sale of the fixed assets as well as $21.6 million in deposits.

Average non-interest-bearing demand deposits increased $10.7 million, or 5.8%, to $195.3 million at December 31, 2014 compared to $184.6 million at December 31, 2013 which mirrors the overall growth of our deposit base. These core deposits are very valuable to the Bank given their non-interest bearing status.

Transaction accounts consist of interest-bearing checking held by individuals, municipalities, non-profit organizations and sole proprietorships. Average transaction accounts increased $16.2 million, or 5.5%, to $309.1 million at December 31, 2014 compared to $292.9 million on December 31, 2013. The blended yield for all transaction accounts in 2013 was 0.06%, a decrease of 1 bp from 0.07% in 2013.

The daily average balance of money market deposit accounts increased $0.2 million, or 0.1%, to $224.8 million for 2014 compared to $224.6 million in 2013. The increase in money market accounts during 2014 is due to the relatively attractive interest rates paid on this product compared to certain transaction accounts and longer term certificates of deposits. The yield on money market deposits decreased 6 bp to 0.13% for 2014 from 0.19% in 2013.

The daily average balance of savings accounts increased $4.1 million, or 2.0%, to $210.5 million for the year ended December 31, 2014 from $206.4 million at December 31, 2013. The yield on basic savings was 0.03% in 2014 and 0.04% in 2013. Savings include savings sweep accounts for businesses in the amount of $11.5 million with rates that are tied to the Fed funds rate and vary as that index moves.

The daily average balance of time deposits decreased by $29.6 million, or 19.2%, to $124.8 million at December 31, 2014, from $154.4 million at December 31, 2013. The decline was primarily due to deposits moving from fixed rate products with longer terms into floating interest rate products, such as money market accounts given the very low rates available in 2014. Within that total, time deposits less than $100,000 decreased $21.7 million, or 21.8%, to $77.6 million at year-end 2014 from $99.3 million at December 31, 2013. The yield on time deposits less than $100,000 was 0.50% in 2014, down from 0.71% in 2013. Time deposits $100,000 or more decreased by $7.9 million, or 14.4%, to $47.1 million at year-end 2043 from $55.0 million at December 31, 2013. The yield on time deposits $100,000 or more was 0.70% in 2014, down from 0.87% in 2013.

**Capital**

The adequacy of the Corporation's capital is regularly reviewed to ensure that sufficient capital is available for current and future needs and is in compliance with regulatory guidelines. The assessment of overall capital adequacy depends on a variety of factors, including asset quality, liquidity, earnings stability, changing competitive forces, economic condition in markets served, and strength of management. Table 10 presents the capital levels for the years ended December 31, 2014, 2013 and 2012.

**Table 10**

**CAPITAL**
**(Dollars and Share Numbers in Thousands)**

| | For the Years Ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | 2012 |
| Total stockholders' equity | $ 127,837 | $ 118,216 | $ 109,384 |
| Tier 1 capital | $ 126,715 | $ 117,831 | $ 108,689 |
| Total capital | $ 136,000 | $ 127,107 | $ 118,312 |
| Book value per common share | $ 14.36 | $ 13.28 | $ 12.28 |
| Cash dividends declared per common share | $ - | $ - | $ 2.33 |
| Tier 1 leverage ratio | 10.39% | 9.98% | 9.10% |
| Tier 1 risk-based capital ratio | 16.70% | 15.93% | 14.16% |
| Total risk-based capital ratio | 17.95% | 17.18% | 15.41% |
| Shares outstanding (period end) | 8,905 | 8,905 | 8,905 |
| Basic shares outstanding (average) | 8,905 | 8,905 | 8,905 |
| Diluted shares outstanding (average) | 8.905 | 8,905 | 8,905 |

Total stockholders' equity at December 31, 2014 increased $9.6 million to $127.8 million, or $14.36 book value per common share compared with $118.2 million, or $13.28 book value per common share at December 31, 2013. The increase in stockholders' equity during 2014 was due $8.7 million in net income and an increase accumulated other comprehensive income of $0.9 million.

No dividends were paid in 2013 or 2014 as the Corporation paid a special dividend of $1.70 per share in December of 2012. A key factor in receiving regulatory approval to pay that dividend was the Board's commitment to return to capital levels which existed before the dividend was paid. Management is pleased to report that earnings in 2013 and 2014 have accomplished that commitment. As a result, the Board of Directors resumed dividend payments and declared a dividend of $0.12 per share payable on February 5, 2015 to shareholders as of the record date of January 26, 2015.

As of December 31, 2014, the Corporation's Tier 1 leverage ratio was 10.39% compared to 9.98% at December 31, 2013. Tier 1 risk-based capital ratios were 16.70% and 15.93% at December 31, 2014 and 2013, respectively, and total risk-based capital ratios were 17.95% and 17.18% at December 31, 2014 and 2013, respectively. All of the Corporation's ratios remain significantly in excess of minimum regulatory requirements. A bank is "well capitalized" if it maintains a minimum Tier 1 leverage ratio of 5.0%, a minimum Tier 1 risk based capital ratio of 6.0% and a minimum total risk-based capital ratio of 10.0%. Earnings continue to be stable and provide sufficient capital retention for anticipated growth. Management actively reviews capital strategies for the Corporation and each of its subsidiaries in light of perceived business risks, future growth opportunities, industry standards and regulatory requirements including the implementation of BASIL III capital rules as of beginning on January 1, 2015.

**Interest Rate Risk**

Financial institutions derive their income primarily from the excess of interest collected over interest paid. The rates of interest an institution earns on its assets and pays on its liabilities generally are established contractually for a period of time. Since market interest rates change over time, an institution is exposed to changes in profit margins (or losses) if it cannot adapt to interest rate changes. Interest Rate Risk ("IRR") is the exposure of an organization's financial condition to adverse movements in interest rates. Accepting this risk can be an important source of profitability and stockholder value. However, excessive levels of IRR could pose a significant threat to the Bank's earnings and capital base. Accordingly, effective risk management that maintains IRR at prudent levels is essential to the Bank's safety and soundness.

When assessing IRR, the Bank seeks to ensure that appropriate policies, procedures, management information systems and internal controls are in place to maintain IRR at prudent levels with consistency and continuity. Evaluating the quantitative level of IRR exposure requires the Bank to assess the existing and potential future effects of changes in interest rates on its consolidated financial condition, including capital adequacy, earnings, liquidity and, where appropriate, asset quality.

Financial institutions are also subject to prepayment risk in falling rate environments. For example, mortgage loans and other financial assets may be prepaid by a debtor so that the debtor may refinance its obligations at new, lower rates. Prepayments of assets carrying higher rates reduce the Bank's interest income and overall asset yields. Certain portions of an institution's liabilities may be short-term or due on demand, while most of its assets may be invested in long-term loans or investments. Accordingly, the Bank seeks to have in place sources of cash to meet short-term demands. These funds can be obtained by increasing deposits, borrowing or selling assets. Also, short-term borrowings provide additional sources of liquidity for the Bank.

Several ways an institution can manage IRR include selling existing assets or repaying certain liabilities and matching repricing periods for new assets and liabilities by shortening terms of new loans or investments. The Bank has employed all these strategies in varying degrees. An institution might also invest in more complex financial instruments intended to hedge or otherwise mitigate IRR. Interest rate swaps, futures contracts, options on futures and other such derivative financial instruments are often used for this purpose. The Bank has never purchased any of these types of derivative financial instruments.

In order to measure earnings sensitivity to changing rates, the Bank uses two different measurement tools: static gap analysis and simulation of earnings. The static gap analysis starts with contractual repricing information for assets and liabilities. These items are then combined with repricing estimations for administered rate (interest-bearing demand deposits, savings, and money market accounts) and non-rate related products (demand deposit accounts, other assets and other liabilities) to create a baseline repricing balance sheet.

As table 11 below illustrates, the Bank's balance sheet was asset sensitive to interest rate movements for principal amounts maturing in one year at December 31, 2014. Asset sensitive means that interest-bearing assets will reprice faster than interest-bearing liabilities. In a rising rate environment, an asset sensitive bank will generally be beneficial. Liability sensitive means interest-bearing deposits will reprice faster than interest-bearing assets. In a rising rate environment a liability sensitive bank will generally not be beneficial.

**Table 11**

**STATIC GAP ANALYSIS**
**December 31, 2014**
**(Dollars in Thousands)**

| | Principal Amount Maturing in: | | | | | | |
|---|---|---|---|---|---|---|---|
| | Immediate | 2015 | 2016 | 2017 | 2018 | Thereafter | Total |
| Rate-sensitive assets: | | | | | | | |
| I/B Due From Banks | $ 106,308 | $ - | $ - | $ - | $ - | $ - | $ 106,308 |
| Fed Funds Sold | 2,097 | - | - | - | - | - | 2,097 |
| U. S. Agencies | - | 18,000 | 20,000 | 10,050 | 16,000 | 20,000 | 84,050 |
| Mortgage-Backed Securities | - | 58,967 | 42,993 | 32,020 | 23,250 | 54,498 | 211,728 |
| Municipal Securities | - | 7,091 | 5,021 | 4,194 | 4,525 | 40,328 | 61,159 |
| FRB Stock | 322 | - | - | - | - | - | 322 |
| Commercial | 11,169 | 45,072 | 9,706 | 7,587 | 1,948 | 2,239 | 77,721 |
| Real Estate | 49,809 | 199,576 | 157,787 | 116,135 | 33,184 | 37,113 | 593,604 |
| Consumer | 601 | 1,743 | 1,443 | 1,147 | 311 | 104 | 5,349 |
| Other Loans | 37 | 574 | 538 | 496 | 474 | 2792 | 4911 |
| Total RS Assets | $ 170,343 | $ 331,023 | $ 237,488 | $ 171,629 | $ 79,692 | $ 157,074 | $ 1,147,249 |
| Rate-sensitive liabilities: | | | | | | | |
| NOW Accounts | $ - | $ 52,656 | $ 52,656 | $ 52,656 | $ 52,656 | $ 140,416 | $ 351,040 |
| Money Market Accounts | - | 120,616 | 120,616 | - | - | - | 241,232 |
| Savings | - | 19,992 | 19,991 | 19,991 | 19,991 | 119,948 | 199,913 |
| Time Deposits | - | 83,225 | 17,038 | 9,913 | 3,544 | 2,381 | 116,101 |
| Total RS Liabilities | $ - | $ 276,489 | $ 210,301 | $ 82,560 | $ 76,191 | $ 262,745 | $ 908,286 |

The Corporation's funding acquisition and deployment strategy, management reporting and board approved limits target a cumulative ratio of 1.0 for Rate Sensitive Assets vs. Rate Sensitive Liabilities ("RSA/RSL") at one year. The Bank RSA/RSL ratio is 1.81 at December 31, 2014 (where a cumulative ratio of 1.0 is balanced and neither asset nor liability sensitive after one year). The asset sensitive difference of 0.81 means that $224.9 million more interest-earning assets will be rate adjusted than interest bearing liabilities over the next 12 months. The ratio and analysis includes assumptions that closely follow the Bank's techniques for managing risk: lagged interest rate adjustments, administered rate products, rate adjustment of cash flow from amortization and prepayment of loans through reinvestment, and the reinvestment of maturing assets and liabilities. In this case, management has positioned the Bank to benefit from rising interest rates as the Bank has more assets that will reprice in the next 12 months than liabilities which would positively impact net interest income.

Along with the static gap analysis, determining the sensitivity of short-term future earnings to a hypothetical plus or minus 100 bp and 200 bp parallel rate shock can be accomplished through the use of simulation modeling. In addition to the assumptions used to create the static gap, simulation of earnings includes the modeling of the balance sheet as an ongoing entity. The model projects net interest income based on a hypothetical change in interest rates. The resulting net interest income for the next 12-month period is compared to the net interest income amount calculated using flat rates. Table 12 below represents the Corporation's earnings sensitivity to a plus or minus 100 and 200 bp parallel rate shock.

**Table 12**

**NET INTEREST INCOME OVER ONE YEAR HORIZON**
**(Dollars in Thousands)**

| | Amount | Dollar Change | Percentage Change |
|---|---|---|---|
| +200 bps | $ 40,457 | $ 2,057 | 5.36 % |
| +100 bps | 39,355 | 955 | 2.49 % |
| Base | 38,400 | - | - % |
| -100 bps | 36,178 | (2,222) | (5.79) % |
| -200 bps | 34,266 | (4,134) | (10.76) % |

These results are based solely on the modeled changes in market rates, and do not reflect the earnings sensitivity that may arise from other factors such as the shape of the yield curve and changes in spread between key market rates. These actions also do not include any action management may take to mitigate potential income variances. Actual results will differ from simulated results due to the timing, magnitude and frequency of interest rate changes as well as changes in market conditions and management strategies.

**Liquidity**

The ability to provide the necessary funds for the Bank's day-to-day operations depends on a sound liquidity position. Management monitors the Bank's liquidity by reviewing the maturity distribution between interest-earning assets and interest-bearing liabilities. Fluctuations in interest rates can be the primary cause for the flow of funds into or out of a financial institution. The Bank continues to offer products that are competitive and encourages depositors to invest their funds in these products. Management believes that these efforts will help the Bank to not only retain these deposits, but to encourage continued deposit growth. As of December 31, 2014, the Bank has the ability to borrow up to $70.0 million in federal funds purchased and $23.7 million available for short-term liquidity through the Federal Reserve Bank Discount window.

During the year, the Bank manages its overall liquidity, taking into consideration funded and unfunded commitments as a percentage of its liquidity sources. The Bank's liquidity sources have been and are expected to continue to be sufficient to meet the cash requirements of its lending activities.

**Off-Balance Sheet Arrangements**

The Bank uses certain derivative financial instruments to meet the ongoing credit needs of its customers and to manage the market exposure of its residential loans held for sale and its commitments to extend credit for residential loans. Derivative financial instruments include commitments to extend credit and forward loan sale commitments. The Bank does not use interest rate contracts (e.g. swaps, caps or floors) or other derivatives to manage interest rate risk and has none of these instruments outstanding at December 31, 2014 or 2013. The Bank, through its normal operations, does have loan commitments and standby letters of credit outstanding as of December 31, 2014 and December 31, 2013 in the amount of $105.5 million and $98.0 million, respectively. These items are further explained in Note 18 of the Notes to Consolidated Financial Statements.

**Tri City Bankshares Corporation**
**Selected Financial Data**

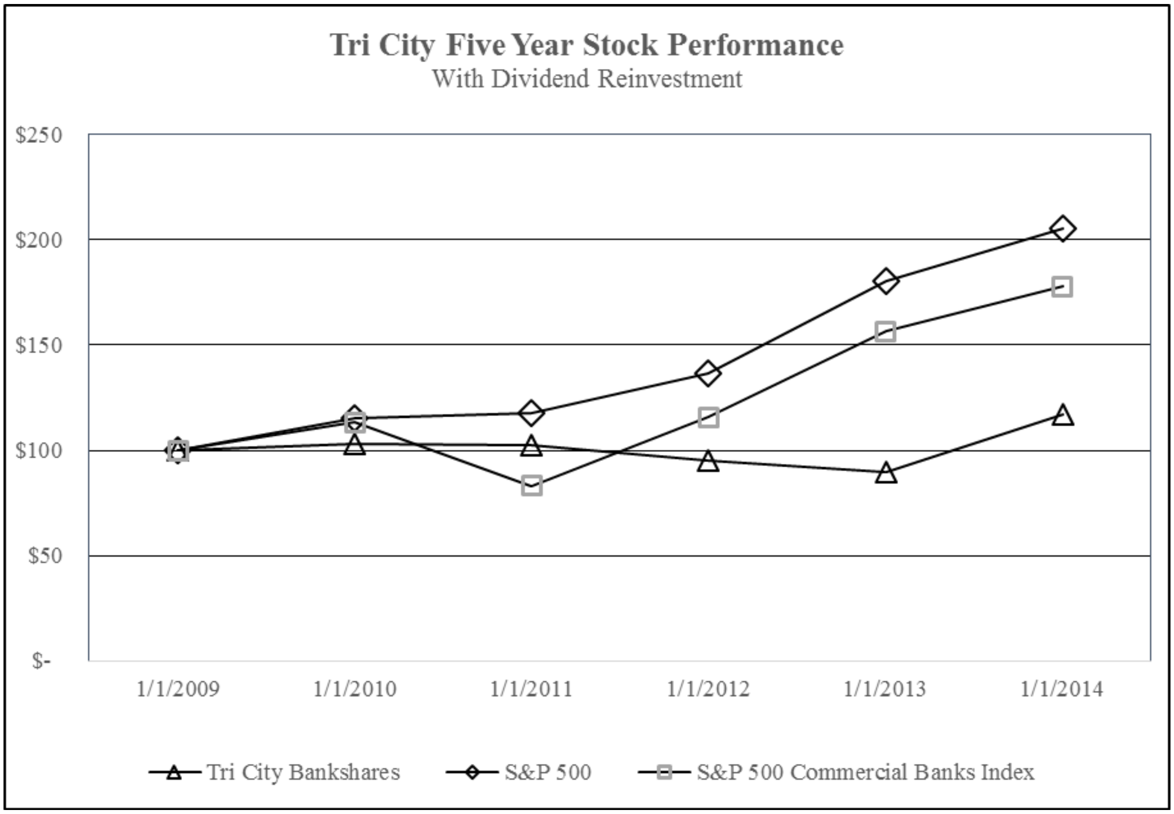
| | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| **Results of Operations:** | | | | | |
| Total interest income | $ 41,031,315 | $ 40,260,922 | $ 45,472,669 | $ 53,196,793 | $ 61,928,649 |
| Total interest expense | 1,285,720 | 1,914,793 | 3,213,143 | 4,583,358 | 5,712,618 |
| Net interest income | 39,745,595 | 38,346,129 | 42,259,526 | 48,613,435 | 56,216,031 |
| Provision for loan losses | 3,000,000 | 6,482,000 | 7,200,000 | 8,370,000 | 6,930,000 |
| Net interest income after PLL | 36,745,595 | 31,864,129 | 35,059,526 | 40,243,435 | 49,286,031 |
| Non-interest income | 13,057,598 | 17,332,360 | 17,191,751 | 14,790,163 | 16,476,536 |
| Non-interest expense | 38,325,052 | 37,993,007 | 40,081,136 | 40,824,792 | 43,078,525 |
| Gain on sale of bank branches | | 2,152,957 | - | - | - |
| Bank owned life insurance death benefit | 1,001,628 | | - | - | - |
| Provision for income tax | 3,768,500 | 4,443,584 | 4,018,157 | 4,692,601 | 8,374,000 |
| Net income | $ 8,711,267 | $ 8,912,855 | $ 8,151,984 | $ 9,516,205 | $ 14,310,042 |
| **Per Share Data:** | | | | | |
| Basic earnings per share | $ 0.98 | $ 1.00 | $ 0.92 | $ 1.07 | $ 1.61 |
| Cash dividends declared per share | $ - | $ - | $ 2.33 | $ 0.21 | $ 2.40 |
| **Selected Financial Condition Data (at December 31):** (Dollars in Thousands) | | | | | |
| Total assets | $ 1,251,881 | $ 1,180,647 | $ 1,231,752 | $ 1,215,143 | $ 1,141,687 |
| Total net loans | 676,541 | 670,639 | 692,440 | 696,786 | 737,302 |
| Investment securities | 357,659 | 331,177 | 351,523 | 360,566 | 227,804 |
| Total deposits | 1,120,507 | 1,058,776 | 1,119,207 | 1,070,480 | 1,018,447 |
| Total stockholders’ equity | 127,837 | 118,216 | 109,384 | 121,981 | 114,335 |

## Market for Corporation's Common Stock

The Corporation's stock is quoted over-the-counter on the OTCQB bulletin board under the trading symbol "TRCY" and on the Pink Sheets under the trading symbol "TRCY.PK." Over-the-counter quotations do not reflect retail mark-up, mark-down or commission and may not necessarily reflect actual transactions.

## STOCK PERFORMANCE GRAPH

The following graph shows the cumulative total stockholder return on the Corporation's common stock over the last five fiscal years compared to the returns of the Standard & Poor's 500 Stock Index and S&P 500 Commercial Banks Index compiled by Standard & Poor's and consisting of 13 regional banks, assuming that $100 is invested on December 31, 2009 with dividends reinvested.




| PERIOD (FISCAL YEAR COVERED) | S&P 500 | S&P 500 COMMERCIAL BANKS | TRI CITY BANKSHARES |
|---|---|---|---|
| 2009 | $ 100.00 | $ 100.00 | $ 100.00 |
| 2010 | $ 115.06 | $ 113.13 | $ 103.08 |
| 2011 | $ 117.49 | $ 83.05 | $ 102.38 |
| 2012 | $ 136.30 | $ 115.70 | $ 94.98 |
| 2013 | $ 180.44 | $ 156.56 | $ 89.89 |
| 2014 | $ 205.14 | $ 177.80 | $ 117.03 |

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# INDEPENDENT AUDITORS' REPORT

Board of Directors and Shareholders
Tri City Bankshares Corporation
Oak Creek, Wisconsin

### *Report on the Financial Statements*

We have audited the accompanying consolidated financial statements of Tri City Bankshares Corporation and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### *Management's Responsibility for the Financial Statements*

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

### *Auditors' Responsibility*

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

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

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

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Tri City Bankshares Corporation and its subsidiaries as of December 31, 2014 and 2013 and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

We also have audited in accordance with attestation standards established by the American Institute of Certified Public Accountants, Tri City Bankshares Corporation and its subsidiaries internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") (1992 framework) and our report dated March 6, 2015 expressed an unqualified opinion.

Baker Tilly Virchow Krause, LLP

Milwaukee, Wisconsin
March 6, 2015

**TRI CITY BANKSHARES CORPORATION**

CONSOLIDATED BALANCE SHEETS

As of December 31, 2014 and 2013

***ASSETS***

| | 2014 | 2013 |
|---|---|---|
| Cash and due from banks | $ 149,820,849 | $ 114,523,575 |
| Federal funds sold | 2,096,707 | 2,986,359 |
| Cash and cash equivalents | 151,917,556 | 117,509,934 |
| Held to maturity securities, at amortized cost | 208,203,370 | 298,904,927 |
| Securities available for sale, at fair value | 149,455,784 | 32,272,071 |
| Loans held for investment, less allowance for loan losses of $12,103,357 and $12,370,590 as of 2014 and 2013, respectively | 676,541,152 | 670,639,122 |
| Premises and equipment – net | 14,824,325 | 15,895,213 |
| Cash surrender value of life insurance | 35,175,395 | 29,339,423 |
| Mortgage servicing rights – net | 1,653,047 | 1,751,649 |
| Core deposit intangible | 291,929 | 464,541 |
| Other real estate owned - net | 4,772,139 | 5,709,401 |
| Accrued interest receivable and other assets | 9,045,906 | 8,160,899 |
| **TOTAL ASSETS** | $ 1,251,880,603 | $ 1,180,647,180 |

**LIABILITIES AND STOCKHOLDERS' EQUITY**

| | 2014 | 2013 |
|---|---|---|
| **LIABILITIES** | | |
| Deposits | | |
| Demand | $ 212,462,972 | $ 194,943,002 |
| Savings and NOW | 791,945,928 | 728,358,155 |
| Other time | 116,098,323 | 135,474,838 |
| Total Deposits | 1,120,507,223 | 1,058,775,995 |
| Accrued interest payable and other liabilities | 3,536,818 | 3,655,601 |
| Total Liabilities | 1,124,044,041 | 1,062,431,596 |
| **STOCKHOLDERS' EQUITY** | | |
| Cumulative preferred stock, $1 par value 200,000 shares authorized, no shares issued | - | - |
| Common stock, $1 par value, 15,000,000 shares authorized, 8,904,915 shares issued and outstanding in 2014 and 2013 | 8,904,915 | 8,904,915 |
| Additional paid-in-capital | 26,543,470 | 26,543,470 |
| Accumulated other comprehensive income (loss) | 828,175 | (81,536 ) |
| Retained earnings | 91,560,002 | 82,848,735 |
| Total Stockholders' Equity | 127,836,562 | 118,215,584 |
| **TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY** | $ 1,251,880,603 | $ 1,180,647,180 |

See accompanying notes to consolidated financial statements.

**TRI CITY BANKSHARES CORPORATION**

CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31, 2014 and 2013

| | 2014 | 2013 |
|---|---|---|
| **INTEREST INCOME** | | |
| Loans | $ 32,709,920 | $ 36,024,369 |
| Investment securities | | |
| Taxable | 7,014,986 | 2,926,997 |
| Tax exempt | 1,148,970 | 1,104,994 |
| Federal funds sold and due from banks | 138,113 | 185,236 |
| Other | 19,326 | 19,326 |
| Total Interest Income | 41,031,315 | 40,260,922 |
| **INTEREST EXPENSE** | | |
| Deposits | 1,285,562 | 1,914,736 |
| Other borrowings | 158 | 57 |
| Total Interest Expense | 1,285,720 | 1,914,793 |
| Net Interest Income before Provision for Loan Losses | 39,745,595 | 38,346,129 |
| Provision for loan losses | 3,000,000 | 6,482,000 |
| Net Interest Income after Provision for Loan Losses | 36,745,595 | 31,864,129 |
| **NONINTEREST INCOME** | | |
| Service charges on deposits | 9,699,258 | 9,777,598 |
| Loan servicing income | 467,859 | 356,779 |
| Net gain on sale of loans | 456,268 | 1,557,687 |
| Increase in cash surrender value of life insurance | 962,319 | 1,010,498 |
| Bank owned life insurance death benefit | 1,001,628 | - |
| Gain on sale of bank branches | - | 2,152,957 |
| Non-accretable loan discount | 484,166 | 3,680,013 |
| Other income | 987,728 | 949,785 |
| Total Noninterest Income | 14,059,226 | 19,485,317 |
| **NONINTEREST EXPENSES** | | |
| Salaries and employee benefits | 21,492,554 | 21,405,721 |
| Net occupancy costs | 4,143,585 | 4,092,791 |
| Furniture and equipment expenses | 1,624,362 | 1,740,409 |
| Computer services | 3,115,265 | 2,978,800 |
| Advertising and promotional | 744,221 | 729,900 |
| FDIC and other regulatory assessments | 1,140,036 | 1,273,385 |
| Office supplies | 841,185 | 765,107 |
| Core deposit intangible amortization | 172,613 | 230,381 |
| Other expense | 5,051,233 | 4,776,513 |
| Total Noninterest Expenses | 38,325,054 | 37,993,007 |
| Total Income before Taxes | 12,479,767 | 13,356,439 |
| Less: Income tax expense | 3,768,500 | 4,443,584 |
| **NET INCOME** | $ 8,711,267 | $ 8,912,855 |
| Basic earnings per share | $ 0.98 | $ 1.00 |
| Weighted average shares outstanding | 8,904,915 | 8,904,915 |

See accompanying notes to consolidated financial statements.

**TRI CITY BANKSHARES CORPORATION**

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2014 and 2013

| | 2014 | 2013 |
|---|---|---|
| NET INCOME | $ 8,711,267 | $ 8,912,855 |
| Other Comprehensive income (loss), net of tax: | | |
| Unrealized gain (losses) on securities available for sale: | | |
| Net unrealized holding gains (losses) arising during the period | 1,519,600 | (136,200) |
| Tax effect | (609,889) | 54,664 |
| Total other comprehensive income (loss), net of tax: | 909,711 | (81,536) |
| COMPREHENSIVE INCOME | $ 9,620,978 | $ 8,831,319 |

See accompanying notes to consolidated financial statements.

**TRI CITY BANKSHARES CORPORATION**

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the Years Ended December 31, 2014 and 2013

| | Common Stock | Additional Paid-in Capital | Accumulated Other Comprehensive Income (Loss) | Retained Earnings | Total |
|---|---|---|---|---|---|
| **BALANCES –** January 1, 2013 | $ 8,904,915 | $ 26,543,470 | $ - | $ 73,935,880 | $ 109,384,265 |
| Net income | - | - | - | 8,912,855 | 8,912,855 |
| Net changes in unrealized gain (loss) on securities available for sale | - | - | (136,200) | - | (136,200) |
| Tax effect | - | - | 54,664 | - | 54,664 |
| Total Comprehensive income | | | | | 8,831,319 |
| **BALANCES –** December 31, 2013 | 8,904,915 | 26,543,470 | (81,536) | 82,848,735 | 118,215,584 |
| Net Income | - | - | - | 8,711,267 | 8,711,267 |
| Net changes in unrealized gain (loss) On securities available for sale | - | - | 1,519,600 | - | 1,519,600 |
| Tax effect | | | (609,889) | | (609,889) |
| Total Comprehensive income | | | | | 9,620,978 |
| **BALANCES –** December 31, 2014 | $ 8,904,915 | $ 26,543,470 | $ 828,175 | $ 91,560,002 | $ 127,836,562 |

See accompanying notes to consolidated financial statements.

**TRI CITY BANKSHARES CORPORATION**

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2014 and 2013

| | 2014 | 2013 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Net Income | $ 8,711,267 | $ 8,912,855 |
| Adjustments to reconcile net income to net cash flows from operating activities: | | |
| Depreciation | 1,627,918 | 1,905,020 |
| Amortization (accretion) of servicing rights, premiums and discounts | 733,500 | (376,752) |
| Gain on sale of loans | (456,268) | (1,557,687) |
| Amortization of other intangibles | 172,613 | 230,381 |
| Provision for loan losses | 3,000,000 | 6,482,000 |
| Benefit for deferred income taxes | (122,295) | (733,998) |
| Proceeds from sales of loans held for sale | 20,139,151 | 60,894,249 |
| Originations of loans held for sale | (19,823,143) | (59,794,904) |
| Increase in cash surrender value of life insurance | (962,319) | (1,010,498) |
| Gain on other real estate owned | (111,445) | (803,891) |
| Provision for valuation allowance on other real estate owned | 107,500 | - |
| Gain on sale of bank branches | - | (2,152,957) |
| Loss (gain) on disposal of premises and equipment | 29,062 | (6,923) |
| Gain on death benefits of life insurance policy | (1,001,628) | - |
| Net change in: | | |
| Accrued interest receivable and other assets | (885,007) | (410,387) |
| Payable for investments purchased | 2,361 | - |
| Accrued interest payable and other liabilities | (608,738) | 1,283,353 |
| Net Cash Flows From Operating Activities | 10,552,529 | 12,859,861 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Activity in held to maturity securities: | | |
| Maturities, prepayments and calls | 89,910,801 | 138,080,907 |
| Purchases | (621,148) | (90,825,232) |
| Activity in available for sale securities: | | |
| Maturities, prepayments and calls | 11,667,995 | - |
| Purchases | (128,104,629) | (32,416,354) |
| Net (increase) decrease in loans | (10,132,740) | 11,450,735 |
| Purchase of life insurance | (6,000,000) | - |
| Purchases of premises and equipment – net | (623,724) | (742,254) |
| Proceeds from sale of other real estate owned | 3,861,703 | 13,646,937 |
| Proceeds of life insurance death benefit | 2,127,975 | - |
| Proceeds from sales of premises and equipment | 37,632 | 3,107,167 |
| Net Cash Flows From Investing Activities | (37,876,135) | 42,301,906 |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Net increase (decrease) in deposits | 61,731,228 | (60,431,142) |
| Net Cash Flows From Financing Activities | 61,731,228 | (60,431,142) |
| **Net Change in Cash and Cash Equivalents** | 34,407,622 | (5,269,375) |
| CASH AND CASH EQUIVALENTS – BEGINNING OF YEAR | 117,509,934 | 122,779,309 |
| **CASH AND CASH EQUIVALENTS – END OF YEAR** | $ 151,917,556 | $ 117,509,934 |

See accompanying notes to consolidated financial statements.

**TRI CITY BANKSHARES CORPORATION**

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2014 and 2013

(continued)

| | 2014 | 2013 |
|---|---|---|
| SUPPLEMENTAL CASH FLOW DISCLOSURES | | |
| Cash paid for interest | $ 1,311,754 | $ 1,977,489 |
| Cash paid for income taxes | 4,970,000 | 4,980,000 |
| Loans receivable transferred to other real estate owned | 2,920,496 | 10,007,782 |
| Mortgage servicing rights resulting from sales of loans | 140,260 | 458,342 |

See accompanying notes to consolidated financial statements.

## NOTE 1 - Summary of Significant Accounting Policies

The consolidated financial statements of Tri City Bankshares Corporation (the "Corporation") include the accounts of its wholly owned subsidiary, Tri City National Bank (the "Bank"). The Bank includes the accounts of its wholly owned subsidiaries, Tri City Capital Corporation, a Nevada investment subsidiary, and Title Service of Southeast Wisconsin, Inc., a title company subsidiary. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") and conform to general practices within the banking industry. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements. The Corporation has evaluated the consolidated financial statements for subsequent events through the report issue date.

The consolidated income of the Corporation is principally from the income of the Bank. The Bank grants commercial, real estate and installment loans and accepts deposits primarily in Southeastern Wisconsin. The Corporation and the Bank are subject to competition from other financial institutions and nonfinancial institutions providing financial products. Additionally, the Corporation and the Bank are subject to the regulations of certain regulatory agencies and undergo periodic examination by those regulatory agencies.

On June 3, 2013, the Bank entered into a branch sale agreement to sell the Bank's branch operations in Cedarburg and Grafton Wisconsin. On November 1, 2013, the transaction, which included total deposits of $21.6 million was consummated, resulting in a gain on sale of $2.2 million.

*Use of Estimates*

In preparing consolidated financial statements in conformity with U.S. GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, valuation of other real estate owned, deferred taxes, other than temporary impairment of securities and fair values of financial instruments

*Cash and Cash Equivalents*

For purposes of reporting cash flows, cash and cash equivalents include cash and balances due from banks and federal funds sold, all of which mature within ninety days. The Bank maintains amounts due from banks which exceeded federally insured limits by $0.4 million as of December 31, 2014. The Bank has not experienced any losses in such accounts.

*Securities*

Securities classified as held to maturity are those securities the Bank has both the intent and ability to hold to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions. Interest and dividends are included in interest income from the related securities as earned. Securities are accounted for on a trade date basis and carried at cost, adjusted for amortization of premium and accretion of discount, computed by the effective interest method over their contractual lives. The sale of a security within three months of its maturity date or after collection of at least 85 percent of the principal outstanding at the time the security was acquired is considered a maturity for purposes of classification and disclosure

Securities are classified as available for sale when the Bank intends to hold them for an indefinite period of time but not necessarily to maturity. Securities available for sale are accounted for on a trade date basis and carried at fair value, with unrealized holding gains and losses excluded from net income and reported in accumulated other comprehensive income, net of tax. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Declines in the fair value of securities below their cost that are other-than-temporary due to credit issues are reflected as "Other than temporary impairment of securities" in the consolidated statement of income. In estimating other-than-temporary losses, management considers: (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the Corporation's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value. The difference between the present values of the cash flows expected to be collected and the amortized cost basis is the credit loss. The credit loss is the portion of the other-than-temporary impairment that is recognized in earnings and is a reduction to the cost basis of the security. The portion of other-than-temporary impairment related to all other factors is included in other comprehensive income (loss).

**NOTE 1 - Summary of Significant Accounting Policies** (cont.)

*Loans*

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the amount of unpaid principal, reduced by an allowance for loan losses and any deferred fees or costs in originating loans. Interest income is accrued and credited to income on a daily basis based on the unpaid principal balance. Loan origination fees, net of certain direct loan origination costs, are deferred and recognized as an adjustment of the loan yield using an effective interest method. The accrual of interest income on impaired loans is discontinued when, in the opinion of management, there is reasonable doubt as to the borrower's ability to meet payment of interest or principal when they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Cash collections on impaired loans are credited to the loan receivable balance and no interest income is recognized on those loans until the principal balance is current. Loans are returned to accrual status when the principal and interest amounts contractually due are brought current and future payments are reasonably assured. A troubled debt restructuring (“TDR”) includes a loan modification where a borrower is experiencing financial difficulty and the Bank grants a concession to that borrower that the Bank would not otherwise consider except for the borrower’s financial difficulties. All TDRs are classified as impaired loans. TDRs may be on accrual or non-accrual status based upon the performance of the borrower and management’s assessment of collectability. Loans deemed non-accrual may return to accrued status based on performance in accordance with terms of the restructuring, generally 6 months.

Consistent with regulatory guidance, charge-offs are taken when specific loans, or portions thereof, are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. The Bank’s policy is to promptly charge these loans off in the period the uncollectible loss amount is reasonably determined. The Bank promptly charges-off commercial and real estate loans, or portions thereof, when available information confirms that specific loans are uncollectible based on information that includes, but is not limited to, (1) the deteriorating financial condition of the borrower, (2) declining collateral values, and/or (3) legal action, including bankruptcy, that impairs the borrower’s ability to adequately meet its obligations. All consumer loans 120 days past due and all other loans with principal and interest 180 days or more past due will be reviewed for potential charge-off at least quarterly.

*Loans Acquired Through Purchase*

Loans acquired through the completion of a purchase, including loans that have evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the Bank will be unable to collect all contractually-required payments receivable, are initially recorded at fair value with no valuation allowance. Loans are evaluated individually at the date of acquisition to determine if there is evidence of deterioration of credit quality since origination. Loans where there is evidence of deterioration of credit quality since origination may be aggregated and accounted for as a pool of loans if the loans being aggregated have common risk characteristics. Contractually-required payments for interest and principal that exceed the undiscounted cash flows expected at acquisition, or the “nonaccretable difference,” are not recognized as a yield adjustment, a loss accrual or a valuation allowance. Non-accretable discount may be taken to non-interest income if a loan pays-off or if the non-accretable discount is greater than a charge-off taken. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior charges or a reclassification of the difference from non-accretable discount to accretable discount with a positive impact on interest income. The difference between the undiscounted cash flows expected at acquisition and the investment in the loan, or the “accretable yield,” is recognized as interest income on a level-yield method over the life of the loan. Increases in expected cash flows subsequent to the initial investment are recognized prospectively through adjustment of the yield on the loan over its remaining life. Decreases in expected cash flows are recognized as provision for loan losses. If the Bank does not have the information necessary to reasonably estimate expected cash flows, it may use the cost recovery method or cash basis method of income recognition. Valuation allowances on these impaired loans reflect only losses incurred after the acquisition (meaning the present value of all cash flows expected at acquisition that ultimately are not to be received).

*Loans Held for Sale*

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net unrealized gains or losses are recognized through a valuation allowance by charges to income. All sales are made without recourse.

**NOTE 1 - Summary of Significant Accounting Policies** (cont.)

*Allowance for Loan Losses*

The allowance for loan losses is a valuation allowance for probable and inherent losses incurred in the loan portfolio. Management maintains allowances for loan losses at levels deemed adequate to absorb estimated probable credit losses inherent in the loan portfolio. The adequacy of the allowances is determined based on periodic evaluations of the loan portfolios and other relevant factors. The allowance is comprised of both a specific component and a general component. Even though the entire allowance is available to cover losses on any loan, specific allowances are provided on impaired loans pursuant to accounting standards. The general allowance is based on historical loss experience, adjusted for qualitative and environmental factors. Management reviews the assumptions and methodology related to the general allowance in an effort to update and refine the estimate on a quarterly basis.

In determining the general allowance management has segregated the loan portfolio by loan class. For each class of loan, a historical loss factor is computed. In determining the appropriate period of activity to use in computing the historical loss factor management reviews trends in net charge-off ratios. It is management's intention to utilize a period of activity that is most reflective of current experience. Changes in the historical period are made when there is a distinct change in the trend of net charge-off experience. Management adjusts the historical loss factors for the impact of the following qualitative factors: asset quality, changes in volume and terms, policy changes, ability of management, economic trends, industry conditions, changes in credit concentrations and competitive/legal factors. In determining the impact, if any, of an individual qualitative factor, management compares the current underlying facts and circumstances surrounding a particular factor with those in the historical periods, adjusting the historical loss factor in a directionally consistent manner with changes in the qualitative factor. Management separately evaluates both the Bank's historical portfolio as well as acquired loans that have renewed and are eligible to be considered as part of the general allowance. Management will continue to analyze the qualitative factors on a quarterly basis, adjusting the historical loss factor both up and down, to a factor deemed appropriate for the probable and inherent risk of loss in its portfolio.

Specific allowances are determined as a result of the impairment process. When a loan is identified as impaired it is evaluated for loss using either the fair value of collateral method or the present value of cash flows method. If the present value of expected cash flows or the fair value of collateral exceeds the Bank's carrying value of the loan, no loss is anticipated and no specific reserve is established. However, if the Bank's carrying value of the loan is greater than the present value of expected cash flows or fair value of collateral, a specific reserve is established. In either situation, loans identified as impaired are excluded from the calculation of the general reserve.

The allowance for loan losses is increased by provisions charged to earnings and reduced by charge-offs, net of recoveries. The adequacy of the allowance for loan losses is reviewed and approved by the Bank's Board of Directors on a quarterly basis. The allowance for loan losses reflects management's best estimate of the probable and inherent losses on loans and is based on a risk model developed and implemented by management and approved by the Bank's Board of Directors.

In addition, various regulatory agencies periodically review the allowance for loan losses. These agencies may suggest additions to the allowance for loan losses based on their judgments of collectability based on information available to them at the time of their examination.

*Transfers of Financial Assets*

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is 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.

*Mortgage Servicing Rights*

The Bank records a mortgage servicing right ("MSR") asset when it continues to service borrower payments and perform maintenance activities on loans in which the loan has been sold to secondary market investors. The servicing rights are initially capitalized at fair value on an individual loan level basis. In the period in which the loan is sold to the secondary market investors, the gain on sale of the loan is increased by the value of the initial MSR. Amortization of MSRs is calculated based on actual payment activity on a per loan basis and is included in loan servicing income on the consolidated statements of income.

Quarterly impairment testing is performed by the Bank to determine that MSRs are recorded at the lower of fair value or amortized cost. Annually the Bank engages a third party specialist to calculate the fair value using significant inputs/assumptions such as prepayment speed, default rates, cost to service and discount rates. A valuation allowance is recorded when the fair value of the MSRs is less than its amortized cost.

**NOTE 1 - Summary of Significant Accounting Policies** (cont.)

*Premises and Equipment*

Depreciable assets are stated at cost less accumulated depreciation. Provisions for depreciation are computed on straight-line methods over the estimated useful lives of the assets, which range from 3 to 10 years for furniture and equipment and 15 to 40 years for buildings and lease-hold improvements. Repairs and maintenance costs are expensed as incurred.

*Other Real Estate Owned*

Other real estate owned ("OREO") comprises real estate acquired in partial or full satisfaction of loans. OREO is recorded at estimated fair value less estimated selling costs at the date of transfer, establishing a new cost basis, with any excess of the related loan balance over the fair value less expected selling costs charged to the allowance for loan losses. Subsequently, properties are evaluated and if fair value declines, a valuation allowance is recorded through expense. The amount the Bank ultimately recovers on repossessed assets may differ substantially from the net carrying value of these assets because of future market factors beyond the Bank's control. Net costs of maintaining and operating the properties are expensed as incurred.

*Intangible Assets*

The Bank's intangible assets include the value of ongoing customer relationships (core deposit intangible) arising from the purchase of certain assets and the assumption of certain liabilities from unrelated entities. Core deposit intangibles are amortized over an eight year period. Any impairment in the intangibles would be recorded against income in the period of impairment. No impairment was recorded during the years ended December 31, 2014 and 2013.

*Federal Reserve Bank Stock*

The Bank's investment in Federal Reserve Bank ("FRB") stock meets the minimum amount required by current regulations and is carried at cost, which approximates fair value.

*Off-Balance Sheet Financial Instruments*

In the ordinary course of business the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

*Derivative Financial Instruments*

The Bank utilizes derivative financial instruments to meet the ongoing credit needs of its customers and in order to manage the market exposure of its residential loans held for sale and its commitments to extend credit for residential loans. Derivative financial instruments include commitments to extend credit. The Bank does not use interest rate contracts (e.g. swaps, caps, floors) or other derivatives to manage interest rate risk and has none of these instruments outstanding at December 31, 2014 or 2013.

*Advertising Costs*

All advertising costs incurred by the Bank are expensed in the period in which they are incurred and recorded in noninterest expense.

*Income Taxes*

The Corporation files a consolidated federal income tax return and combined state income tax returns. Income tax expense is recorded based on the liability method. Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The differences relate principally to the allowance for loan losses, mortgage servicing rights, deferred loan fees, and premises and equipment. Valuation allowances are established when necessary to reduce deferred income tax assets to the amount expected to be realized. The Corporation also accounts for the uncertainty in income taxes related to the recognition and measurement of a tax position taken or expected to be taken in an income tax return. The Corporation follows the applicable accounting guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition related to the uncertainty in these income tax positions. It is the Corporation's policy to include interest and penalties in tax expense.

**NOTE 1 - Summary of Significant Accounting Policies** (cont.)

*Earnings Per Share*

Basic earnings per share is computed based upon the weighted average number of common shares outstanding during each year. The Corporation had no potentially dilutive shares outstanding during the periods ended December 31, 2014 and 2013.

*Segment Reporting*

The Corporation has determined that it has one reportable segment - community banking. The Bank offers a range of financial products and services to external customers, including: accepting deposits and originating residential, consumer and commercial loans. Revenues for each of these products and services are disclosed in the consolidated statements of income.

*Employee Benefit Plan*

The Bank has established a defined contribution 401(k) profit-sharing plan for qualified employees. The Bank's policy is to fund contributions as accrued.

*Bank Owned Life Insurance*

The Bank has purchased life insurance policies on certain key employees. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is net cash surrender value. Appreciation in value of the insurance policies is classified as noninterest income.

*Reclassifications*

Certain 2014 and 2013 amounts have been reclassified to conform to the 2014 presentation. The reclassifications have no effect on previously reported consolidated net income, basic earnings per share, and consolidated stockholders' equity.

*Recent Accounting Pronouncements*

In January 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2015-01 *Income Statement - Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items.* The amendment eliminates from U.S. GAAP the concept of extraordinary items. Subtopic 225-20, Income Statement – Extraordinary and Unusual Items, required that an entity separately classify, present, and disclose extraordinary events and transactions. Presently, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. If an event or transaction meets the criteria for extraordinary classification, an entity is required to segregate the extraordinary item from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. The entity also is required to disclose applicable income taxes and either present or disclose earnings-per-share data applicable to the extraordinary item. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively or retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The adoption of this guidance is not expected to have a significant impact on the consolidated financial condition, results of operations or liquidity of the Corporation.

In November 2014, the FASB issued ASU No. 2014-17, *Business Combinations (Topic 805): Pushdown Accounting*. The amendments in ASU 2014-17 provide an acquired entity with an option to apply pushdown accounting in its separate financial statements upon occurrence of an event in which an acquirer obtains control of the acquired entity. An acquired entity may elect the option to apply pushdown accounting in the reporting period in which the change-in-control event occurs. An acquired entity should determine whether to elect to apply pushdown accounting for each individual change-in-control event in which an acquirer obtains control of the acquired entity. If pushdown accounting is not applied in the reporting period in which the change-in-control event occurs, an acquired entity will have the option to elect to apply pushdown accounting in a subsequent reporting period to the acquired entity's most recent change-in-control event. An election to apply pushdown accounting in a reporting period after the reporting period in which the change-in-control event occurred should be considered a change in accounting principle in accordance with Topic 250, Accounting Changes and Error Corrections. If pushdown accounting is applied to an individual change-in-control event, that election is irrevocable. This guidance is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The adoption of this guidance is not expected to have a significant impact on the consolidated financial condition, results of operations or liquidity of the Corporation.

**NOTE 1 - Summary of Significant Accounting Policies** (cont.)

In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements – Going Concern (Subtopic 205-40)*. In connection with preparing financial statements for each annual and interim reporting periods, an entity's management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable). Management's evaluation should be based on relevant conditions and events that are known and reasonably knowable at the date that the financial statements are issued (or at the date that the financial statements are available to be issued when applicable). The amendments in this update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. The adoption of this guidance is not expected to have a significant impact on the consolidated financial condition, results of operations or liquidity of the Corporation.

In August 2014, the FASB issued ASU No. 2014-14, *Receivables – Troubled Debt Restructuring by Creditors (Subtopic 310-40)*. The amendments in this update require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: (1) the loan has a government guarantee that is not separable from the loan before foreclosure. (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim and (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in this update are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The adoption of this guidance is not expected to have a significant impact on the consolidated financial condition, results of operations or liquidity of the Corporation.

In June 2014, the FASB issued ASU No. 2014-11, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financing, and Disclosures.* The amendments in this guidance require repurchase-to-maturity transactions to be accounted for as secured borrowings. The guidance for certain transactions accounted for as a sale, as well as new disclosures for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions accounted for as secured borrowings is effective prospectively, for annual and interim periods, beginning after December 15, 2014. The adoption of the guidance is not expected to have a significant impact on the consolidated financial condition, results of operations or liquidity of the Corporation.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606).* Under the amended guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance is effective prospectively, for annual and interim periods, beginning after December 15, 2016. Management is currently evaluating this guidance and does not expect this guidance will have a significant impact on the consolidated financial condition, results of operations or liquidity of the Corporation.

In January 2014, the FASB issued ASU No. 2014-04, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40) Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force).* The amendments in ASU 2014-04 clarify when an in-substance repossession or foreclosure occurs — that is, 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 receivable should be derecognized and the real estate property recognized. The new ASU requires a creditor to reclassify a collateralized consumer mortgage loan to real estate property upon obtaining legal title to the real estate collateral, or the borrower voluntarily conveying all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. This ASU is effective for the Corporation beginning January 1, 2015. The provisions of this guidance are not expected to have a significant impact on the consolidated financial condition, results of operations or liquidity of the Corporation.

## NOTE 2 - Fair Value of Financial Instruments

The accounting guidance for fair value measurements and disclosures establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy favors the transparency of inputs to the valuation of an asset or liability as of the measurement date and thereby favors use of Level 1 if appropriate information is available, and otherwise Level 2 and finally Level 3 if a Level 2 input is not available. The three levels are defined as follows.

- Level 1 — Fair value is based upon quoted prices (unadjusted) for identical assets or liabilities in active markets in which the Corporation can participate.
- Level 2 — Fair value is based upon quoted prices for similar (i.e., not identical) assets and liabilities in active markets, and other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 — Fair value is based upon financial models using primarily unobservable inputs.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input within the valuation hierarchy that is significant to the fair value measurement.

The Corporation has an established process for determining fair value of assets on both a recurring and nonrecurring basis. Fair value is based upon quoted market prices, where available. If listed prices or quotes are not available, fair value is based upon internally developed models that use primarily market-based or independently-sourced market parameters, including interest rate yield curves and option volatilities. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments include amounts to reflect counterparty credit quality, creditworthiness, liquidity and unobservable parameters that are applied consistently over time. Any changes to the valuation methodology are reviewed by management to determine appropriateness of the changes.

*Securities available for sale* - The fair value of securities available for sale is determined by obtaining market price quotes from independent third parties wherever such quotes are available. Where such quotes are not available, management utilizes independent third party valuation analysis to support these estimates and judgments in determining fair value. The table below presents, for the periods noted the Corporation's fair value of securities available for sale in accordance with the fair value hierarchy described above.

*Loans held for investment* - The Bank does not record loans held for investment at fair value on a recurring basis. However, from time to time, a particular loan may be considered impaired and an allowance for loan losses established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with relevant accounting guidance. The fair value of impaired loans is estimated using either the fair value of collateral method or the present value of cash flows method. Those impaired loans requiring an allowance represent loans for which the fair value of the expected repayments or collateral does not exceed the recorded investments in such loans. The Bank records these impaired loan as nonrecurring level 3 in the fair value hierarchy. At December 31, 2014 and 2013, substantially all of the impaired loans were evaluated based on the fair value of the collateral.

*Other real estate owned* - Loans on which the underlying collateral has been repossessed are recorded at fair value less estimated costs to sell upon transfer to OREO establishing a new cost basis. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral and recorded as nonrecurring level 3 in the fair value hierarchy.

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

**NOTE 2 - Fair Value of Financial Instruments** (cont.)

Assets measured at fair value on a recurring basis for 2014 and 2013 are summarized below:

## Assets measured on a recurring basis

| | Balance at 12/31/14 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Securities available for sale: | | | | |
| Collateralized mortgage obligations | $ 72,169,725 | $ - | $ 72,169,725 | $ - |
| Mortgage-backed securities | 62,574,818 | - | 62,574,818 | - |
| State and political subdivision (tax exempt) | 14,711,241 | - | 14,711,241 | - |
| Total securities available for sale | $ 149,455,784 | $ - | $ 149,455,784 | $ - |

| | Balance at 12/31/13 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Securities available for sale: | | | | |
| Collateralized mortgage obligations | $ 5,277,348 | $ - | $ 5,277,348 | $ - |
| Mortgage-backed securities | 26,994,723 | - | 26,994,723 | - |
| Total securities available for sale | $ 32,272,071 | $ - | $ 32,272,071 | $ - |

Assets measured at fair value on a non-recurring basis for 2014 and 2013 are summarized below:

## Assets measured on a nonrecurring basis

| | Balance at 12/31/14 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Loans held for investment | $ 14,992,514 | $ - | $ - | $ 14,992,514 |
| Other real estate owned | 4,772,139 | - | - | 4,772,139 |
| Totals | $ 19,764,653 | $ - | $ - | $ 19,764,653 |

| | Balance at 12/31/13 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Loans held for investment | $ 16,865,798 | $ - | $ - | $ 16,865,798 |
| Other real estate owned | 5,709,401 | - | - | 5,709,401 |
| Totals | $ 22,575,199 | $ - | $ - | $ 22,575,199 |

Disclosure of fair value information about financial instruments, for which it is practicable to estimate that value, is required whether or not recognized in the consolidated balance sheets. 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, could not be realized in immediate settlement of the instruments. Certain financial instruments with a fair value that is not practicable to estimate and all non-financial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented do not necessarily represent the underlying value of the Corporation.

**NOTE 2 - Fair Value of Financial Instruments (**cont.)

The following is a description of the valuation methodologies used by the Corporation to estimate fair value, as well as the general classification of financial instruments pursuant to the valuation hierarchy:

*Cash and due from banks* – Due to their short-term nature, the carrying amount of cash and due from banks approximates fair value.

*Fed funds sold* – Due to their short-term nature, the carrying amount of Fed funds sold approximates fair value.

*Held to maturity and available for sale securities* – The fair value is estimated using quoted market prices.

*Federal Reserve Bank Stock* – It is not practical to determine the fair value of FRB stock due to restrictions placed on its transferability. No secondary market exists for FRB stock. The stock is bought and sold at par by the FRB. Management believes the recorded value is the fair value.

*Loans held for investment* – The fair value of loans held for investment is estimated using the rates currently offered for loans held for investment segregated by loan purpose and term.

*Cash surrender value of life insurance* – Fair value is based on the cash surrender value of the individual policies as provided by the insurance agency.

*Mortgage servicing rights* - The fair value of MSRs is estimated using third-party information for selected asset price tables for servicing cost and servicing fees applied to the Bank's portfolio of serviced loans.

*Accrued interest receivable* – The carrying amount of accrued interest receivable approximates fair value.

*Deposits* - The fair value of demand deposits and savings accounts approximates the carrying amount. The fair value of fixed maturity certificates of deposit is estimated using the rates currently offered for certificates of deposit with similar remaining maturities.

*Accrued interest payable* – The carrying amount of accrued interest payable approximates fair value.

The estimated fair values of financial instruments as of December 31,

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| **FINANCIAL ASSETS** | | | | |
| Cash and due from banks | $ 149,820,849 | $ 149,820,849 | $ 114,523,575 | $ 114,523,575 |
| Federal funds sold | 2,096,707 | 2,096,707 | 2,986,359 | 2,986,359 |
| Held to maturity securities | 208,203,370 | 210,535,155 | 298,904,927 | 294,615,354 |
| Available for sale securities | 149,455,784 | 149,455,784 | 32,272,071 | 32,272,071 |
| Federal reserve stock | 322,100 | 322,100 | 322,100 | 322,100 |
| Loans held for investment, net | 676,541,152 | 679,158,659 | 670,639,122 | 675,172,328 |
| Cash surrender value of life insurance | 35,175,395 | 35,175,395 | 29,339,423 | 29,339,423 |
| Mortgage servicing rights | 1,653,047 | 1,874,076 | 1,751,649 | 2,608,349 |
| Accrued interest receivable | 3,414,994 | 3,414,994 | 3,262,918 | 3,262,918 |
| **FINANCIAL LIABILITIES** | | | | |
| Deposits | $ 1,120,507,223 | $ 1,120,099,925 | $ 1,058,775,995 | $ 1,058,222,293 |
| Accrued interest payable | 89,839 | 89,839 | 115,873 | 115,873 |

The estimated fair value of fee income on letters of credit outstanding at December 31, 2014 and December 31, 2013 is insignificant. Loan commitments on which the committed interest rate is less than the current market rate are also insignificant at December 31, 2014 and December 31, 2013.

## NOTE 3 - Cash and Due from Banks

The Bank is required to maintain vault cash and reserve balances with the FRB based upon a percentage of deposits. There were no reserve requirements as of both December 31, 2014 and December 31, 2013 due to the level of average balances held at the Federal Reserve.

## NOTE 4 - Held to Maturity and Available for Sale Securities

Amortized costs and fair values of held to maturity securities as of December 31, are summarized as follows:

| | 2014 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Obligations of: | | | | |
| States and political subdivisions | $ 47,506,822 | $ 675,643 | $ (195,900) | $ 47,986,565 |
| U.S. government sponsored entities | 84,050,000 | - | (1,114,795) | 82,935,205 |
| Collateralized mortgage obligations | 32,350,632 | 187,040 | (65,913) | 32,471,759 |
| Mortgage-backed securities | 44,295,916 | 2,845,710 | - | 47,141,626 |
| Totals | $ 208,203,370 | $ 3,708,393 | $ (1,376,608) | $ 210,535,155 |

| | 2013 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Obligations of: | | | | |
| States and political subdivisions | $ 55,281,869 | $ 829,413 | $ (771,695) | $ 55,339,587 |
| U.S. government sponsored entities | 150,199,687 | - | (6,349,322) | 143,850,365 |
| Collateralized mortgage obligations | 36,062,991 | 179,281 | (752,602) | 35,489,670 |
| Mortgage-backed securities | 57,360,380 | 2,575,352 | - | 59,935,732 |
| Totals | $ 298,904,927 | $ 3,584,046 | $ (7,873,619) | $ 294,615,354 |

The amortized cost and fair value of held to maturity securities as of December 31, 2014 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers or issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Amortized Cost | Fair Value |
|---|---|---|
| Due in one year or less | $ 7,004,320 | $ 7,065,005 |
| Due after one year less than 5 years | 100,787,034 | 103,792,767 |
| Due after 5 years less than 10 years | 92,412,016 | 91,740,583 |
| Due over 10 years | 8,000,000 | 7,936,800 |
| Totals | $ 208,203,370 | $ 210,535,155 |

## NOTE 4 - Held to Maturity and Available for Sale Securities (cont.)

Held to maturity securities with an amortized cost of $94,469,463 and $132,969,749 at December 31, 2014 and 2013, respectively, were pledged as collateral on public deposits and for other purposes as required or permitted by law.

The following tables summarize the portion of the Bank's held to maturity securities portfolio which has gross unrealized losses, reflecting the length of time that individual securities have been in a continuous unrealized loss position as of December 31:

| | 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Continuous unrealized losses existing for less than 12 Months | | Continuous unrealized losses existing for greater than 12 months | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of: | | | | | | |
| States and political subdivisions | $ 2,939,399 | $ (13,106) | $ 10,619,372 | $ (182,794) | $ 13,558,771 | $ 195,900 |
| U.S. government sponsored entities | 9,868,000 | (132,000) | 73,067,205 | (982,795) | 82,935,205 | 1,114,795 |
| Collateralized mortgage Obligations | 10,031,388 | (65,913) | - | - | 10,031,388 | 65,913 |
| Totals | $ 22,838,787 | $ (211,019) | $ 83,686,577 | $ (1,165,589) | $ 106,525,364 | $ 1,376,608 |

| | 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Continuous unrealized losses existing for less than 12 Months | | Continuous unrealized losses existing for greater than 12 months | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of: | | | | | | |
| States and political subdivisions | $ 19,588,793 | $ (771,695) | $ - | $ - | $ 19,588,793 | $ 771,695 |
| U.S. government sponsored entities | 150,199,687 | (6,349,322) | - | - | 150,199,687 | 6,349,322 |
| Collateralized mortgage obligations | 22,461,319 | (752,602) | - | - | 22,461,319 | 752,602 |
| Totals | $ 192,249,799 | $ (7,873,619) | $ - | $ - | $ 192,249,799 | $ 7,873,619 |

**NOTE 4 - Held to Maturity and Available for Sale Securities** (cont.)

Management does not believe any individual unrealized loss as of December 31, 2014 and 2013 represents other than temporary impairment. The Bank held thirty seven investment securities at December 31, 2014 that had unrealized losses existing for greater than 12 months. The Bank held no investment securities as of December 31, 2013 that had unrealized losses existing for greater than 12 months. Management believes the temporary impairment in fair value was caused by market fluctuations in rates. Because securities are held to maturity, management does not believe that the Bank will experience any losses on these investments.

Amortized costs and fair values of available for sale securities as of December 31, are summarized as follows:

| | 2014 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Obligations of: | | | | |
| States and political subdivisions | $ 14,247,486 | $ 463,755 | $ - | $ 14,711,241 |
| Collateralized mortgage obligations | 72,028,526 | 284,740 | (143,541) | 72,169,725 |
| Mortgage-backed securities | 61,796,372 | 787,181 | (8,735) | 62,574,818 |
| Totals | $ 148,072,384 | $ 1,535,676 | $ (152,276) | $ 149,455,784 |

| | 2013 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Obligations of: | | | | |
| States and political subdivisions | $ - | $ - | $ - | $ - |
| Collateralized mortgage obligations | 5,310,619 | - | (33,271) | 5,277,348 |
| Mortgage-backed securities | 27,097,652 | 74,545 | (177,474) | 26,994,723 |
| Totals | $ 32,408,271 | $ 74,545 | $ (210,745) | $ 32,272,071 |

The amortized cost and fair value of available for sale securities as of December 31, 2014 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers or issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Amortized Cost | Fair Value |
|---|---|---|
| Due after one year less than 5 years | $ 58,800,814 | $ 59,175,648 |
| Due after 5 years less than 10 years | 75,195,829 | 75,756,334 |
| Due over 10 years | 14,075,741 | 14,523,802 |
| Totals | $ 148,072,384 | $ 149,455,784 |

**NOTE 4 - Held to Maturity and Available for Sale Securities** (cont.)

The following table presents the portion of the Bank's available for sale maturities portfolio which has gross unrealized losses, reflecting the length of time that individual securities have been in a continuous unrealized loss position as of December 31:

| | 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Continuous unrealized losses existing for less than 12 months | | Continuous unrealized losses existing for greater than 12 months | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of: | | | | | | |
| Collateralized mortgage Obligations | $ 19,472,534 | $ (143,541) | $ - | $ - | $ 19,472,534 | $ 143,541 |
| Mortgage-backed securities | 4,096,162 | (8,735) | - | - | 4,096,162 | 8,735 |
| Totals | $ 23,568,696 | $ (152,276) | $ - | $ - | $ 23,568,696 | $ 152,276 |

| | 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Continuous unrealized losses existing for less than 12 months | | Continuous unrealized losses existing for greater than 12 months | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of: | | | | | | |
| Collateralized mortgage obligations | $ 5,310,619 | $ (33,271) | $ - | $ - | $ 5,310,619 | $ 33,271 |
| Mortgage-backed securities | 17,746,263 | (177,474) | - | - | 17,746,263 | 177,474 |
| Totals | $ 23,056,882 | $ (210,745) | $ - | $ - | $ 23,056,882 | $ 210,745 |

Management does not believe any individual unrealized loss as of December 31, 2014 and 2013 represents other than temporary impairment. The Bank held no investment securities as of December 31, 2014 or December 31, 2013 that had unrealized losses existing for greater than 12 months. Management believes the temporary impairment in fair value was caused by market fluctuations in interest rates. Management does not believe that the Bank will experience any losses on these investments.

**NOTE 5 – Loans**

Major classifications of loans are as follows as of December 31:

| | 2014 | 2013 |
|---|---|---|
| Commercial | $ 31,260,517 | $ 20,576,973 |
| Real Estate | | |
| Construction | 26,021,439 | 29,492,647 |
| Commercial | 365,053,901 | 346,972,401 |
| Residential | 214,868,258 | 229,564,938 |
| Multifamily | 41,470,101 | 45,610,330 |
| Installment and other | 9,970,293 | 10,792,423 |
| | 688,644,509 | 683,009,712 |
| Less: Allowance for loan losses | (12,103,357) | (12,370,590) |
| Net Loans | $ 676,541,152 | $ 670,639,122 |

**NOTE 5 – Loans** (cont.)

The following table presents the contractual aging of the recorded investment in loans as of December 31:

| 2014 | Current Loans | Days Past Due 30-59 | Days Past Due 60-89 | Days Past Due Over 90 | Days Past Due Total | Total Loans |
|---|---|---|---|---|---|---|
| Commercial | $ 31,232,863 | $ 4,543 | $ - | $ 23,111 | $ 27,654 | $ 31,260,517 |
| Real Estate | | | | | | |
| Construction | 26,021,439 | - | - | - | - | 26,021,439 |
| Commercial | 355,843,092 | 1,961,718 | 1,123,451 | 6,125,640 | 9,210,809 | 365,053,901 |
| Residential | 203,898,068 | 4,817,943 | 867,748 | 5,284,499 | 10,970,190 | 214,868,258 |
| Multifamily | 40,976,221 | - | 80,907 | 412,973 | 493,880 | 41,470,101 |
| Installment and other | 9,542,786 | 68,445 | 256,185 | 102,877 | 427,507 | 9,970,293 |
| Total loans | 667,514,469 | 6,852,649 | 2,328,291 | 11,949,100 | 21,130,040 | 688,644,509 |
| Purchase credit-impaired loans | (11,511,000) | (467,882) | (212,360) | (905,343) | (1,585,585) | (13,096,585) |
| Total loans, excluding purchase credit-impaired Loans | $ 656,003,469 | $ 6,384,767 | $ 2,115,931 | $ 11,043,757 | $ 19,544,455 | $ 675,547,924 |

| 2013 | Current Loans | Days Past Due 30-59 | Days Past Due 60-89 | Days Past Due Over 90 | Days Past Due Total | Total Loans |
|---|---|---|---|---|---|---|
| Commercial | $ 20,478,350 | $ 34,093 | $ 42,228 | $ 22,302 | $ 98,623 | $ 20,576,973 |
| Real Estate | | | | | | |
| Construction | 28,346,729 | - | 1,145,918 | - | 1,145,918 | 29,492,647 |
| Commercial | 339,316,371 | 926,782 | 430,642 | 6,298,606 | 7,656,030 | 346,972,401 |
| Residential | 216,409,850 | 3,876,315 | 1,288,457 | 7,990,316 | 13,155,088 | 229,564,938 |
| Multifamily | 44,280,364 | - | 1,329,966 | - | 1,329,966 | 45,610,330 |
| Installment and other | 10,336,632 | 39,710 | 132,912 | 283,169 | 455,791 | 10,792,423 |
| Total loans | 659,168,296 | 4,876,900 | 4,370,123 | 14,594,393 | 23,841,416 | 683,009,712 |
| Purchase credit-impaired loans | (14,733,545) | (717,940) | (63,595) | (1,707,309) | (2,488,844) | (17,222,389) |
| Total loans, excluding purchase credit-impaired loans | $ 644,434,751 | $ 4,158,960 | $ 4,306,528 | $ 12,887,084 | $ 21,352,572 | $ 665,787,323 |

Commercial loans deemed to be inadequately collateralized and past due 90 days or more for principal or interest are placed in a non-accrual status. Residential real estate loans are not subject to these guidelines if well-secured, as deemed by the Senior Loan Committee, and in the process of collection.

**NOTE 5 – Loans** (cont.)

The following table presents the recorded investment in nonaccrual loans and loans past due ninety days or more and still accruing by class of loans as of December 31:

| | 2014 | |
|---|---|---|
| | Nonaccrual | Past due 90 days or More and accruing |
| Commercial | $ 26,488 | $ - |
| Real estate | | |
| Construction | 136,026 | - |
| Commercial | 10,055,510 | - |
| Residential | 9,423,825 | 633,757 |
| Multifamily | 1,209,468 | - |
| Installment and other | 96,381 | 93,535 |
| Total Loans | 20,947,698 | 727,292 |
| Purchase Credit Impaired Loans: | | |
| Commercial | - | - |
| Real estate | | |
| Construction | - | - |
| Commercial | (95,855) | - |
| Residential | (1,118,322) | - |
| Multifamily | - | - |
| Installment & Other | - | - |
| Total Purchased Credit-Impaired Loans | (1,214,177) | - |
| Total Loans, excluding Purchase Credit Impaired Loans | $ 19,733,521 | $ 727,292 |

| | 2013 | |
|---|---|---|
| | Nonaccrual | Past due 90 days or More and accruing |
| Commercial | $ 30,136 | $ - |
| Real estate | | |
| Construction | - | - |
| Commercial | 7,079,352 | - |
| Residential | 10,018,596 | 323,523 |
| Multifamily | 1,329,966 | - |
| Installment and other | 28,808 | 254,361 |
| Total Loans | 18,486,858 | 577,884 |
| Purchase Credit Impaired Loans: | | |
| Commercial | - | - |
| Real estate | | |
| Construction | - | - |
| Commercial | (56,980) | - |
| Residential | (2,013,234) | - |
| Multifamily | - | - |
| Installment & Other | - | - |
| Total Purchased Credit-Impaired Loans | (2,070,214) | - |
| Total Loans, excluding Purchase Credit Impaired Loans | $ 16,416,644 | $ 577,884 |

**NOTE 5 – Loans** (cont.)

Management uses an internal asset classification system as a means of identifying problem and potential problem assets. At the quarterly meetings, the Board of Directors of the Bank reviews trends for loans classified as "Special Mention," "Substandard" and "Doubtful" for the previous twelve months both as a total dollar volume in each classified category and as the percent of capital each classified category represents. A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at a future date. An asset is classified Substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets classified as Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Assets that do not currently expose the Bank to sufficient risk to warrant classification in one of the aforementioned categories, but possess weaknesses that may or may not be within the control of the customer are classified as "Pass." The following tables present the risk category of loans by class of loans based on the most recent analysis performed and the contractual aging as of December 31:

| | 2014 | | | | |
|---|---|---|---|---|---|
| | Pass | Special Mention | Substandard | Doubtful | Total |
| Commercial | $ 29,256,933 | $ 371,738 | $ 1,631,846 | $ - | $ 31,260,517 |
| Real estate | | | | | |
| Construction | 24,069,027 | - | 1,952,412 | - | 26,021,439 |
| Commercial | 335,310,129 | 7,961,835 | 21,144,234 | 637,703 | 365,053,901 |
| Multifamily | 39,356,023 | 904,610 | 1,209,468 | - | 41,470,101 |
| Total | $ 427,992,112 | $ 9,238,183 | $ 25,937,960 | $ 637,703 | $ 463,805,958 |
| | | | | | |
| Current | $ 426,512,798 | 9,238,183 | $ 17,978,080 | $ 344,554 | $ 454,073,615 |
| 30-59 | 1,004,000 | - | 962,261 | - | 1,966,261 |
| 60-89 | 475,314 | - | 729,043 | - | 1,204,358 |
| Over 90 | - | - | 6,268,576 | 293,149 | 6,561,724 |
| Total | $ 427,992,112 | $ 9,238,183 | $ 25,937,960 | $ 637,703 | $ 463,805,958 |

| | 2013 | | | | |
|---|---|---|---|---|---|
| | Pass | Special Mention | Substandard | Doubtful | Total |
| Commercial | $ 19,606,705 | $ 739,767 | $ 222,820 | $ 7,681 | $ 20,576,973 |
| Real estate | | | | | |
| Construction | 27,863,822 | - | 1,628,825 | - | 29,492,647 |
| Commercial | 321,010,091 | 9,975,662 | 15,986,648 | - | 346,972,401 |
| Multifamily | 44,280,364 | - | 1,329,966 | - | 45,610,330 |
| Total | $ 412,760,982 | $ 10,715,429 | $ 19,168,259 | $ 7,681 | $ 442,652,351 |
| | | | | | |
| Current | $ 410,628,416 | 10,715,429 | $ 11,077,969 | $ - | $ 432,421,814 |
| 30-59 | 884,653 | - | 76,222 | - | 960,875 |
| 60-89 | 1,247,913 | - | 1,700,841 | - | 2,948,754 |
| Over 90 | - | - | 6,313,227 | 7,681 | 6,320,908 |
| Total | $ 412,760,982 | $ 10,715,429 | $ 19,168,259 | $ 7,681 | $ 442,652,351 |

**NOTE 5 – Loans** (cont.)

For residential real estate and installment loan classes, the Bank also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in those loan classes based on payment activity as of December 31:

| | 2014 | | |
|---|---|---|---|
| | Performing | Nonperforming | Total |
| Residential Real Estate | $ 204,810,676 | $ 10,057,582 | $ 214,868,258 |
| Installment & Other | 9,780,377 | 189,916 | 9,970,293 |
| Total | $ 214,591,053 | $ 10,247,498 | $ 224,838,551 |

| | 2013 | | |
|---|---|---|---|
| | Performing | Nonperforming | Total |
| Residential Real Estate | $ 219,222,819 | $ 10,342,119 | $ 229,564,938 |
| Installment & Other | 10,509,254 | 283,169 | 10,792,423 |
| Total | $ 229,732,073 | $ 10,625,288 | $ 240,357,361 |

At December 31, 2014, the Bank has identified $41.8 million of loans as impaired, including $20.9 million of performing TDRs. The Bank evaluates loans placed on the watch list for impairment. A loan is identified as impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. A performing TDR consists of loans that have been modified and are performing in accordance with the modified terms for a sufficient length of time, generally six months, or loans that were modified on a proactive basis. A summary of the details regarding impaired loans as of December 31 follows:

| | 2014 | 2013 |
|---|---|---|
| Loans for which there was a related allowance for loan loss | $ 21,943,451 | $ 23,728,748 |
| Impaired loans with no related allowance | 19,893,832 | 12,573,993 |
| Total Impaired Loans | $ 41,837,283 | $ 36,302,741 |
| | | |
| Average quarterly balance of impaired loans | $ 40,627,321 | $ 37,110,435 |
| Related allowance for loan losses | 6,950,937 | 6,862,950 |
| Interest income recognized while impaired | 758,518 | 581,355 |

**NOTE 5 – Loans** (cont.)

The following table presents loans individually evaluated for impairment by class of loans as of December 31:

| | 2014 | | | |
|---|---|---|---|---|
| | Unpaid Principal Balance | Partial Charge-offs | Allowance For Loan Losses Allocation | Recorded Investment |
| **Loans with no related allowance recorded:** | | | | |
| Commercial | $ 16,847 | $ 7,192 | $ - | $ 9,655 |
| Real estate | | | | |
| Construction | 324,382 | 3,949 | - | 320,433 |
| Commercial | 7,233,427 | 509,017 | - | 6,724,410 |
| Residential | 15,747,315 | 3,863,017 | - | 11,884,298 |
| Multifamily | 842,030 | 16,947 | - | 825,083 |
| Installment & Other | 175,326 | 45,373 | - | 129,953 |
| Total | 24,339,327 | 4,445,495 | - | 19,893,832 |
| **Loans with a related allowance recorded:** | | | | |
| Commercial | 67,177 | - | 67,177 | - |
| Real estate | | | | |
| Construction | 903,778 | - | 184,088 | 719,690 |
| Commercial | 10,573,936 | 89,909 | 3,672,211 | 6,811,816 |
| Residential | 10,993,619 | 1,119,838 | 2,808,313 | 7,065,468 |
| Multifamily | 496,577 | 15,313 | 179,664 | 301,600 |
| Installment & Other | 159,529 | 26,105 | 39,484 | 93,940 |
| Total | 23,194,616 | 1,251,165 | 6,950,937 | 14,992,514 |
| Total Impaired Loans | $ 47,533,943 | $ 5,696,660 | $ 6,950,937 | $ 34,886,346 |

| | 2013 | | | |
|---|---|---|---|---|
| | Unpaid Principal Balance | Partial Charge-offs | Allowance For Loan Losses Allocation | Recorded Investment |
| **Loans with no related allowance recorded:** | | | | |
| Commercial | $ 8,191 | $ 355 | $ | $ 7,836 |
| Real estate | | | | |
| Construction | 146,810 | - | - | 146.810 |
| Commercial | 4,997,099 | 141,566 | - | 4,855,533 |
| Residential | 7,808,304 | 261,918 | - | 7,546,386 |
| Multifamily | - | - | - | - |
| Installment & Other | 17,428 | - | - | 17,428 |
| Total | 12,977,832 | 403,839 | - | 12,573,993 |
| **Loans with a related allowance recorded:** | | | | |
| Commercial | 32,904 | 10,602 | 22,302 | - |
| Real estate | | | | |
| Construction | 1,075,166 | - | 120,859 | 954,307 |
| Commercial | 8,080,918 | 195,248 | 2,127,837 | 5,757,833 |
| Residential | 13,800,586 | 511,615 | 4,172,490 | 9,116,481 |
| Multifamily | 1,344,570 | 14,604 | 383,966 | 946,000 |
| Installment & Other | 128,303 | 1,630 | 35,496 | 91,177 |
| Total | 24,462,447 | 733,699 | 6,862,950 | 16,865,798 |
| Total Impaired Loans | $ 37,440,279 | $ 1,137,538 | $ 6,862,950 | $ 29,439,791 |

## NOTE 5 – Loans (cont.)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio class and based on impairment method as of December 31:

| 2014 | Commercial | Construction Real Estate | Commercial Real Estate | Residential Real Estate | Multifamily Real Estate | Installment & Other | Total |
|---|---|---|---|---|---|---|---|
| **Allowance for loan losses:** | | | | | | | |
| Beginning balance | $ 361,270 | $ 478,828 | $ 3,979,192 | $ 6,997,152 | $ 383,966 | $ 170,182 | $ 12,370,590 |
| Charge-offs | - | - | (678,842) | (2,930,425) | - | (64,298) | (3,673,565) |
| Recoveries | 472 | - | 157,514 | 233,503 | - | 14,843 | 406,332 |
| Provision | (434) | - | 478,688 | 2,476,336 | - | 45,410 | 3,000,000 |
| Ending Balance | $ 361,308 | $ 478,828 | $ 3,936,552 | $ 6,776,566 | $ 383,966 | $ 166,137 | $ 12,103,357 |
| **Loans:** | | | | | | | |
| Ending balance | $ 31,260,517 | $ 26,021,439 | $ 365,053,901 | $ 214,868,258 | $ 41,470,101 | $ 9,970,293 | $ 688,644,509 |
| Allowance for loan losses; | | | | | | | |
| Individually evaluated for impairment | 67,177 | 184,088 | 3,672,211 | 2,808,313 | 179,664 | 39,484 | 6,950,937 |
| Collectively evaluated for impairment | 294,131 | 294,740 | 264,341 | 3,968,253 | 204,302 | 126,653 | 5,152,420 |
| Total allowance for loan losses | 361,308 | 478,828 | 3,936,552 | 6,776,566 | 383,966 | 166,137 | 12,103,357 |
| Recorded Investment | $ 30,899,209 | $ 25,542,611 | $ 361,117,349 | $ 208,091,693 | $ 41,086,135 | $ 9,804,156 | $ 676,541,152 |
| **Ending Balance:** | | | | | | | |
| Individually evaluated for impairment | $ 76,832 | $ 1,224,211 | $ 17,208,437 | $ 21,758,079 | $ 1,306,347 | $ 263,377 | $ 41,837,283 |
| Collectively evaluated for impairment | 31,177,175 | 24,797,228 | 347,050,758 | 185,001,638 | 39,290,353 | 9,699,750 | 637,016,902 |
| Acquired | 6,510 | - | 794,706 | 8,108,541 | 873,401 | 7,166 | 9,790,324 |
| Total ending balance | $ 31,260,517 | $ 26,021,439 | $ 365,053,901 | $ 214,868,258 | $ 41,470,101 | $ 9,970,293 | $ 688,644,509 |

| 2013 | Commercial | Construction Real Estate | Commercial Real Estate | Residential Real Estate | Multifamily Real Estate | Installment & Other | Total |
|---|---|---|---|---|---|---|---|
| **Allowance for loan losses:** | | | | | | | |
| Beginning balance | $ 361,022 | $ 476,986 | $ 3,971,661 | $ 6,858,876 | $ 360,611 | $ 167,856 | $ 12,197,012 |
| Charge-offs | (20,204) | (110,736) | (362,875) | (6,303,596) | (116,519) | (101,533) | (7,015,463) |
| Recoveries | 11,183 | 43,780 | 89,178 | 364,559 | 181,350 | 16,991 | 707,041 |
| Provision | 9,269 | 68,798 | 281,228 | 6,077,313 | (41,476) | 86,868 | 6,482,000 |
| Ending Balance | $ 361,270 | $ 478,828 | $ 3,979,192 | $ 6,997,152 | $ 383,966 | $ 170,182 | $ 12,370,590 |
| **Loans:** | | | | | | | |
| Ending balance | $ 20,576,973 | $ 29,492,647 | $ 346,972,401 | $ 229,564,938 | $ 45,610,330 | $ 10,792,423 | $ 683,009,712 |
| Allowance for loan losses; | | | | | | | |
| Individually evaluated for impairment | 22,302 | 120,859 | 2,127,837 | 4,172,490 | 383,966 | 35,496 | 6,862,950 |
| Collectively evaluated for impairment | 338,968 | 357,969 | 1,851,355 | 2,824,662 | - | 134,686 | 5,507,640 |
| Total allowance for loan losses | 361,270 | 478,828 | 3,979,192 | 6,997,152 | 383,966 | 170,182 | 12,370,590 |
| Recorded Investment | $ 20,215,703 | $ 29,013,819 | $ 342,993,209 | $ 222,567,786 | $ 45,226,364 | $ 10,622,241 | $ 670,639,122 |
| **Ending Balance:** | | | | | | | |
| Individually evaluated for impairment | $ 30,136 | $ 1,221,976 | $ 12,741,203 | $ 20,835,359 | $ 1,329,966 | $ 144,101 | $ 36,302,741 |
| Collectively evaluated for impairment | 20,535,446 | 28,270,671 | 332,403,122 | 198,038,704 | 43,370,751 | 10,639,310 | 633,258,004 |
| Acquired | 11,391 | - | 1,828,076 | 10,690,875 | 909,613 | 9,012 | 13,448,967 |
| Total ending balance | $ 20,576,973 | $ 29,492,647 | $ 346,972,401 | $ 229,564,938 | $ 45,610,330 | $ 10,792,423 | $ 683,009,712 |

**NOTE 5 – Loans** (cont.)

The Corporation continues to evaluate loans purchased for impairment in accordance with U.S. GAAP. The purchased loans were considered impaired at the acquisition date if there was evidence of deterioration since origination and if it was probable that not all contractually required principal and interest payments would be collected. The following table reflects the carrying value of all purchased loans as of December 31:

| | 2014 | | |
|---|---|---|---|
| | Contractually Required Payments Receivable | | |
| | Credit Impaired | Non-Credit Impaired | Carrying Value of Purchased Loans |
| Commercial | $ 17,476 | $ - | $ 4,800 |
| Real Estate | | | |
| Construction | - | 36,865 | 35,997 |
| Commercial | 1,496,377 | 237,094 | 1,060,152 |
| Residential | 21,499,217 | 35,854,414 | 43,618,019 |
| Multifamily | 1,172,379 | 206,183 | 1,003,043 |
| Installment and Consumer | 28,790 | 491,656 | 322,271 |
| Total | $ 24,214,239 | $ 36,826,212 | $ 46,044,282 |

| | 2013 | | |
|---|---|---|---|
| | Contractually Required Payments Receivable | | |
| | Credit Impaired | Non-Credit Impaired | Carrying Value of Purchased Loans |
| Commercial | $ 24,067 | $ 12,809 | $ 14,421 |
| Real Estate | | | |
| Construction | - | 39,554 | 38,655 |
| Commercial | 2,789,024 | 196,797 | 2,001,907 |
| Residential | 26,722,489 | 38,348,858 | 49,044,826 |
| Multifamily | 1,208,591 | - | 909,613 |
| Installment and Consumer | 12,037 | 1,575,607 | 971,710 |
| Total | $ 30,756,208 | $ 40,173,625 | $ 52,981,132 |

As of December 31, 2014, the estimated contractually-required payments receivable on credit impaired and non-credit impaired loans was $24.2 million and $36.8 million, respectively. The cash flows expected to be collected related to principal as of December 31, 2014 on all purchased loans is $46.0 million. As a result, there is $15.0 million of remaining discount on the purchased loans. These amounts are based upon the estimated fair values of the underlying collateral or discounted cash flows as of December 31, 2014. The difference between the contractually required payments at acquisition and the cash flow expected to be collected at acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows will result in a reversal of the provision for loan losses charged to earnings to the extent of prior charges or a reclassification of the difference from non-accretable discount to accretable discount, with a positive impact on interest income. Further, any excess of cash flows expected over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows.

The change in the carrying amount of accretable yield for purchased loans was as follows for the years ended December 31:

| | For Twelve Months Ended December 31, | |
|---|---|---|
| | 2014 | 2013 |
| Beginning Balance | $ 4,201,963 | $ 5,653,497 |
| Additions | 811,787 | 1,008,424 |
| Accretion[1] | (1,205,620) | (2,459,958) |
| Ending Balance | $ 3,808,130 | $ 4,201,963 |

(1) Accretable yield is recognized in interest income as the purchased loans pay down, mature, renew or pay off.

## NOTE 5 – Loans (cont.)

Contractual maturities of loans with accretable yield range from 1 year to 30 years. Actual maturities may differ from contractual maturities because borrowers have the right to prepay or renew their loan prior to maturity or the loan may be charged off.

Certain directors and executive officers of the Corporation, and their related interests, had loans outstanding in the aggregate amounts of $11.5 million and $17.3 million as of December 31, 2014, and 2013, respectively. During 2014, $0.1 million of new loans were made and repayments totaled $5.9 million. Management believes these loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other persons and did not involve more than normal risks of collectability or present other unfavorable features. Certain affiliated parties of the Corporation are investors in loan participations of the Bank. The outstanding balance of loan participations with affiliated parties totaled $8.1 and $8.9 million at December 31, 2014 and 2013, respectively. The participations represent investments by the affiliated parties in a portion of the affiliated party loans described in the paragraph above.

Residential and commercial real estate loans approximating $29.03million and $126.5 million as of December 31, 2014 and 2013, respectively, were pledged as collateral on public deposits and for other purposes as required or permitted by law.

## NOTE 6 – Allowance for Loan Losses

The allowance for loan losses reflected in the accompanying consolidated financial statements represents the allowance available to absorb loan losses that are probable and inherent in the portfolio. An analysis of changes in the allowance is presented in the following tabulation as of December 31:

| | 2014 | 2013 |
|---|---|---|
| Balance at beginning of year | $ 12,370,590 | $ 12,197,012 |
| Charge-offs | (3,673,565) | (7,015,463) |
| Recoveries | 406,332 | 707,041 |
| Provision charged to operation | 3,000,000 | 6,482,000 |
| Balance at end of year | $ 12,103,357 | $ 12,370,590 |

## NOTE 7 - Other Real Estate Owned

The following is a summary of the activity in OREO for the years ended December 31:

| | 2014 | 2013 |
|---|---|---|
| Beginning Balance | $ 5,709,401 | $ 8,544,665 |
| Additions | 2,920,496 | 10,007,782 |
| Valuation Adjustments | (107,500) | - |
| Sales, net | (3,750,258) | (12,843,046) |
| Ending Balance | $ 4,772,139 | $ 5,709,401 |

The following is a summary of the changes in the valuation allowance for losses on other real estate owned as of December 31, 2014. There was no valuation allowance as of December 31, 2013.

| | 2014 |
|---|---|
| Beginning Balance | $ - |
| Provision charged to operation | 107,500 |
| Amounts related to properties disposed | - |
| Ending Balance | $ 107,500 |

## NOTE 8 - Troubled Debt Restructuring

A TDR includes a loan modification where a borrower is experiencing financial difficulty and the Bank grants a concession to that borrower that the Bank would not otherwise consider except for the borrower's financial difficulties. Modifications include below market interest rates, interest-only terms, forgiveness of principal, or an exceptionally long amortization period. Most of the Bank's modifications are below market interest rate concessions. A TDR may be either on accrual or nonaccrual status based upon the performance of the borrower and management's assessment of collectability. If a TDR is placed on nonaccrual status, it remains there until it performs under the restructured terms for a sufficient period of time, generally six consecutive months at which time it is returned to accrual status.

A summary of TDRs as of December 31, 2014 and 2013 are noted in the tables below.

| 2014 | Number of Modifications | Total Trouble Debt Restructurings | Allowance For Loan Losses Allocation | Recorded Investment |
|---|---|---|---|---|
| Commercial | 2 | $ 61,709 | $ 50,344 | $ 11,365 |
| Real estate | | | | |
| Construction | 4 | 1,088,186 | 184,088 | 904,098 |
| Commercial | 25 | 13,943,117 | 3,048,805 | 10,894,312 |
| Residential | 152 | 16,174,411 | 2,017,305 | 14,157,106 |
| Multifamily | 7 | 893,374 | 179,664 | 713,710 |
| Installment & Other | 15 | 260,635 | 38,742 | 221,893 |
| Total Loans | 205 | $ 32,421,432 | $ 5,518,948 | $ 26,902,484 |

| 2013 | Number of Modifications | Total Trouble Debt Restructurings | Allowance For Loan Losses Allocation | Recorded Investment |
|---|---|---|---|---|
| Commercial | 1 | $ 48,765 | $ 44,765 | $ 4,000 |
| Real estate | | | | |
| Construction | 2 | 1,221,976 | 120,859 | 1,101,117 |
| Commercial | 15 | 9,731,985 | 1,939,354 | 7,792,631 |
| Residential | 84 | 13,187,234 | 2,138,597 | 11,048,637 |
| Multifamily | 1 | 1,329,966 | 383,966 | 946,000 |
| Installment & Other | 3 | 115,293 | 17,498 | 97,795 |
| Total Loans | 106 | $ 25,635,219 | $ 4,645,039 | $ 20,990,180 |

## NOTE 8 - Troubled Debt Restructuring (cont.)

The following is a summary of TDR's as of December 31, 2014 and 2013 that defaulted during the period and were modified within the previous 12 months. TDR's in default are past due 90 days or more at the end of the period.

| | December 31, 2014 | | December 31, 2013 | |
|---|---|---|---|---|
| | Number of Modifications | Total in Default | Number of Modifications | Total in Default |
| Commercial | - | $ - | - | $ - |
| Real Estate | | | | |
| Construction | - | - | - | - |
| Commercial | - | - | - | - |
| Residential | 1 | 71,331 | 5 | 920,930 |
| Multifamily | - | - | - | - |
| Installment and other | - | - | - | - |
| Total Loans | 1 | $ 71,331 | 5 | $ 920,930 |

A summary of the type of modifications made on TDR's that occurred during 2014 and 2013 are noted in the table below.

For the Year Ended December 31, 2014

| | Modification of Terms | | Reduction of Interest Rate | | Modification to Interest-only Payments | | Bankruptcy | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Count | Balance | Count | Balance | Count | Balance | Count | Balance | Count | Balance |
| Commercial | - | $ - | - | $ - | - | $ - | 1 | $ 11,365 | 1 | $ 11,365 |
| Real estate | | | | | | | | | | |
| Construction | 1 | 23,169 | - | - | - | - | 1 | 22,726 | 2 | 45,895 |
| Commercial | 1 | 63,366 | 5 | 4,049,598 | 2 | 403,012 | 4 | 224,285 | 12 | 4,740,261 |
| Residential | 4 | 890,540 | 9 | 681,032 | 5 | 449,704 | 62 | 4,234,677 | 80 | 6,255,953 |
| Multifamily | - | - | 6 | 796,495 | - | - | 1 | 96,880 | 7 | 893,375 |
| Installment & Other | - | - | 2 | 50,653 | - | - | 10 | 140,882 | 12 | 191,535 |
| Total Loans | 6 | $ 977,075 | 22 | $ 5,577,778 | 7 | $ 852,716 | 79 | $ 4,730,815 | 114 | $ 12,138,384 |

For the Year Ended December 31, 2013

| | Modification of Terms | | Reduction of Interest Rate | | Modification to Interest-only Payments | | Forgiveness of Debt | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Count | Balance | Count | Balance | Count | Balance | Count | Balance | Count | Balance |
| Commercial | - | $ - | - | $ - | - | $ - | - | $ - | - | $ - |
| Real estate | | | | | | | | | | |
| Construction | - | - | 1 | 146,810 | - | - | - | - | 1 | 146,810 |
| Commercial | 1 | 1,075,166 | - | - | 2 | 1,894,545 | - | - | 3 | 2,969,711 |
| Residential | 2 | 299,490 | 13 | 2,486,553 | 1 | 85,000 | 6 | 567,408 | 22 | 3,438,451 |
| Multifamily | - | - | - | - | 1 | 1,329,966 | - | - | 1 | 1,329,966 |
| Installment & Other | - | - | - | - | - | - | - | - | - | - |
| Total Loans | 3 | $ 1,374,656 | 14 | $ 2,633,363 | 4 | $ 3,309,511 | 6 | $ 567,408 | 27 | $ 7,884,938 |

## NOTE 9 - Core Deposit Intangible Asset

Estimated future amortization expense as of December 31, 2014 by year is as follows:

| | | |
|---|---|---|
| 2015 | $ | 130,381 |
| 2016 | | 98,275 |
| 2017 | | 63,273 |
| Total | $ | 291,929 |

## NOTE 10 - Mortgage Servicing Rights

The following is an analysis of the mortgage servicing rights activity for the years ended December 31:

| | | 2014 | | 2013 |
|---|---|---|---|---|
| Balance at beginning of year | $ | 1,751,649 | $ | 1,685,893 |
| Additions of mortgage servicing rights | | 140,260 | | 458,342 |
| Amortization | | (238,862) | | (392,586) |
| Balance at end of year | $ | 1,653,047 | $ | 1,751,649 |

The carrying value of MSRs is determined in accordance with relevant accounting guidance. This guidance permits capitalized MSRs to be amortized in proportion to and over the period of estimated net servicing income and to be assessed for impairment. The Bank relies on industry data to estimate the initial fair value of MSRs to be capitalized as a percentage of the principal balance of the loans sold. The Bank adjusts the carrying value monthly for reductions due to normal amortization and actual prepayments, including defaults. The Bank assesses its MSRs for impairment each reporting period by using a third party source. As of December 31, 2014 and 2013, the weighted average coupon rates of mortgage loans underlying the MSRs were 3.67% and 3.74%, respectively, and the weighted average remaining maturity of the mortgage loans underlying the MSRs were 206 months and 209 months, respectively. The estimated fair values of MSRs were $1,874,076 and $2,608,349 at December 31, 2014 and 2013, respectively. As the carrying value of the Bank's MSRs are less than the estimated fair value at December 31, 2014 and 2013, no impairment existed.

The carrying value of MSRs was $1,653,047 or 0.60% of loans serviced for others at December 31, 2014 compared with $1,751,649, or 0.60% of loans serviced at December 31, 2013.

## NOTE 10 - Mortgage Servicing Rights (cont.)

The projections of amortization expense shown below for mortgage servicing rights are based on existing asset balances and the existing interest rate environment as of December 31, 2014. Future amortization may be significantly different depending upon changes in the mortgage servicing portfolio, mortgage interest rates and market conditions.

Estimated future amortization by year is as follows:

| | | |
|---|---|---|
| 2015 | $ | 152,527 |
| 2016 | | 127,406 |
| 2017 | | 103,824 |
| 2018 | | 91,364 |
| 2019 | | 90,896 |
| Thereafter | | 1,087,030 |
| | $ | 1,653,047 |

The unpaid principal balance of mortgage loans serviced for others, which is not included in the accompanying consolidated balance sheets, was $274,578,760 and $294,313,925 at December 31, 2014 and 2013, respectively.

Custodial escrow balances maintained in connection with the foregoing loan servicing and included in demand deposits were $709,441 and $682,285 at December 31, 2014 and 2013, respectively.

## NOTE 11 - Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation as of December 31 and are summarized as follows:

| | 2014 | 2013 |
|---|---|---|
| Land | $ 6,047,077 | $ 5,997,024 |
| Buildings and leasehold improvements | 29,246,770 | 29,172,179 |
| Furniture and equipment | 13,589,168 | 13,579,656 |
| Total | 48,883,015 | 48,748,859 |
| Less: Accumulated depreciation | (34,058,690) | (32,853,646) |
| Net Premises and Equipment | $ 14,824,325 | $ 15,895,213 |

Depreciation expense amounted to $1,627,918 and $1,905,020, in 2014 and 2013, respectively.

## NOTE 12 – Accrued Interest Receivable and Other Assets

A summary of accrued interest receivable and other assets as of December 31 is as follows:

| | 2014 | 2013 |
|---|---|---|
| Accrued interest receivable | $ 3,414,994 | $ 3,262,918 |
| Federal Reserve Bank Stock | 322,100 | 322,100 |
| Prepaid expenses and other assets | 5,308,812 | 4,575,881 |
| Total | $ 9,045,906 | $ 8,160,899 |

## NOTE 13 - Deposits

The aggregate amount of time deposits, each with a minimum denomination of $100,000, was $47,120,147 and $55,021,251 as of December 31, 2014 and 2013, respectively.

Scheduled maturities of time deposits at December 31 are:

| | 2014 | 2013 |
|---|---|---|
| Due within one year | $ 82,502,360 | $ 88,247,508 |
| After one year but within two years | 17,252,042 | 27,423,012 |
| After two years but within three years | 10,044,227 | 8,398,930 |
| After three years but within four years | 3,836,774 | 7,479,680 |
| After four years but within five years | 2,462,920 | 3,925,708 |
| | $ 116,098,323 | $ 135,474,838 |

## NOTE 14 - Other Borrowings

The Bank has the ability to borrow (purchase) federal funds of up to $70,000,000 under a revolving line-of-credit. Such borrowings bear interest at the lender bank's announced daily federal funds rate and mature daily. There were no federal funds purchased outstanding as of December 31, 2014 or 2013.

As of December 31, 2014, the Bank could pledge up to $238,018,965 of additional securities as collateral under the existing agreements if needed to obtain additional borrowings. The Bank may be required to provide additional collateral based on the fair value of the underlying securities. The Bank may also borrow through the Federal Reserve Bank Discount Window short term funds up to the amount of $23,674,500 and $27,630,000 as of December 31, 2014 and 2013, respectively. These funds are secured by U.S. government sponsored entity securities or qualified municipal securities totaling $26,305,000 and $30,700,000 as of December 31, 2014 and 2013, respectively.

## NOTE 15 - Income Taxes

The provision for income taxes included in the accompanying consolidated financial statements consists of the following components for the year ending December 31:

| | 2014 | 2013 |
|---|---|---|
| Current tax expense | | |
| Federal | $ 3,516,560 | $ 4,027,397 |
| State | 984,123 | 1,095,520 |
| Total current expense | 4,500,683 | 5,122,917 |
| Deferred income taxes benefit | | |
| Federal | (602,948) | (569,607) |
| State | (129,235) | (109,727) |
| Total deferred benefit | (732,183) | (679,334) |
| Total income tax expense | $ 3,768,500 | $ 4,443,583 |

The net deferred income tax assets in the accompanying consolidated balance sheets include the following amounts of deferred income tax assets and liabilities at December 31:

| | 2014 | 2013 |
|---|---|---|
| Deferred income tax assets: | | |
| Allowance for loan losses | $ 4,859,323 | $ 4,966,577 |
| Reserve for health plan | 150,417 | - |
| Depreciation | 477,336 | 352,061 |
| Non-accrual interest | 516,292 | 536,223 |
| Loss carryforwards | 36,801 | 38,965 |
| Unrealized losses on securities available for sale | - | 54,664 |
| Other real estate owned | 187,250 | 68,705 |
| Other | 174,322 | 189,866 |
| Total deferred income tax assets | 6,401,741 | 6,207,061 |
| Deferred income tax liabilities: | | |
| Loan acquisition fair market valuation | (1,397,234) | (1,640,020) |
| Core deposit intangible asset | (117,166) | (186,444) |
| Deferred loan fees | - | (249,042) |
| Mortgage servicing rights | (660,107) | (699,681) |
| Reserve for health plan | - | (75,162) |
| Unrealized gains on securities available for sale | (555,225) | - |
| Other | (246,814) | (53,813) |
| Total deferred income tax liabilities | (2,976,546) | (2,904,162) |
| Net deferred income tax asset | $ 3,425,194 | $ 3,302,899 |

The Corporation has state net business loss carryforwards of approximately $717,000 and $759,000 as of December 31, 2014 and 2013, respectively. The net business loss carryforwards expire in 2031.

Realization of the deferred income tax asset over time is dependent upon the existence of taxable income in carryback periods or the Corporation generating sufficient taxable income in future periods. In determining that realization of the deferred income tax asset recorded was more likely than not, the Corporation gave consideration to a number of factors including its recent earnings history, its expectations for earnings in the future, and where applicable, the expiration dates associated with tax carryforwards.

## NOTE 15 - Income Taxes (cont.)

Due to a change in law, the Corporation has released the valuation allowance established against state deferred income taxes for those entities which have state net business loss carryforwards in which management believes that it is now more likely than not that the state deferred income tax assets will be realized.

A reconciliation of statutory federal income taxes based upon income before taxes to the provision for federal and state income taxes is as follows:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Amount | % of Pretax Income | Amount | % of Pretax Income |
| Federal income taxes at statutory rate | $ 4,367,917 | 35.00% | $ 4,674,754 | 35.00% |
| Adjustments for: | | | | |
| Tax exempt interest on municipal obligations | (402,139) | (3.22) | (386,748) | (2.90) |
| Increase in taxes resulting from state income taxes, net of federal tax benefit | 555,677 | 4.45 | 640,766 | 4.80 |
| Increase in cash surrender value of life insurance | (336,812) | (2.70) | (353,674) | (2.65) |
| Life insurance proceeds | (350,570) | (2.81) | - | - |
| Other – net | (65,573) | (0.52) | (58,390) | (0.43) |
| Income tax expense | $ 3,768,500 | 30.20% | $ 4,520,675 | 33.85% |

As of December 31, 2014 and 2013, the Corporation had no uncertain tax positions. The Corporation's policy is to record interest and penalties related to income tax liabilities in income tax expense. The Corporation, along with its subsidiaries, files U.S. Federal and Wisconsin income tax returns. The Corporation's federal tax returns for 2010 and prior and its 2009 and prior year Wisconsin tax returns are no longer subject to examination by tax authorities.

## NOTE 16 - Employee Benefit Plans

The Bank has a contributory defined-contribution 401(k) retirement plan. This plan covers substantially all employees who have attained the age of 21 and completed one year of service. Participants may contribute a portion of their compensation (up to IRS limits) to the plan. The Bank may make regular and matching contributions to the plan each year. In 2014 and 2013, the Bank provided a dollar-for-dollar match of employee contributions up to 5% of their compensation. Participants direct the investment of their contributions into one or more investment options. The Bank recorded contribution expense of $535,381 and $530,726, in 2014 and 2013, respectively.

The Bank purchased paid-up life insurance as owner and beneficiary on certain officers and executives to provide the Bank with funds in the event of the death of such individuals and to help recover the cost of employee benefits. Included in the consolidated financial statements is $35,175,395 and $29,339,423 of related cash surrender value as of December 31, 2014 and 2013, respectively.

## NOTE 17 - Operating Leases

The Corporation leases various banking facilities under operating lease agreements from various companies. Three of these facilities are leased from companies held by a director and major shareholder of the Corporation. All of the agreements include renewal options and one agreement requires the subsidiary Bank to pay insurance, real estate taxes and maintenance costs associated with the lease. Rental amounts are subject to annual escalation based upon increases in the Consumer Price Index. Aggregate rental expense under all leases amounted to $1,179,184 and $1,191,574 in 2014 and 2013 respectively, including $495,785 and $485,603 respectively, on facilities leased from companies held by a director and major shareholder of the Corporation.

As of December 31, 2014, the future minimum lease payments for each of the five succeeding years and in the aggregate are as follows:

| | | |
|---|---|---|
| 2015 | $ | 1,092,387 |
| 2016 | | 734,408 |
| 2017 | | 566,523 |
| 2018 | | 470,778 |
| 2019 | | 468,420 |
| Thereafter | | 143,135 |
| | $ | 3,475,651 |

Office space at certain facilities is leased to outside parties. Rental income included in net occupancy costs was $730,133 and $923,308 for the years ended December 31, 2014 and 2013, respectively.

## NOTE 18 - Commitments and Contingencies

The Corporation and Bank are 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 include commitments to extend credit, financial guarantees and standby letters of credit. They involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized on the consolidated balance sheets.

## NOTE 18 - Commitments and Contingencies (cont.)

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and issuing letters of credit as they do for on-balance-sheet instruments.

A summary of the contract or notional amount of the Bank's exposure to off-balance sheet risk as of December 31, are as follows:

| | 2014 | 2013 |
|---|---|---|
| Financial instruments whose contract amounts represent credit risk: | | |
| Commitments to extend credit | $ 100,096,202 | $ 95,102,668 |
| Standby letters of credit | 5,354,728 | 2,942,872 |
| Forward commitment to sell mortgage loans | 781,218 | 209,800 |

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. Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank evaluates each customer's credit worthiness 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 and equipment, and income-producing commercial properties. The Bank also enters into forward commitments to sell mortgage loans to a secondary market agency.

## NOTE 19 - Stockholders' Equity

*Cumulative Preferred Stock*

The Corporation's articles of incorporation authorize the issuance of up to 200,000 shares of $1 par value cumulative preferred stock. The Board of Directors is authorized to divide the stock into series and fix and determine the relative rights and preferences of each series. No shares have been issued.

*Retained Earnings*

The principal source of income and funds of the Corporation are dividends from the Bank. Dividends declared by the Bank that exceed the retained net income for the most current year plus retained net income for the preceding two years must be approved by federal regulatory agencies.

In December of 2012, the Corporation paid a special dividend of $1.70 per share. The dividend was a prepayment of future dividends in anticipation of potential changes in the tax code related to dividend income. As a result, no dividend payments were made during 2013 or 2014. The special dividend payment resulted in the Corporation paying more dividends than net income generated during 2012 and the preceding two years combined. Thus, the Corporation did ask for and receive regulatory approval to pay the special dividend.

Under Federal Reserve regulations, the Bank is limited as to the amount it may lend to its affiliates, including the Corporation. Such loans are required to be collateralized by investments defined in the regulations. In addition, the maximum amount available for transfer from the Bank to the Corporation in the form of loans is limited to 10% of the Bank's stockholders' equity in the case of any one affiliate or 20% in the case of all affiliates.

## NOTE 20 - Regulatory Capital Requirements

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

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth in the table that follows) 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). As of December 31, 2014 and 2013, the Corporation and the Bank met all capital adequacy requirements to which they were subject.

As of December 31, 2014, the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since these notifications that management believes have changed the institution's category.

Listed below is a comparison of the Corporation's and the Bank's actual capital amounts with the minimum requirements for well capitalized and adequately capitalized banks, as defined by the federal regulatory agencies' Prompt Corrective Action Rules, as of December 31, 2014 and 2013.

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provision | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of December 31, 2014 | | | | | | |
| Total capital (to risk weighted assets) | | | | | | |
| Tri City Bankshares Corporation | $ 136,222,000 | 17.9% | $ 60,718,560 | 8.0% | $ n/a | n/a |
| Tri City National Bank | $ 134,545,000 | 17.8% | $ 60,635,680 | 8.0% | $ 75,794,600 | 10.0% |
| Tier 1 capital (to risk weighted assets) | | | | | | |
| Tri City Bankshares Corporation | $ 126,715,000 | 16.7% | $ 30,359,280 | 4.0% | $ n/a | n/a |
| Tri City National Bank | $ 125,038,000 | 16.5% | $ 30,317,840 | 4.0% | $ 45,476,760 | 6.0% |
| Tier 1 capital (to average assets) | | | | | | |
| Tri City Bankshares Corporation | $ 126,715,000 | 10.4% | $ 48,763,040 | 4.0% | $ n/a | n/a |
| Tri City National Bank | $ 125,038,000 | 10.3% | $ 48,699,760 | 4.0% | $ 60,874,700 | 5.0% |
| As of December 31, 2013 | | | | | | |
| Total capital (to risk weighted assets) | | | | | | |
| Tri City Bankshares Corporation | $ 127,107,000 | 17.2% | $ 59,186,000 | 8.0% | $ n/a | n/a |
| Tri City National Bank | $ 125,340,000 | 17.0% | $ 59,122,000 | 8.0% | $ 73,902,000 | 10.0% |
| Tier 1 capital (to risk weighted assets) | | | | | | |
| Tri City Bankshares Corporation | $ 117,831,000 | 15.9% | $ 29,593,000 | 4.0% | $ n/a | n/a |
| Tri City National Bank | $ 116,064,000 | 15.7% | $ 29,561,000 | 4.0% | $ 44,341,000 | 6.0% |
| Tier 1 capital (to average assets) | | | | | | |
| Tri City Bankshares Corporation | $ 117,831,000 | 10.0% | $ 47,212,000 | 4.0% | $ n/a | n/a |
| Tri City National Bank | $ 116,064,000 | 9.8% | $ 47,176,000 | 4.0% | $ 58,970,000 | 5.0% |

**NOTE 21 - Concentration of Credit Risk**

Practically all of the Bank's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area of Southeastern Wisconsin. Although the Bank has a diversified loan portfolio, the ability of its debtors to honor its contracts is dependent on the economic conditions of the counties surrounding the Bank. The concentration of credit by type of loan is set forth in Note 5.