If we had a nickel for every year in a row we achieved record-level financial performance, we'd have 35¢.

Arbor Bancorp, Inc. | 2016 Annual Report

bank of ann arbor

Member FDIC

And if we had a penny for every helpful deed our team of the World's Best Bankers—a.k.a., the Bank of Ann Arbor team—has done for our customers and the community, we'd all be filthy rich.

But we don't. So we'll just go on being helpful.

Dear fellow shareholders:

In 2016, our positive momentum continued.

We're proud to report our seventh consecutive year of record-setting earnings. Hopefully, you're enjoying the value (not all in nickels) our performance has brought to your investment in Bank of Ann Arbor.

EXPANDING EASTWARD, TO BIRMINGHAM

In 2016, we announced the acquisition of the Bank of Birmingham, a full-service community bank that served individuals, families, and businesses throughout Oakland County since 2006. In January 2017, with the completion of the transaction, we added 25 employees to our team and $290 million in assets to our balance sheet. **Today, Bank of Ann Arbor employs 225 people and operates eight locations in Washtenaw, western Wayne and Oakland Counties.**

It's not the first time we've significantly expanded our organization. In 2010, we acquired New Liberty Bank in Plymouth, Michigan. In 2013, we acquired Ann Arbor based UniFi Equipment Finance. With the Bank of Birmingham acquisition, the opportunity we've been looking for—to expand into Oakland County—presented itself. The performance and culture of our two organizations are similar, but our differences will benefit us greatly. We will bring our successful technology banking group, mortgage lending platform, and trust and investment management services to the new partnership, and Bank of Birmingham's robust offering of SBA lending products will be invaluable going forward.

Jenny Meier, a Bank of Birmingham employee since the company's inception and most recently executive vice president and chief lending officer, is now the **Birmingham district president.** Jenny has great energy, enthusiasm, leadership skills, and vast knowledge of the Oakland County market and the bank's client base. The future of our Birmingham office is bright with Jenny at the helm.

TECHNOLOGY INDUSTRY GROUP: 15 YEARS OF HELPING START-UPS

Back in 2002, Michigan was consistently ranked near the bottom of the 50 states in supporting and nurturing innovation-based businesses. That year, Michael Cole moved with his family back to his native Ann Arbor from Los Angeles, where he had spent 13 years as a commercial lender serving technology-based companies. **The idea to build a specialty banking group was too good to resist, so we launched our Technology Industry Group with Michael providing his experience and leadership.** Over the last 15 years, the Tech Group has contributed greatly to Ann Arbor becoming a leading center in the Midwest for fostering the development of innovation-based companies. Michael and his team helped launch two important venture capital efforts, the Ann Arbor Angels and the Michigan Venture Capital Association. In 2006, Bank of Ann Arbor became a founding member of Ann Arbor SPARK, thanks to our ever-growing tech banking area. The Technology Industry Group has also developed strong relationships with various entities within the University of Michigan that serve the entrepreneurial initiatives of staff and students, including the Tech Transfer area and the University of Michigan Zell Lurie Institute for Entrepreneurial Studies. We applaud Michael and his team for their success in building a significant loan, deposit, and investment portfolio for entrepreneurs, innovative businesses, and venture capital firms.

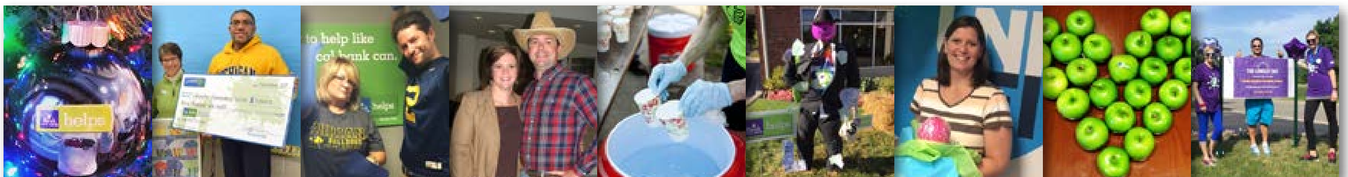
OTHER 2016 HIGHLIGHTS

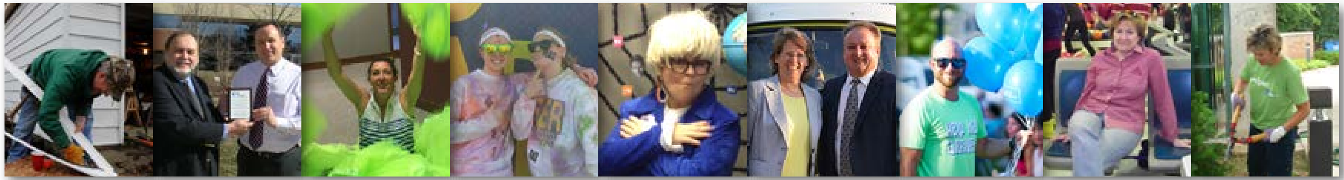
At the Annual Convention of the Michigan Bankers Association in June, **Tim Marshall was elected Chairman of the MBA's Board of Directors.** Tim's been privileged to guide and direct our great state's leading banking association. With such a demanding regulatory environment, advocacy at both the state and national levels is critical. Along with other prominent Michigan bankers, Tim is spearheading the effort on behalf of community banking institutions to get much needed relief from regulations and is encouraging other bankers to impress upon lawmakers the need for change.

At the Michigan Bankers Association annual BEST Conference, our Financial Literacy team, led by Ms. Lou Morse, won the **2016 Innovator Award for Financial Literacy.** The award recognized the team's efforts to educate seniors about elder financial scams, provide young adults with basic budgeting lessons, give bank tours to elementary school students, and counsel bank clients individually to strengthen their understanding of banking services.

From June through August, Bank of Ann Arbor's **Sonic Lunch concert series** once again filled Liberty Plaza every Thursday. The 2016 series featured a range of artists with Michigan roots, including Ann Arbor's own Laith Al-Saadi. A regular Sonic Lunch

Over the last 15 years, our Tech Group has contributed greatly to Ann Arbor becoming a center for fostering the development of innovation-based companies.





performer since the series began in 2007, Laith had a very successful run on "The Voice," NBC's immensely popular talent show. In 2017, we look forward to the series' 10th anniversary year. Stay tuned for details.

In August, the bank won the **2016 Governor's Service Award** in the Corporate Community Leader category. With the award, Bank of Ann Arbor was recognized for its history of volunteerism and dedication to helping others in the communities we serve. We celebrate this award with all of our colleagues who give generously of their time, energy, and talent to area nonprofit organizations, schools, faith-based institutions, their fellow citizens, and others.

In 2016, **we congratulated several officers at the bank who retired from their successful careers: Tom Kallewaard, Walt Byers, Dennis Ticknor, and Bella Fernandez,** an original employee of the bank. In early 2017, we will be offering similar well wishes to Kirsty Haboian and Mike Michon.

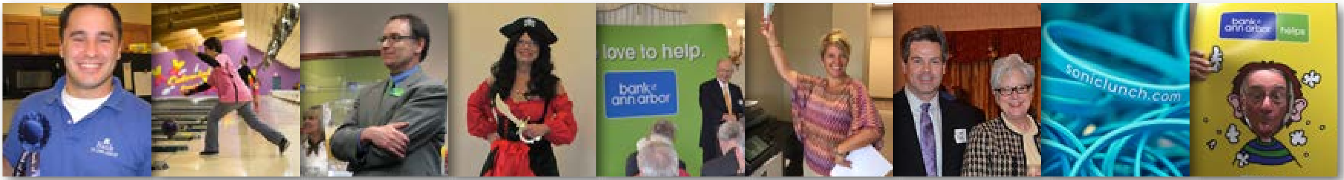
This past summer, **the two-year remodeling and expansion of our main office building in downtown Ann Arbor was completed.** Special thanks goes to our own **Hans Maier** for his hard work, persistence, and patience in managing this project. We also thank our architects at **Bowers Associates** and our team of contractors led by **O'Neal Construction.** All performed admirably in working to complete this project successfully. Please stop by to see our much-improved digs, and the **considerable number of works by local and regional artists on display.**

NOW, THE NUMBERS

Financially speaking, the successful operations of all revenue-generating areas of the bank positively impacted our earnings growth. We finished the year with a **16.2% improvement in earnings** to $16,476,000 **and earnings per share of $17.96** which, for the seventh consecutive year, set a record for the bank. We've enjoyed average annual earnings increases of 21.7% since 2010, when our earnings were $5.1 million. Our **2016 efficiency ratio**—the amount of expense required to generate $1 in revenue—**was just 52.6%, which compares favorably to the rest of our peer bank group at 65.3% and to all banks in Michigan at 66.2%.** Generally, the more efficiently a bank operates, the better its earnings will be. Your team at Bank of Ann Arbor is ever diligent in generating new revenue while keeping expenses to a minimum.

Growth in Earnings and Earnings per share

	2016	2015	2014	2013	2012	2011	2010
Earnings (In thousands)	$16,476	14,160	11,637	9,674	8,449	6,583	5,097
Earnings per share	$17.96	15.64	13.17	10.93	9.62	7.55	5.90
Book value per share	$125.56	98.19	85.64	72.00	66.19	57.00	47.84



When we opened the bank in 1996, shareholder return on equity (ROE) was $3 million. In 2016, it was $115 million.

Our balance sheet includes more than $1.2 billion in total assets. Total deposits exceeded $1 billion for the second year in a row. At year's end, total loans approached $900 million. Since the end of 2010, assets have grown by $528 million, or 77%. **We are now the second largest bank in Ann Arbor, with nearly 14% market share in deposits.** Only Chase is bigger. Our Commercial Banking Group and UniFi Equipment Finance contributed mightily to the increase in our loan portfolio, which grew by 9.5% in loans and 22.6% in leases. We consider these numbers quite impressive considering the U.S. economy has only grown by about 2%. A banking metric that compares profitability levels to assets is the return-on-assets ratio (ROA). In 2016, our ROA was 1.42%, well beyond the national average of 1.03% and our peer group of community banks' ratio of .97%.

When we opened the bank in 1996, shareholder equity was $3 million. In 2016, it was $115 million.

Bank of Ann Arbor is among the best banks in the country for our return-on-shareholders-equity ratio (ROE). Our 2016 ROE at 17.4% placed us among the top 2.2% of all banks in the country (the national average is 9.2%; our peer group's average is 8.53%).

For you, our valued shareholders, we **increased the annual dividend to $2.10 per share** while we continue to manage capital levels to support growth. **Over the past six years, the bank's total assets have grown by nearly 77%** and our "well-capitalized" status by the FDIC, their highest designation, has been preserved. We've identified opportunities for additional growth within the communities we serve. Your Board of Directors has deemed a conservative capital management policy built around earnings retention as being integral to cultivating these growth opportunities.

OUR PEOPLE MADE ALL THIS HAPPEN

Our outstanding financials were made possible by, well, everyone. The hard work of our sales and support teams was integral to our success. Emphasis on building total relationships with our clients while insisting on high-quality credit means our growth is strong, yes, but not over-inflated. Our self-imposed checks and balances help ensure all new accounts and loans are valuable solutions for our clients and not merely generated to meet sales goals.

SPECIFIC 2016 HIGHLIGHTS

Commercial Banking Group: Another terrific year. Closed new commercial loan commitments of $217 million. Generated total fee income of over $1.4 million. In a difficult interest rate environment, managed the portfolio yield above planned levels every month of the year. Year in and year out, the commercial lending team finds a way to uncover new quality lending opportunities to support our revenue growth.

Mortgage Banking Group: Fabulous year by all measures. Total production fee income of over $2.8 million was the biggest in our history and exceeded prior-year levels by 16.6%. Our mortgage team is ideally positioned to add our mortgage banking platform to the Birmingham office in 2017.

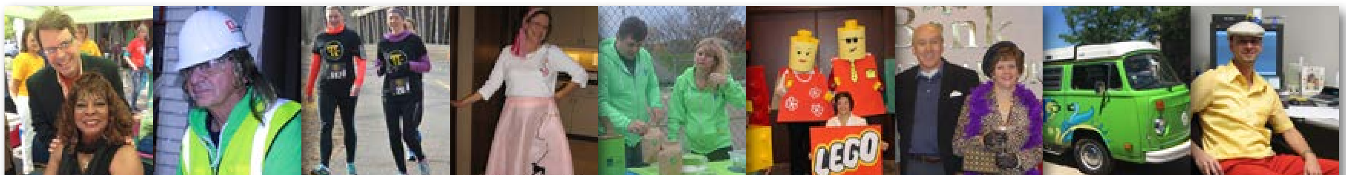
Trust and Investment Management Group: Assets in trusts and investments exceeded $1 billion, finishing 2016 at nearly $1.2 billion. Revenue exceeded $5 million for the first time in bank history. Our highly talented team closed over $100 million in new accounts and added $93 million to existing accounts. In 2017, we will begin to offer our trust and investment management services in the Birmingham market.

UniFi Equipment Finance: Continued progress in growth and profitability led to another exceptional year. Lease originations were at a record level. Leases on the balance sheet grew by over 22%. Credit metrics are better than our peers. Profits were up over tenfold. We continue to add talent to help scale up the business for continued growth and success.

Credit Administration: Our growth in lending does not mean the quality of our loan decisions suffers. The credit administration team works hard to make sure all of our underwriting is fundamentally sound and, in partnership with the lending team, the quality of our assets are exceptional. Our credit quality standards are critically important to our success. Past-due loans and charge-offs are minimal, far lower than the industry as a whole.

In spite of strong credit quality metrics, we continue to be conservative in our approach to funding **our allowance for loan loss, which grew by nearly $1.7 million year over year.** Mistakes happen. It's important to have an adequate reserve to minimize the adverse effects of any problems that arise in our loan portfolio.

Our team, the World's Best Bankers, works hard, drives efficiency, supports each other, takes ownership and solves problems.



Much of our success over the years can be attributed to our overall efficiency, and the efforts of every member of our team, **the World's Best Bankers.** They work hard, drive efficiency, support each other, take ownership, and solve problems. No excuses are made. Our team is extremely productive, energetic, collaborative, and always helpful.

The impressive group of Board members provides great oversight, and our shareholders are supportive beyond measure. The strength and stability of Bank of Ann Arbor, our steadfast commitment to the community, and the consistently strong operational execution by our team has fueled our growth and enabled us to help more individuals and businesses over the years.

This year, the goal is to keep our momentum going. Our emphasis on quality personal service will continue. We look forward to building strong relationships in and around Birmingham. As technology evolves and becomes even more important to the delivery of banking services, we will demand that our vendors provide best-in-class products and services for us and for our clients.

As always, we value the referrals you make on our behalf so we can become the bank of choice for even more individuals, families, and businesses in our communities. If we can be helpful in any way, please do not hesitate to contact us.

Sincerely,

Timothy G. Marshall

Tim Marshall

President & CEO

William C. Martin

Bill Martin

Chairman of the Board

The billboard shown above is not real. It is merely a work of Photoshop fiction.

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2016 AND 2015

	2016	2015
ASSETS		
Cash and due from financial institutions	$ 20,251	$ 18,795
Interest-bearing balances in banks	107,138	170,791
Cash and cash equivalents	127,389	189,586
Securities available-for-sale	127,958	146,181
Loans held for sale	4,545	3,158
Loans, excluding covered loans, net	897,038	832,633
Covered loans	1,836	3,157
Total loans	898,874	835,790
Federal Home Loan Bank stock, at cost	1,740	1,740
Premises and equipment, net	20,484	17,888
Cash surrender value of life insurance	20,306	14,757
Other real estate owned (OREO)	866	1,594
FDIC indemnification asset	–	–
Accrued interest receivable and other assets	14,843	15,394
	$ 1,217,005	**$1,226,088**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$ 328,753	$ 293,950
Interest-bearing	700,590	760,229
Total deposits	1,029,343	1,054,179
Other borrowings	–	24,909
Federal Home Loan Bank advances	–	749
Repurchase agreements	36,156	38,985
Accrued expense and other liabilities	8,258	12,840
Subordinated debentures	27,465	5,155
Total liabilities	1,101,222	1,136,817
Shareholders' equity		
Preferred stock, $1,000 value; 15,000 shares authorized; 12,350 and 0 shares issued and outstanding at December 31, 2016 and 2015, liquidation value of $12,350,000 and $0 at December 31, 2016 and 2015	12,196	–
Common stock, no par value; 2,000,000 shares authorized; 908,589 and 895,886 shares issued and outstanding at December 31, 2016 and 2015	65,618	4,929
Retained earnings	37,418	82,738
Accumulated other comprehensive income/(loss)	551	1,604
Total shareholders' equity	115,783	89,271
	$ 1,217,005	**$1,226,088**

All dollar amounts in thousands except per share data. Unaudited.

CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
Interest income		
Loans, including fees	$ 42,086	$ 38,797
Securities:		
Taxable	1,280	1,242
Tax exempt	1,821	1,977
Federal funds sold and other	716	461
	45,903	42,477
Interest expense		
Deposits	1,619	1,549
Federal Home Loan Bank advances	12	15
Subordinated debentures	195	174
Other borrowings	–	7
Repurchase agreements	157	163
	1,983	1,908
Net interest income	43,920	40,569
Provision for loan losses	2,209	2,680
Net interest income after provision for loan losses	41,711	37,889
Noninterest income		
Service charges on deposit accounts	517	444
Income from fiduciary activities	5,084	4,745
Net gains on sales of loans	2,318	1,889
Net gains on sales of securities	–	6
Gain (loss) on sales of OREO	694	1,406
Other	3,051	2,778
	11,664	11,268
Noninterest expense		
Salaries and employee benefits	20,612	19,534
Occupancy and equipment	3,045	2,825
Marketing and business promotion	1,440	1,432
FDIC expense	636	550
Provision for loan repurchase liability	(1,000)	561
Other	5,367	4,311
	30,100	29,213
Income before income taxes	23,275	19,944
Income tax expense	6,799	5,784
Net income	**$ 16,476**	**$ 14,160**
Basic earnings per share	$ 17.96	$ 15.64
Diluted earnings per share	16.84	14.91

All dollar amounts in thousands except per share data. Unaudited.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
Net income	**$** 16,476	**$** 14,160
Other comprehensive income (loss):		
Unrealized gains/losses on securities:		
Unrealized holding gain/(loss) arising during the period	(1,595)	(79)
Reclassification adjustment for losses (gains) included in net income	–	(6)
Tax effect	542	29
Net of tax	(1,053)	(56)
Comprehensive income	**$ 15,423**	**$ 14,104**

All dollar amounts in thousands except per share data. Unaudited.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2016 AND 2015

	Preferred Stock	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, January 1, 2015	$ –	$ 4,613	$ 69,736	$ 1,660	$ 76,009
Net income	–	–	14,160	–	14,160
Other comprehensive income (loss)	–	–	–	(56)	(56)
Deferred shares plan	–	41	–	–	41
Exercise of stock options (28,918 shares)	–	1,897	–	–	1,897
Repurchase of 20,616 shares of common stock	–	(2,168)	–	–	(2,168)
Stock based compensation expense	–	546	–	–	546
Cash Dividend ($1.30 per share)	–	–	(1,158)	–	(1,158)
Balance, December 31, 2015	–	4,929	82,738	1,604	89,271
Net income	–	–	16,476	–	16,476
Other comprehensive income (loss)	–	–	–	(1,053)	(1,053)
Regulatory transfers[1]	–	60,000	(60,000)	–	–
Deferred shares plan (278 shares)	–	37	–	–	37
Stock purchases (470 shares)	–	61	–	–	61
Exercise of stock options (24,978 shares)	–	1,571	–	–	1,571
Repurchase of 12,745 shares of common stock	–	(1,570)	–	–	(1,570)
Issuance of preferred stock, net of issuance costs	12,196	–	–	–	12,196
Stock based compensation expense	–	590	–	–	590
Cash Dividend ($2.00 per share)	–	–	(1,796)	–	(1,796)
Balance, December 31, 2016	**$ 12,196**	**$ 65,618**	**$ 37,418**	**$ 551**	**$ 115,783**

(1) To facilitate adequate Tier 1 voting common stock equity of 51 percent or greater, $60,000 was transferred from retained earnings to common stock. The transfer was approved by the Corporation's board of directors and executed in December 2016.

All dollar amounts in thousands except per share data. Unaudited.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Principles of Consolidation: The consolidated financial statements include Arbor Bancorp, Inc. and its wholly owned subsidiary, Bank of Ann Arbor ("Bank"), together referred to as "the Corporation." On January 1, 2013, the Corporation, through a newly established Bank subsidiary, Bank of Ann Arbor Leasing ("Leasing Company"), acquired all of the stock of the Ervin Leasing Company; an Ann Arbor, Michigan based leasing company which provides business equipment direct financing leases to companies across the United States. Intercompany transactions and balances are eliminated in consolidation. As of July 1, 2014, Ervin Leasing Company renamed and rebranded to UniFi Equipment Finance.

The Bank provides financial services through its offices in Washtenaw and Wayne counties. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are residential mortgage, commercial, and installment loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Commercial loans are expected to be repaid from cash flow from operations of businesses. Other financial instruments, which potentially represent concentrations of credit risk, include deposit accounts in other financial institutions and federal funds sold.

Subsequent Events: The Corporation has evaluated subsequent events for recognition and disclosure through March 7, 2017, which is the date the financial statements were available to be issued.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ.

Cash Flows: Cash and cash equivalents includes cash, deposits with other financial institutions under 90 days, short-term investments and federal funds sold. Net cash flows are reported for customer loan and deposit transactions, federal funds purchased and repurchase agreements.

Interest-Bearing Deposits in Banks: Interest bearing deposits in banks mature within one year and are carried at cost. The balance outstanding at year end 2016 and 2015 was held at the Federal Reserve Bank.

Securities: Debt securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax. Interest income includes amortization of purchase premium or discount. Gains and losses on sales are based on the amortized cost of the security sold.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer and also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) other-than-temporary impairment (OTTI) related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Federal Home Loan Bank (FHLB) Stock: The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Loans Held for Sale: Loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value, in the aggregate, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Loans are sold with servicing released. Buyers do not have recourse against the Corporation for subsequent loan losses. However, in certain situations, the buyer can require the Corporation to repurchase loans.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of purchase premiums and discounts and an allowance for loan losses. Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term.

Interest income on all loans is generally discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Covered Loans: Loans acquired in 2010 in a Federal Deposit Insurance Corporation (FDIC)-assisted transaction are covered under a loss sharing agreement and are referred to as "covered loans." Pursuant to the terms of the loss sharing agreements, covered loans are subject to a stated loss threshold whereby the FDIC will reimburse the Corporation for 80% of losses incurred. The FDIC's obligation to reimburse the Corporation for losses with respect to covered loan begins with the first dollar of loss incurred. The loss share agreement on non-single family loans ended in May 2015. The loss share on single family loans expires in 2020. The Corporation will reimburse the FDIC for its share of recoveries with respect to losses for which the FDIC paid the Corporation a reimbursement under the loss sharing agreement.

Covered loans were recorded at fair value at the time of acquisition. Fair values for covered loans are based on a discounted cash flow methodology that considered various factors including the type of loan and related collateral, classification status, fixed or variable interest rate, term of loan and whether or not the loan was amortizing, and a discount rate reflecting the Corporation's assessment of risk inherent in the cash flow estimates. Covered loans were grouped together according to similar characteristics and were treated in the aggregate when applying various valuation techniques.

At purchase, certain covered loans had evidence of credit deterioration since origination. These loans are accounted for individually. The Corporation estimates the amount and timing of expected cash flows for each purchased loan, and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan or pool (accretable yield). The excess of the loan's or pool's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference). Over the life of the loan or pool, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Direct Financing Lease Receivables: The results of the Corporation's equipment leasing activities are recorded within loans on the consolidated balance sheet. These direct financing leases provide for full recovery of the equipment cost over the term of the lease. The types of equipment financed include computer hardware and software, telecommunications equipment, photocopiers, forklifts, machine tools and other hard asset collateral types.

The Corporation's net investment in direct financial leases is comprised of the following elements: minimum lease payments receivable, the estimated unguaranteed residual value of the leased equipment at the lease termination dates, and unamortized initial direct costs, less unearned income. Estimated guaranteed residual values are reviewed periodically to determine if the current estimate of the equipment's fair value appears to be below its recorded estimate. If required, residual values are adjusted downward to reflect adjusted estimates of fair market values. Upward adjustments to residual values are not permitted.

Unearned income is the amount by which the minimum lease payments receivable plus the estimated unguaranteed residual value exceeds the cost of the leased equipment at the inception of the lease. Unearned income is amortized over the initial lease term to produce a constant rate of return on the net investment in the lease. Initial direct costs of acquiring a lease are capitalized when incurred and amortized over the life of the lease consistent with the method used to recognize interest income.

The Corporation evaluates the collectability of its lease receivables based upon certain factors, such as historical collection trends and aging categories. Lease receivables are written off against the allowance for loan losses when the receivable is determined to be uncollectible.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge offs less recoveries. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers non classified loans and is based on historical loss experience adjusted for current factors.

A loan is impaired when full payment under the loan terms is not expected. Non-homogeneous loan classes such as commercial and commercial real estate loans and homogeneous loan segments, such as mortgage and consumer loans modified as troubled

debt restructurings or loans associated with non-homogeneous relationships, are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component covers non impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Corporation over the most recent five years. For all segments, the actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified:

Commercial – Loans to businesses that are sole proprietorships, partnerships, limited liability companies and corporations. These loans are for commercial, industrial, or professional purposes. The risk characteristics of these loans vary based on the borrowers' business and industry as repayment is typically dependent on cash flows generated from the underlying business. Within this loan segment, the Corporation has identified loan classes of commercial and industrial, commercial real estate and commercial land development.

Real Estate – Loans to purchase or refinance single family residences. The risks associated with this segment are generally dependent on the overall real estate value environment and individual payment obligations. Real estate is subject to changes in market valuation and can be unstable for a variety of reasons. Within this segment the Corporation has identified classes of residential and home equity loans.
tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

Consumer – Term loans or lines of credit for the purchase of consumer goods, vehicles or home improvement. The risk characteristics of the loans in this segment vary depending on the type of collateral but generally repayment is expected from a customer continuing to generate a cash flow that supports the calculated payment obligation. Secondary support could involve liquidation of collateral.

Leases – Direct Finance equipment leases. Risk characteristics vary based from the borrower's business and industry as repayment is typically dependent upon cash flows generated from the borrower's operations. Secondary support could involve repossessing the leased collateral.

FDIC Indemnification Asset: The FDIC indemnification asset results from the loss share agreements in the FDIC-assisted transaction. The asset is measured separately from the related covered assets as they are not contractually embedded in the assets and are not transferable with the assets should the Corporation choose to dispose of them and represent the acquisition date fair value of expected reimbursements from the FDIC. Pursuant to the terms of the loss sharing agreement, covered loans are subject to a stated loss threshold whereby the FDIC will reimburse the Corporation for 80% of losses incurred. These expected reimbursements do not include reimbursable amounts related to future covered expenditures. These cash flows are discounted to reflect a metric of uncertainty of the timing and receipt of the loss sharing reimbursement from the FDIC. This asset decreases

when losses are realized and claims are submitted to the FDIC or when customers repay their loans in full and expected losses do not occur. This asset increases when estimated future losses increase and also decreases when estimated future losses decrease. When estimated future loan losses increase, the Corporation records a provision for loan losses and increases its allowance for loan losses accordingly. The resulting increase in the FDIC indemnification asset is recorded as an offset to the provision for loan losses. During 2016 and 2015, the provision for loan losses was offset by $0 and $36 related to increases in the FDIC indemnification asset. As of December 31, 2016 and 2015 there is no indemnification asset recorded as the remaining covered portfolio consists of single-family home loans for which the indemnification asset expires in 2020 and no significant losses are currently expected.

Other Real Estate Owned (OREO): Assets are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Premises, Equipment and Leasehold Improvements: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation, generally computed on the straight-line basis over the assets' useful lives, and over the terms of the lease or the estimated useful lives for leasehold improvements, whichever is shorter.

Cash Surrender Value of Life Insurance: The Corporation has purchased life insurance policies on certain key executives. Cash surrender value of life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Long-Term Assets: Premises and equipment, other intangible assets and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Repurchase Agreements: Substantially all repurchase agreement liabilities represent amounts advanced by various customers. These balances are not deposits and are not covered by federal deposit insurance. Securities are pledged to cover these liabilities.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Corporation, 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 the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Stock Based Compensation: Compensation cost is recognized for stock options and restricted stock awards issued to employees and directors, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options while the valuation price of the Corporation's common stock as of the grant date is used for restricted stock awards.

Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense.

Off-Balance-Sheet Financial Instruments: Financial instruments include off balance-sheet credit instruments, such as commitments to make loans and standby letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Earnings Per Share: Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share include the dilutive effect of additional potential common shares issuable under equity based plans.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale which are also recognized as separate components of equity.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Restrictions on Cash: Cash on hand or on deposit with the Federal Reserve Bank of $1,816 and $1,824 was required to meet regulatory reserve and clearing requirements at year end 2016 and 2015.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the bank to the holding company or by the holding company to shareholders.

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

Preferred Stock: On December 19, 2016, the shareholders of the Corporation authorized the board of directors of the Corporation to issue up to 15,000 shares of non-cumulative perpetual preferred stock in connection with an acquisition. As of December 31, 2016, 12,350 shares of preferred stock were issued and outstanding. Shares are not redeemable prior to December 30, 2021, subsequent to this date; the Corporation has the right to redeem these shares. Preferred stock can be converted into common stock, at the election of the Holder, at a set price of $143 per share. The number of common stock issued upon a conversion will be determined by dividing each preferred share of $1,000 by the $143 set price of common stock. Dividends approved by the board of directors are paid quarterly in arrears at 6 percent. Holders of preferred stock do not have voting rights. Refer to Note 2 for further acquisition details.

Newly Issued Not Yet Effective Accounting Standards: In May 2014 the FASB amended existing guidance related to revenue from contracts with customers. This amendment supersedes and replaces nearly all existing revenue recognition guidance, including industry-specific guidance, establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, this amendment specifies the accounting for some costs to obtain or fulfill a contract with a customer. These amendments are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The amendments should be applied retrospectively to all periods presented or retrospectively with the cumulative effect recognized at the date of initial application. The Company is currently evaluating the impact of this new accounting standard on the consolidated financial statements.

In February 2016, the FASB amended existing guidance that requires lessees recognize the following for all leases, except short-term leases, at the commencement date. A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. These amendments are effective for annual reporting periods beginning after December 15, 2019, including interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted upon issuance. The adoption of this standard is expected to increase both assets and liabilities.

In June 2016, FASB issued guidance to replace the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (CECL) model. The CECL model is applicable to the measurement of credit losses on financial assets measured at amortized cost, including loan receivables, held-to maturity debt securities, and reinsurance receivables. It also applies to off-balance sheet credit exposures not accounted for as insurance and net investments in leases recognized by a lessor. The standard will be effective for annual reporting periods beginning after December 15, 2020, including interim periods within fiscal years beginning after December 15, 2021. Early adoption is permitted for fiscal years beginning after December 15, 2018. The Company is currently evaluating the impact of this new accounting standard on the consolidated financial statements.

NOTE 2 – BUSINESS COMBINATIONS

Birmingham Bloomfield Bancshares, Inc. Business Combination

On January 6, 2017, the Corporation acquired 100% of the outstanding common shares of Birmingham Bloomfield Bancshares, Inc. in exchange for cash consideration of $32.3 million. Under the terms of the acquisition, all common shareholders received cash of $16.50 per share. Birmingham Bloomfield Bancshares, Inc. results of operations will be included in the Corporation's results beginning January 6, 2017. This transaction provides the Corporation with the beginnings of a well-established and highly respected footprint in Oakland County, while providing the opportunity to introduce our successful technology banking group, mortgage lending platform, and trust and investment management services to the area.

At the acquisition date, Birmingham added total assets of $297.4 million (unaudited), including total loans of $258.8 million (unaudited), total deposits of $271.2 million (unaudited), and total equity of $19.5 million (unaudited) to the Corporation's consolidated statement of financial position. In connection with the acquisition of Birmingham, the Corporation is expected to record goodwill, which was primarily attributable to the synergies and economies of scale expected from combining the operations of the Corporation and Birmingham. In addition, the Corporation expects to record a core deposit intangible assets in conjunction with the acquisition. All assets and liabilities will be recorded at fair value; however such valuations are in process at the date of the financial statements.

ADDITIONAL INFORMATION

We have included financial information for the year ended December 31, 2016. Our full financial statements including notes were audited by Crowe Horwath, our independent public accountant, and Crowe Horwath gave an unqualified opinion. The complete audited financial statements including the auditor's opinion and notes are available upon request.

If you would like a copy of the audited financial statements or if you have any questions concerning the annual meeting, please contact your bank president, Timothy G. Marshall, at 125 South Fifth Avenue, P.O. Box 8009, Ann Arbor, Michigan 48107.

OFFICERS

Executive Management

Timothy G. Marshall
President &
Chief Executive Officer

Charles E. Crone, Jr.
Executive Vice President &
Chief Revenue Officer

Patti H. Judson
Executive Vice President &
Chief Operating Officer

Erik W. Bakker
Executive Vice President &
Trust & Investment Management
Group Manager

Cynthia J. Livesay
Executive Vice President &
Chief Credit Officer

Mark J. Slade
Executive Vice President &
Chief Financial Officer

Commercial Lending Group

Charles E. Crone, Jr.
Executive Vice President &
Chief Revenue Officer

Mark D. Baily
Vice President &
Commercial Loan Officer

Jonathan F. Bowdler
Vice President &
Commercial Real Estate Manager

Michael A. Cole
Group President, Technology
Industry Group

Michelle M. Desmarais
Vice President &
Commercial Loan Officer

Rita L. Facchini
Senior Vice President &
Senior Loan Officer

Timothy M. Gretkierewicz
Senior Vice President &
Loan Group Manager

David A. Guenther
Vice President &
Senior Loan Officer

Sara L. Hoffman
Assistant Vice President &
Small Business Lending Officer

Mark H. Holtz
Vice President,
Technology Industry Group

Satish B. Jasti
Senior Vice President &
Senior Loan Officer

Hans W. Maier
Senior Vice President,
Specialty Banking

Jeffrey S. McKelvey
President, Ypsilanti District

Jenny S. Meier
President, Birmingham District

Michael L. Michon
President, Plymouth District

James J. Plummer
Vice President &
Commercial Loan Officer

Aaron M. Reeder
Vice President &
Commercial Loan Officer

Robert R. Rose
Vice President &
Senior Loan Officer

Michael P. Sampson
Vice President &
Commercial Loan Officer

James J. Simone
Senior Vice President &
Business Development Officer

Rachel S. Thompson
Vice President &
Commercial Loan Officer

Credit Administration

Cynthia J. Livesay
Executive Vice President &
Chief Credit Officer

Stephanie N. Harrigan
Vice President, Consumer
Credit & Compliance

Christine A. Johnson
Assistant Vice President &
Real Estate Appraisal Coordinator

Dawn M. Prescott
Senior Vice President &
Managed Assets Officer

Trina M. VanNest
Vice President & Credit Manager

Pamela J. Wetzel
Credit Administration Officer

Finance & Compliance

Mark J. Slade
Executive Vice President &
Chief Financial Officer

Pamela F. Brown
Accounting Officer

John E. Foster
Vice President, BSA, OFAC &
Security Officer

Hwey-Ling Hsu (Angela)
BSA/Deposit Compliance Officer

Lisa A. Mason
Vice President & Internal Auditor

Barbara L. Morrison
Vice President

Timothy T. Otto
Vice President & Controller

Cynthia K. Shaeffer
Assistant Vice President,
BSA/Security Specialist

Susan E. Wagner
Vice President, Compliance Officer
& Compliance Department Manager

HR, IS, & Marketing

James A. Miller
Vice President &
Director, Human Resources

Rhonda J. Foxworth
Assistant Vice President,
Senior Administrator

Jeffrey J. Stanton
Senior Vice President &
Chief Information Officer

Erin M. Tecker
Vice President &
Information Technology Officer

Janice M. Ortbring
Vice President &
Marketing Department Manager

Mortgage Group

James T. Fagan
Vice President & Mortgage
Department Manager

Kimberly A. Clugston
Vice President &
Senior Mortgage Loan Officer

Charles W. Cracraft
Vice President &
Mortgage Sales Manager

OFFICERS

Joseph D. Craigmile
Mortgage Loan Officer

Carl D. Ent
Vice President &
Mortgage Loan Officer

Kevin C. Salley
Mortgage Loan Officer

Denise J. Staffeld
Vice President &
Mortgage Loan Officer

Private Banking Services

Patrick A. Tamblyn
Senior Vice President & Private Banking Manager

Pamela R. Audette
Vice President &
Private Banking Officer

Linda S. Brewer
Vice President &
Private Banking Officer

Margaret K. Currier
Vice President &
Private Banking Officer

Mary Hays
Vice President &
Private Banking Officer

Kevin M. Kramer
Vice President &
Private Banking Officer

John P. Landis
Vice President &
Business Development Officer

Retail Banking, Cash Management & Operations

Patti H. Judson
Executive Vice President &
Chief Operating Officer

Sandra L. Beever
Deposit Operations Officer

Rene G. Halkides
Cash Management Officer

Amanda M. Hart
Vice President,
Administration & Operations

Christine G. Held
Vice President, Cash Management

Joan C. Hendricks
Vice President &
Main Office Manager

Maggie A. Jannott
Birmingham Office Manager

Stacy B. Johnson
Ellsworth Office
Assistant Manager

Michael R. Kofsky
Ellsworth Office Manager

Kristina L. Mayer
Vice President &
Plymouth Office Manager

David E. Norton
Stadium Office Manager

David K. Pate
Ypsilanti Office Manager

Natalia V. Pelava
Traver Office Manager

Shelley L. Rankin
Saline Office Manager

Kimberly K. Snow
Relationship Banking &
Cash Management Officer

Trust & Investment Management Group

Erik W. Bakker
Executive Vice President,
Trust & Investment Management Group Manager

Jena P. Agler
Trust Officer

Erin E. Archambault
Vice President,
Trust Operations Manager

Sarah Dobson Campbell
Trust Officer

Lyle F. Dahlberg
First Vice President &
Trust Team Manager

Keith W. Daucher
Trust Operations Officer

Eric P. Helber
Vice President &
Director of Business Development

Trever M. Helmstead, CFA
Vice President & Investment Officer

Jacqueline Jenkins
Vice President, Portfolio Manager &
Business Development Officer

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Vice President & Business
Development Officer

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Assistant Vice President,
401(k) Relationship &
Portfolio Manager

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Investment Officer

Christopher M. Prisby, CFA
Senior Vice President &
Investment Team Manager

Daniel M. Rose
Trust Operations Officer

Cathleen L. Savoie, CFA
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Investment Officer

Stephen J. Seymour, CFA
Senior Vice President & Senior
Investment Officer

Mitzi J. Talon
Vice President & Trust Officer

Diane S. Winner, CFP
Vice President &
Investment Officer

UniFi Equipment Finance

Raymond J. Grimshaw
President &
Chief Executive Officer

Jeffrey L. Teucke
Senior Vice President of Sales

DIRECTORS

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President, Midtown Group, Inc.

Jan L. Garfinkle
Founder & Managing Director,
Arboretum Ventures

Isadore J. King
President &
Chief Executive Officer,
Integrated Care Alliance, LLC

Timothy G. Marshall
President &
Chief Executive Officer,
Bank of Ann Arbor

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First Martin Corporation

William C. Martin, Chairman
Athletic Director Emeritus,
University of Michigan

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Perich + Partners, Ltd.

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360 Advisors, LLC

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Government Relations,
University of Michigan

Jeffrey S. Williams
Chairman &
Chief Executive Officer,
NeuMoDx Molecular, Inc.

Directors Emeritus

James W. Anderson, Jr.
President,
The Anderson Associates

Richard P. Eidswick
Managing Partner,
Arbor Partners

Jan Barney Newman
President
Ann Arbor District Library Board

Richard N. Robb, DDS
Regent Emeritus,
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From our entire team, thank you for investing your hard-earned money in Bank of Ann Arbor.

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