

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Huron Community Financial Services, Inc.
East Tawas, Michigan

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Huron Community Financial Services, Inc. which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations and comprehensive income, changes in 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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.

(Continued)

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Huron Community Financial Services, Inc. as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Crowe Horwath LLP". The signature is written in a cursive, slightly stylized font.

Crowe Horwath LLP

Grand Rapids, Michigan
March 14, 2018

HURON COMMUNITY FINANCIAL SERVICES, INC.
CONSOLIDATED BALANCE SHEETS
December 31, 2017 and 2016
(000's omitted, except share per share data)

	<u>2017</u>	<u>2016</u>
ASSETS		
Cash and due from banks	\$ 4,377	\$ 12,296
Investment securities – available for sale	48,804	29,722
Other securities	877	877
Loans – net of allowance for loan losses of \$1,863 and \$1,874 in 2017 and 2016, respectively	134,689	140,659
Foreclosed assets	533	949
Premises and equipment	2,708	2,765
Goodwill	405	405
Accrued interest receivable	505	433
Cash surrender value of life insurance	6,407	6,093
Other assets	<u>1,433</u>	<u>1,984</u>
 Total assets	 <u>\$ 200,738</u>	 <u>\$ 196,183</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Deposits		
Noninterest-bearing	\$ 42,831	\$ 37,684
Interest-bearing	<u>125,958</u>	<u>125,005</u>
Total deposits	168,789	162,689
 Short-term borrowings	 7,091	 8,808
Accrued and other liabilities	<u>328</u>	<u>210</u>
Total liabilities	176,208	171,707
 Stockholders' equity		
Common stock - \$1 par value: authorized – 1,000,000 shares issued and outstanding – 557,516 and 564,866 shares	558	565
Additional paid-in capital	17,877	18,116
Retained earnings	6,330	5,838
Accumulated other comprehensive income / (loss)	(124)	25
Unearned compensation	<u>(111)</u>	<u>(68)</u>
Total stockholders' equity	<u>24,530</u>	<u>24,476</u>
 Total liabilities and stockholders' equity	 <u>\$ 200,738</u>	 <u>\$ 196,183</u>

See accompanying notes to consolidated financial statements.

HURON COMMUNITY FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
Years ended December 31, 2017 and 2016
(000's omitted, except per share data)

	<u>2017</u>	<u>2016</u>
Interest income		
Loans - including fees	\$ 6,780	\$ 6,610
Investment securities		
Taxable	261	288
Tax-exempt	293	231
Other	<u>216</u>	<u>86</u>
Total interest income	7,550	7,215
Interest expense		
Deposits	394	383
Short-term borrowings	<u>11</u>	<u>10</u>
Total interest expense	<u>405</u>	<u>393</u>
Net interest income	7,145	6,822
Provision for loan losses	<u>(52)</u>	<u>96</u>
Net interest income after provision for loan losses	7,197	6,726
Other operating income		
Service charges - deposits	445	422
Gain on sales of loans	221	165
Bank owned life insurance income	165	164
Loan servicing income	272	259
Other	<u>122</u>	<u>226</u>
Total other operating income	1,225	1,236
Other operating expenses		
Salaries and employee benefits	3,381	3,222
FDIC assessment	56	103
Occupancy expenses	543	588
Service fees	684	377
Depreciation expense	284	263
Other	<u>1,404</u>	<u>1,485</u>
Total other operating expenses	<u>6,352</u>	<u>6,038</u>
Income before income taxes	2,070	1,924
Income tax expense	<u>809</u>	<u>492</u>
Net income	1,261	1,432
Other comprehensive (loss) income – net of tax		
Unrealized (loss) gain on investment securities	<u>(149)</u>	<u>(155)</u>
Total comprehensive income	<u>\$ 1,112</u>	<u>\$ 1,277</u>
Earnings per share		
Basic income per common share	\$ 2.26	\$ 2.57
Diluted earnings per common share	2.25	2.56

See accompanying notes to consolidated financial statements.

HURON COMMUNITY FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years ended December 31, 2017 and 2016
(000's omitted, except share and per share data)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Unearned Compensation	Accumulated Other Comprehensive Income / (Loss)	Total Stockholders' Equity
Balance, January 1, 2016	\$ 556	\$ 17,678	\$ 5,075	\$ (40)	\$ 180	\$ 23,449
Net income	-	-	1,432	-	-	1,432
Other comprehensive loss	-	-	-	-	(155)	(155)
Sale of common stock (21,247 shares)	20	1,041	-	-	-	1,061
Purchase of common stock (11,752 shares)	(12)	(576)	-	-	-	(588)
Stock-based compensation, net	-	(66)	-	12	-	(54)
Dividends declared \$1.26 per common share	-	-	(669)	-	-	(669)
Restricted share units issued (800 shares – net of 100 shares forfeited)	<u>1</u>	<u>39</u>	<u>-</u>	<u>(40)</u>	<u>-</u>	<u>-</u>
Balance, December 31, 2016	565	18,116	5,838	(68)	25	24,476
Net income	-	-	1,261	-	-	1,261
Other comprehensive loss	-	-	-	-	(149)	(149)
Sale of common stock (13,967 shares)	14	703	-	-	-	717
Purchase of common stock (21,317 shares)	(22)	(1,030)	-	-	-	(1,052)
Stock-based compensation, net	-	18	-	28	-	46
Dividends declared \$1.31 per common share	-	-	(769)	-	-	(769)
Restricted share units issued (1,350 shares – net of 0 shares forfeited)	<u>1</u>	<u>70</u>	<u>-</u>	<u>(71)</u>	<u>-</u>	<u>-</u>
Balance, December 31, 2017	<u>\$ 558</u>	<u>\$ 17,877</u>	<u>\$ 6,330</u>	<u>\$ (111)</u>	<u>\$ (124)</u>	<u>\$ 24,530</u>

See accompanying notes to consolidated financial statements.

HURON COMMUNITY FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2017 and 2016
(000's omitted, except per share data)

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities		
Net income	\$ 1,261	\$ 1,432
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	284	263
Net gain on sale of mortgage loans	(221)	(165)
Proceeds from sale of mortgage loans	8,942	7,470
Origination cost of mortgages held for sale	(8,721)	(7,305)
Provision for loan losses	(52)	96
Amortization and accretion on securities	298	350
Increase in cash surrender value of life insurance	(165)	(164)
Stock-based compensation	46	28
Net change in:		
Accrued interest receivable	(72)	(1)
Other assets	881	1,128
Accrued expenses and other liabilities	<u>194</u>	<u>(524)</u>
Net cash provided by operating activities	<u>2,675</u>	<u>2,608</u>
Cash flows from investing activities		
Redemption of other securities	-	-
Activity in available-for-sale securities:		
Maturities, prepayments, calls and sales	13,290	15,216
Purchases	(32,895)	(758)
Purchase of bank owned life insurance	(149)	-
Net increase in loans	6,108	(6,598)
Capital expenditures	<u>(227)</u>	<u>(303)</u>
Net cash provided by (used in) investing activities	<u>(13,873)</u>	<u>7,557</u>
Cash flows for financing activities		
Net (decrease) increase in deposits	6,100	3,726
Net (decrease) increase in short-term borrowings	(1,717)	(3,921)
Proceeds from sale of common stock	717	1,061
Purchases of common stock	(1,052)	(588)
Cash dividends paid on common stock	<u>(769)</u>	<u>(669)</u>
Net cash provided by (used in) financing activities	<u>3,279</u>	<u>(391)</u>
Net change in cash and cash equivalents	(7,919)	9,774
Cash and cash equivalents at beginning of year	<u>12,296</u>	<u>2,522</u>
Cash and cash equivalents at end of year	<u>\$ 4,377</u>	<u>\$ 12,296</u>
Supplemental disclosures of cash flow information		
Cash paid during the year for:		
Interest	\$ 406	\$ 395
Income taxes	440	627
Loans transferred to other real estate	86	118

See accompanying notes to consolidated financial statements.

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 1 - NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation: The consolidated financial statements include the accounts of Huron Community Financial Services, Inc. (the "Corporation") and its wholly owned subsidiary, Huron Community Bank (the "Bank"). All significant intercompany transactions and balances have been eliminated in consolidation.

Nature of Operations: The Bank operates in Iosco, Arenac, and Alcona counties in the state of Michigan. The Bank's revenue results primarily from providing real estate and commercial loans and, to a lesser extent, consumer loans. Its primary deposit products are demand deposits, savings, and term certificate accounts. The Corporation does not have any significant concentrations to any one industry or customer.

Use of Estimates: In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents: Cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold. Federal funds sold are generally sold for one-day periods. Net cash flows are reported for customer loan and deposit transactions and short-term borrowings.

Securities: Securities not classified as held to maturity or trading, including equity securities and deposits with other financial institutions with readily determinable fair values, are classified as "available for sale" and are recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Restricted investment securities include Federal Reserve and Federal Home Loan Bank stock and are carried at cost.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Loans Held for Sale: Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Mortgage loans held for sale are generally sold with servicing retained. The carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Loans: The Corporation grants mortgage, commercial, and consumer loans to customers. A substantial portion of the loan portfolio is represented by commercial and mortgage loans throughout Michigan. The ability of the Corporation's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The accrual of interest on loans is 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 collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loan origination fees, commitment fees, and certain direct origination costs are deferred and amortized as a net adjustment to the related loan's yield. The Bank generally amortizes these costs over the contractual life of such loans.

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 un-collectability of a loan balance is confirmed.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as either doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan are lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors.

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

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Troubled debt restructuring of loans is undertaken to improve the likelihood that the loan will be repaid in full under the modified terms in accordance with a reasonable repayment schedule. All modified loans are evaluated to determine whether the loans should be reported as a troubled debt restructuring (TDR). A loan is a TDR when the Corporation, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower by modifying or renewing a loan that the Corporation would not otherwise consider. To make this determination, the Corporation must determine whether (a) the borrower is experiencing financial difficulties and (b) the Corporation granted the borrower a concession. This determination requires consideration of all of the facts and circumstances surrounding the modification. An overall general decline in the economy or some deterioration in a borrower's financial condition does not automatically mean the borrower is experiencing financial difficulties.

The loan portfolio is allocated to the following segments for allowance analysis purposes:

Commercial and Industrial - 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.

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 an individual continuing to generate a cash flow that supports the calculated payment obligation. Secondary support could involve liquidation of collateral.

Real Estate - The Bank has identified two real estate related segments, commercial and residential. These are loans to purchase or refinance business related real estate or single family residences. The risks associated with this segment are dependent on the customer's ability to continue to generate cash flow that supports the payment obligation under the loan; however the underlying collateral is the business or residential real estate property which is also subject to changes in market valuation.

Foreclosed Assets: Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value at the date of the foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other operating income and expenses.

Banking Premises and Equipment: Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation computed on the straight-line method over the estimated useful lives of the assets.

Goodwill: Goodwill results from prior business acquisitions and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment, and any such impairment will be recognized in the period identified.

Bank-Owned Life Insurance: The Bank has purchased life insurance policies on certain key officers. Bank-owned life insurance is recorded at its cash surrender value, or the amount that can be realized.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Short-Term Borrowings: Short-term borrowings consist of repurchase agreements. Substantially all repurchase agreement liabilities represent amounts advanced by various customers. Securities are pledged to cover these liabilities, which are not covered by federal deposit insurance.

Off-Balance-Sheet Instruments: In the ordinary course of business, the Corporation has entered into commitments under commercial letters of credit and standby letters of credit. Such financial instruments are recorded when funded.

Servicing Rights: Servicing rights represent the fair value of servicing rights retained on loans sold. Servicing rights are expensed in proportion to, and over the period of, estimated net servicing revenues. Impairment is evaluated based on the fair value of the rights, using groupings of the underlying loans as to interest rates and prepayment characteristics. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Any impairment of a grouping is reported as a valuation allowance. Most loans originated for sale are sold servicing retained.

Servicing rights are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Corporation later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. No impairment of servicing rights has been recorded at year end 2017 or 2016. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income is based on a contractual percentage of the outstanding principal and is recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income. Late fees and ancillary fees related to loan servicing are not material.

Stock Purchases and Sales: The Corporation regularly engages in the purchase and sale of Corporation common stock. Proceeds from the sale of common stock are recorded to additional paid-in capital.

Comprehensive Income: Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the consolidated balance sheet, such items, along with net income, are components of comprehensive income. Reclassification adjustments during 2017 were \$2 and are included in other operating income.

Income Taxes: Income tax expense is the sum of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the federal income tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

Earnings per Common Share: Earnings per common share are computed by dividing net income by the average number of common shares outstanding during the period. The number of weighted average common shares outstanding was 553,996 and 558,048 for the years ended December 31, 2017 and 2016, respectively. The Corporation uses the treasury stock method to compute diluted earnings per share, which assumes that proceeds from the assumed exercise of stock options would be used to purchase common stock at the average market price during the period. The dilutive effect of stock options increased average common shares outstanding by 2,553 and 1,819 shares at December 31, 2017 and 2016, respectively. 0 and 2,950 options were not considered for dilution in 2017 and 2016, respectively, because the exercise price was in excess of the current market price.

Fair Values of Financial Statements: Fair values of financial instruments are estimated using the 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.

Subsequent Events: The consolidated financial statements and related disclosures include evaluation of events up through and including March 14, 2018, which is the date the consolidated financial statements were available to be issued.

Reclassification: Certain amounts appearing in the prior year's financial statements have been reclassified to conform to the current year's financial statements.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 2 – SECURITIES

The amortized cost and fair value of securities, with gross unrealized gains and losses, are as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
2017				
State and municipal	\$ 20,968	\$ 71	\$ (132)	\$ 20,907
Corporate bonds	2,860	-	(2)	2,858
Deposits with financial institutions	16,206	-	(12)	16,194
Mortgage-backed securities	5,222	8	(54)	5,176
Collateralized mortgage obligations	<u>3,736</u>	<u>1</u>	<u>(68)</u>	<u>3,669</u>
Total available-for-sale securities	<u>\$ 48,992</u>	<u>\$ 80</u>	<u>\$ (268)</u>	<u>\$ 48,804</u>
2016				
U.S. government and federal agency	\$ 500	\$ 1	\$ -	\$ 501
State and municipal	13,383	235	(70)	13,548
Corporate bonds	3,797	1	(4)	3,794
Deposits with financial institutions	3,323	-	-	3,323
Mortgage-backed securities	6,297	10	(85)	6,222
Collateralized mortgage obligations	<u>2,385</u>	<u>4</u>	<u>(55)</u>	<u>2,334</u>
Total available-for-sale securities	<u>\$ 29,685</u>	<u>\$ 251</u>	<u>\$ (214)</u>	<u>\$ 29,722</u>

At December 31, 2017 and 2016, securities with a carrying value of \$18,622 and \$17,831, respectively, were pledged to secure borrowings and public deposits and for other purposes required or permitted by law.

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2017 are as follows:

	<u>December 31, 2017</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in 1 year or less	\$ 12,410	\$ 12,406
Due in 1 through 5 years	18,070	18,028
Due after 5 years through 10 years	6,111	6,091
Due after 10 years	<u>3,443</u>	<u>3,434</u>
	40,034	39,959
Mortgage-backed securities	5,222	5,176
Collateralized mortgage obligations	<u>3,736</u>	<u>3,669</u>
Total	<u>\$ 48,992</u>	<u>\$ 48,804</u>

Securities sold during 2017 generated proceeds of \$340 and resulted in gross gains of \$2. No securities were sold in 2016.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 2 – SECURITIES (Continued)

Information pertaining to securities with gross unrealized losses at December 31, 2017 and 2016, aggregated by investment category and length of time that individual securities have been in a continuous loss position, is as follows:

	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>
<u>2017</u>						
State and municipal	\$ 13,639	\$ (125)	\$ 1,398	\$ (7)	\$ 15,037	\$ (132)
Corporate bonds	1,299	(1)	599	(1)	1,898	(2)
Deposits with financial institutions	1,225	(12)	-	-	1,225	(12)
Mortgage-backed securities	3,162	(30)	1,378	(24)	4,540	(54)
Collateralized mortgage obligations	<u>2,047</u>	<u>(16)</u>	<u>1,446</u>	<u>(52)</u>	<u>3,493</u>	<u>(68)</u>
Total available-for-sale securities	<u>\$ 21,372</u>	<u>\$ (184)</u>	<u>\$ 4,821</u>	<u>\$ (84)</u>	<u>\$ 26,193</u>	<u>\$ (268)</u>
<u>2016</u>						
State and municipal	\$ 3,260	\$ (4)	\$ 6,282	\$ (66)	\$ 9,542	\$ (70)
Corporate bonds	-	-	2,411	(4)	2,411	(4)
Deposits with financial institutions	-	-	-	-	-	-
Mortgage-backed securities	-	-	5,335	(85)	5,335	(85)
Collateralized mortgage obligations	<u>-</u>	<u>-</u>	<u>1,864</u>	<u>(55)</u>	<u>1,864</u>	<u>(55)</u>
Total available-for-sale securities	<u>\$ 3,260</u>	<u>\$ (4)</u>	<u>\$ 15,892</u>	<u>\$ (210)</u>	<u>\$ 19,152</u>	<u>\$ (214)</u>

At December 31, 2017 and 2016, there were 84 and 49 securities in an unrealized loss position, respectively. Unrealized losses on securities have not been recognized into income because the issuers' bonds are of high credit quality, the Corporation has the intent and ability to hold the securities for the foreseeable future, and the decline in fair value is due primarily to increased market interest rates. The fair value is expected to recover as the bonds approach the maturity date.

Other securities, totaling \$877 and \$877 at December 31, 2017 and 2016, respectively, consist of restricted Federal Home Loan Bank stock and Federal Reserve Bank stock. These stocks are carried at cost, which approximates market value.

NOTE 3 – LOANS

A summary of the balances of loans follows:

	<u>2017</u>	<u>2016</u>
Mortgage loans on real estate – residential 1-4 family	\$ 31,917	\$ 34,064
Commercial loans	98,670	102,323
Consumer installment loans	<u>5,965</u>	<u>6,146</u>
	136,552	142,533
Less allowances for loan losses	<u>1,863</u>	<u>1,874</u>
Net loans	<u>\$ 134,689</u>	<u>\$ 140,659</u>
Allowance for loan losses as a percentage of loans	1.36%	1.31%

In the ordinary course of business, the Bank has granted loans to principal officers and directors and their affiliates amounting to \$2,100 and \$2,675 at December 31, 2017 and 2016, respectively.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2017 and 2016:

	Real Estate - <u>Residential</u>	Real Estate - <u>Commercial</u>	Commercial and <u>Industrial</u>	<u>Consumer</u>	<u>Total</u>
<u>2017</u>					
Beginning balance	\$ 221	\$ 1,027	\$ 544	\$ 82	\$ 1,874
Charge-offs	(1)	-	-	-	(1)
Recoveries	-	42	-	-	42
Provision	<u>(19)</u>	<u>11</u>	<u>(43)</u>	<u>(1)</u>	<u>(52)</u>
Ending allowance balance	<u>\$ 201</u>	<u>\$ 1,080</u>	<u>\$ 501</u>	<u>\$ 81</u>	<u>\$ 1,863</u>
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	\$ 6	\$ 53	\$ -	\$ -	\$ 59
Collectively evaluated for impairment	<u>195</u>	<u>1,027</u>	<u>501</u>	<u>81</u>	<u>1,804</u>
Ending allowance balance	<u>\$ 201</u>	<u>\$ 1,080</u>	<u>\$ 501</u>	<u>\$ 81</u>	<u>\$ 1,863</u>
Loans:					
Individually evaluated for impairment	\$ 716	\$ 352	\$ -	\$ 118	\$ 1,186
Collectively evaluated for impairment	<u>31,201</u>	<u>79,221</u>	<u>19,097</u>	<u>5,847</u>	<u>135,366</u>
Total loans	<u>\$ 31,917</u>	<u>\$ 79,573</u>	<u>\$ 19,097</u>	<u>\$ 5,965</u>	<u>\$ 136,552</u>

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	Real Estate - <u>Residential</u>	Real Estate - <u>Commercial</u>	Commercial and <u>Industrial</u>	<u>Consumer</u>	<u>Total</u>
<u>2016</u>					
Beginning balance	\$ 306	\$ 850	\$ 409	\$ 90	\$ 1,655
Charge-offs	(47)	-	-	(1)	(48)
Recoveries	-	14	155	2	171
Provision	(38)	163	(20)	(9)	96
Ending allowance balance	<u>\$ 221</u>	<u>\$ 1,027</u>	<u>\$ 544</u>	<u>\$ 82</u>	<u>\$ 1,874</u>
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	\$ 6	\$ 70	\$ -	\$ -	\$ 76
Collectively evaluated for impairment	<u>215</u>	<u>957</u>	<u>544</u>	<u>82</u>	<u>1,798</u>
Ending allowance balance	<u>\$ 221</u>	<u>\$ 1,027</u>	<u>\$ 544</u>	<u>\$ 82</u>	<u>\$ 1,874</u>
Loans and leases:					
Individually evaluated for impairment	\$ 828	\$ 511	\$ 34	\$ 131	\$ 1,504
Collectively evaluated for impairment	<u>33,236</u>	<u>77,777</u>	<u>24,001</u>	<u>6,015</u>	<u>141,029</u>
Total loans	<u>\$ 34,064</u>	<u>\$ 78,288</u>	<u>\$ 24,035</u>	<u>\$ 6,146</u>	<u>\$ 142,533</u>

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Risk Grading

As part of the management of the loan portfolio at the time of origination and through the continuing loan review process, the Corporation categorizes each loan into credit risk categories based on several factors including current financial information, overall debt service coverage, comparison against industry averages, collateral coverage, historical payment experience, and current economic trends. The credit risk rating structure used is shown below:

Monitor - A monitor asset is not considered "rated" or "classified" for regulatory purposes, but is considered an asset which bears watching due to some modest deterioration in financial performance or external threats, such as a lawsuit, environmental issue, or potential loss of a significant customer. Some of the following characteristics may exist: financial condition has taken a negative turn and may be temporarily strained; borrower may have experienced recent losses from operations; cash flow may be insufficient to service debt, based on most recent six-month period; financial covenant defaults are occurring with some regularity, and they would be deemed more than inconsequential; need for guarantor is critical, but guarantor's condition adds little substance to credit quality; loss of principal is not at question, unless current trends were to continue; however, there are aspects of this underwriting which may not now conform to bank lending policy; borrowing base deficiencies may exist and are becoming a concern.

Special Mention - A special mention asset 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, or in the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. Some of the following characteristics may exist: loans are currently protected, but are potentially weak due to negative trends in balance sheet or income statement; cash flow may be insufficient to meet debt service, with the prospect that this condition may not be temporary; lack of effective control over the collateral or existence of documentation deficiencies; there is a potential risk of payment default; management's ability to cope with current financial conditions is questioned; collateral coverage has weakened; moderate operating losses may have occurred; financial information may be inadequate to depict condition of borrower adequately; consistent borrowing deficiencies.

Substandard - A substandard asset has well defined weaknesses whereby collection is possible, but jeopardized. However, jeopardized payment does not imply ultimate loss. Assets so classified are inadequately protected by current net worth and repayment capacity, and there is a high probability that collateral will have to be liquidated to repay the debt. If deficiencies are not corrected quickly, there is a real possibility of loss, and of the company's ability to operate as a going concern. Loan may be in default, borrower may be in bankruptcy, loan restructure at less than market terms, or has been partially charged off. Nonaccrual loans would be classified, at least, "substandard."

Doubtful - A doubtful asset has characteristics of "substandard," but information available suggests it is highly improbable that liquidation of collateral will retire the loan in its entirety. It may be impossible to calculate exactly what the loss may be, but the probability of some loss is high. Loans are to be placed on nonaccrual status when a significant percentage is classified "doubtful" and collateral liquidation is probable. (Not all nonaccrual loans necessarily have to be classified "doubtful" if collateral appears adequate to retire remaining outstandings.)

Pass - Credits not covered by the above definitions are pass credits, which are not considered to be adversely rated.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

For residential real estate and consumer loan segments, the Corporation monitors credit quality using a combination of the delinquency status of the loan and other known borrower circumstances and classifies loans as performing and nonperforming:

Performing - Loan pays as agreed and is current.

Nonperforming - Loans which are contractually past due 90 days or more as to interest or principal payments, on nonaccrual status, in process of foreclosure or other forms of liquidation and/or collection or loans where the terms of which have been renegotiated to provide a reduction or deferral on interest or principal.

	<u>Pass</u>	<u>Monitor</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Performing</u>	<u>Non- Performing</u>	<u>Total</u>
<u>2017</u>							
Real estate - commercial							
Commercial real estate and other	\$ 61,809	\$ 787	\$ 470	\$ 1,517	\$ -	\$ -	\$ 64,583
Hotels and motels	11,158	-	-	-	-	-	11,158
Golf courses	3,323	-	509	-	-	-	3,832
Commercial and industrial	18,412	391	-	294	-	-	19,097
Real estate – residential							
1-4 family residential	-	-	-	-	18,395	150	18,545
Construction and land loans	-	-	-	-	13,372	-	13,372
Consumer							
Home equity lines of credit	-	-	-	-	4,212	118	4,330
Other	-	-	-	-	1,635	-	1,635
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total	<u>\$ 94,702</u>	<u>\$ 1,178</u>	<u>\$ 979</u>	<u>\$ 1,811</u>	<u>\$ 37,614</u>	<u>\$ 268</u>	<u>\$ 136,552</u>

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	<u>Pass</u>	<u>Monitor</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Performing</u>	<u>Non- Performing</u>	<u>Total</u>
<u>2016</u>							
Real estate - commercial							
Commercial real estate and other	\$ 64,410	\$ 751	\$ 680	\$ 401	\$ -	\$ -	\$ 66,242
Hotels and motels	8,304	-	-	-	-	-	8,304
Golf courses	3,197	-	545	-	-	-	3,742
Commercial and industrial	23,681	21	-	333	-	-	24,035
Real estate – residential							
1-4 family residential	-	-	-	-	18,819	222	19,041
Construction and land loans	-	-	-	-	15,023	-	15,023
Consumer							
Home equity lines of credit	-	-	-	-	4,570	131	4,701
Other	-	-	-	-	1,445	-	1,445
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,445</u>	<u>-</u>	<u>1,445</u>
Total	<u>\$ 99,592</u>	<u>\$ 772</u>	<u>\$ 1,225</u>	<u>\$ 734</u>	<u>\$ 39,857</u>	<u>\$ 353</u>	<u>\$ 142,533</u>

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Age Analysis of Past Due Loans

The following tables detail the age analysis of past due loans at December 31, 2017 and 2016:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total	Past Due 90 Days and Accruing
<u>2017</u>							
Real estate - commercial							
Commercial real estate and other	\$ 134	\$ 74	\$ -	\$ 208	\$ 64,375	\$ 64,583	\$ -
Hotels and motels	-	-	-	-	11,158	11,158	-
Golf courses	-	-	-	-	3,832	3,832	-
Commercial and industrial	43	-	-	43	19,054	19,097	-
Real estate - residential							
1-4 family residential	433	-	36	469	18,076	18,545	36
Construction and land loans	58	-	-	58	13,314	13,372	-
Consumer							
Home equity lines of credit	24	-	-	24	4,306	4,330	-
Other	-	-	-	-	1,635	1,635	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,635</u>	<u>1,635</u>	<u>-</u>
Total	<u>\$ 692</u>	<u>\$ 74</u>	<u>\$ 36</u>	<u>\$ 802</u>	<u>\$ 135,750</u>	<u>\$ 136,552</u>	<u>\$ 36</u>

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total	Past Due 90 Days and Accruing
<u>2016</u>							
Real estate - commercial							
Commercial real estate and other	\$ 275	\$ 80	\$ -	\$ 355	\$ 65,887	\$ 66,242	\$ -
Hotels and motels	-	-	-	-	8,304	8,304	-
Golf courses	-	-	-	-	3,742	3,742	-
Commercial and industrial	86	-	-	86	23,949	24,035	-
Real estate - residential							
1-4 family residential	393	250	-	643	18,398	19,041	-
Construction and land loans	85	125	-	210	14,813	15,023	-
Consumer							
Home equity lines of credit	20	-	-	20	4,681	4,701	-
Other	16	-	-	16	1,429	1,445	-
	<u>16</u>	<u>-</u>	<u>-</u>	<u>16</u>	<u>1,429</u>	<u>1,445</u>	<u>-</u>
Total	<u>\$ 875</u>	<u>\$ 455</u>	<u>\$ -</u>	<u>\$ 1,330</u>	<u>\$ 141,203</u>	<u>\$ 142,533</u>	<u>\$ -</u>

Impaired Loans

The accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loans are considered impaired when, based on current information and events, it is probable the Corporation will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated on an individual loan basis for all loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, 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. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following are schedules of impaired loans by class, as of December 31, 2017 and 2016, and the amount of allowance allocated. Unpaid principal balance reflects the contractual amount due:

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment for the Year</u>	<u>Interest Income Investment for the Year</u>
<u>2017</u>					
With no related allowance recorded:					
Real estate - commercial:					
Commercial real estate and other	\$ 27	\$ 27	\$ -	\$ 30	\$ 2
Hotels and motels	-	-	-	-	-
Commercial and industrial	-	-	-	-	-
Real estate - residential					
1-4 family residential	681	759	-	771	23
Construction and land loans	-	-	-	-	-
Consumer – home equity lines of credit	<u>118</u>	<u>148</u>	<u>-</u>	<u>160</u>	<u>-</u>
Total	<u>\$ 826</u>	<u>\$ 934</u>	<u>\$ -</u>	<u>\$ 961</u>	<u>\$ 25</u>
With an allowance recorded:					
Real estate – commercial:					
Commercial real estate and other	\$ 325	\$ 325	\$ 53	\$ 355	\$ -
Real estate - residential:					
1-4 family residential	35	43	6	44	-
Construction and land loans	-	-	-	-	-
Consumer – home equity lines of credit	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 360</u>	<u>\$ 368</u>	<u>\$ 59</u>	<u>\$ 399</u>	<u>\$ -</u>

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment for the Year</u>	<u>Interest Income Investment for the Year</u>
<u>2016</u>					
With no related allowance recorded:					
Real estate - commercial:					
Commercial real estate and other	\$ 167	\$ 170	\$ -	\$ 172	\$ 9
Hotels and motels	-	-	-	-	-
Commercial and industrial	34	187	-	39	-
Real estate - residential					
1-4 family residential	789	853	-	810	26
Construction and land loans	-	-	-	-	-
Consumer – home equity lines of credit	<u>131</u>	<u>153</u>	<u>-</u>	<u>126</u>	<u>7</u>
Total	<u>\$ 1,121</u>	<u>\$ 1,363</u>	<u>\$ -</u>	<u>\$ 1,147</u>	<u>\$ 42</u>
With an allowance recorded:					
Real estate – commercial:					
Commercial real estate and other	\$ 344	\$ 344	\$ 70	\$ 476	\$ -
Real estate - residential:					
1-4 family residential	39	45	6	40	-
Construction and land loans	-	-	-	-	-
Consumer – home equity lines of credit	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 383</u>	<u>\$ 389</u>	<u>\$ 76</u>	<u>\$ 516</u>	<u>\$ -</u>

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Nonaccrual Loans

Nonaccrual loan balances at December 31, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Real estate commercial:		
Commercial real estate	\$ -	\$ 134
Hotels and motels	-	-
Golf courses	-	-
Commercial and industrial	-	34
Real estate – residential:		
1-4 family residential	150	222
Construction and land loans	-	-
Consumer:		
Home equity lines of credit	<u>118</u>	<u>131</u>
 Total	 <u>\$ 268</u>	 <u>\$ 521</u>

Nonaccrual

Commercial loans include business installment loans and real estate construction loans. Loans on which interest and/or principal is 90 days or more past due are placed on nonaccrual status and any previously accrued but uncollected interest is reversed against income (current year) or charged to the allowance for loan and lease losses (prior year). Such loans will remain on a cash basis for the recognition of income until such time as the loan has remained current for a period of not less than six (6) months and it is determined an adequate propensity for timely payment to occur in the future. Past due is measured from the date through which interest is due or on which principal payment is due irrespective of the date on which the billing may have been rendered. Unless otherwise specified in the note or loan agreement, demand notes shall, for purposes of measuring past due status, have an interest due date no less frequently than once each calendar quarter. Other loans on which there is serious doubt as to collectability are placed on nonaccrual because of past due status. Any loan whereby some or all of the balance has been charged off is placed on nonaccrual, unless it is part of an A B loan restructure. If the loan was on nonaccrual at the time of the restructure, it will remain in nonaccrual until such time as the above stated criteria is met. If the loan was not in nonaccrual at the time of the A B note restructuring and there is concrete evidence the payment structure will be met, the loan will not have to be placed in nonaccrual, provided the B portion has been charged off. Mortgages are placed on nonaccrual status when the account is three months (typically four payments) past due. All previously accrued but uncollected interest is reversed when the loan is placed on nonaccrual.

Troubled Debt Restructurings

A modification of a loan constitutes a troubled debt restructuring (TDR) when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Company offers various types of concessions when modifying a loan; however, forgiveness of principal is rarely granted.

There were no loans modified as a TDR in 2017 or 2016 and no TDRs defaulted within a year of their modification during 2017 or 2016.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 4 –LOAN SERVICING

Loans serviced for others are not included in the accompanying consolidated balance sheet. The unpaid principal balances of mortgages serviced for others were \$68,202 and \$70,546 at December 31, 2017 and 2016, respectively.

The balance of capitalized servicing rights, net of valuation allowance, included in other assets at December 31, 2017 and 2016 was \$293 and \$333, respectively. The fair value of the capitalized servicing rights approximates the carrying value. The key economic assumptions used in determining the fair value of the mortgage servicing rights include an annual constant prepayment speed (CPR) of 11.5 and 11.4 percent for December 31, 2017 and 2016, respectively, and a discount rate of 10.1% and 9.7% for December 31, 2017 and 2016.

The following summarizes mortgage servicing rights capitalized and amortized, along with the aggregate activity in related valuation allowances:

	<u>2017</u>	<u>2016</u>
Mortgage-servicing rights capitalized	\$ 99	\$ 80
Mortgage-servicing rights amortized and closed	139	138

NOTE 5 – BANK PREMISES AND EQUIPMENT

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

	<u>2017</u>	<u>2016</u>
Buildings and improvements	\$ 4,687	\$ 4,641
Furniture and fixtures	3,675	3,494
Vault and equipment	369	369
Automobiles	94	94
Land	<u>667</u>	<u>667</u>
	9,492	9,265
Accumulated depreciation	<u>(6,784)</u>	<u>(6,500)</u>
Net premises and equipment	<u>\$ 2,708</u>	<u>\$ 2,765</u>

Depreciation expense for the years ended December 31, 2017 and 2016 amounted to \$284 and \$263, respectively.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 December 31, 2017 and 2016
 (000's omitted, except share and per share data)

NOTE 6 - DEPOSITS

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

	<u>2017</u>	<u>2016</u>
NOW accounts	\$ 69,157	\$ 70,684
Savings	27,691	25,426
Money market demand	6,168	2,526
Time		
Under \$250	20,006	22,905
\$250 and over	<u>2,936</u>	<u>3,464</u>
Total interest-bearing deposits	<u>\$ 125,958</u>	<u>\$ 125,005</u>

At December 31, 2017, the scheduled maturities of time deposits are as follows:

2018	\$ 13,301
2019	4,328
2020	2,411
2021	1,897
2022	<u>1,005</u>
	<u>\$ 22,942</u>

NOTE 7 – SHORT-TERM BORROWINGS

Short-term borrowings at year-end 2017 and 2016 consist solely of securities sold under agreements to repurchase, which are classified as secured borrowings and are used by the Bank for its sweep account product and mature daily. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction and are secured by mortgage-backed securities with a fair value of approximately \$5,176 and collateralized mortgage obligation securities with a fair value of approximately \$2,677 as of December 31, 2017.

Discount Window Borrowings - The Bank has a discount window loan agreement with the Federal Reserve Bank that allows for advances. The advances are secured by investment securities with a fair value of approximately \$10,673 and are generally due within 28 days from the date of the advance. The interest rate on the advances is based on the quoted Federal Reserve discount window rate (effective rate of 2.00 percent as of December 31, 2017). There were no outstanding advances at December 31, 2017 and 2016.

NOTE 8 – FEDERAL HOME LOAN BANK ADVANCES

Advances from the Federal Home Loan Bank (FHLB) are secured by the Corporation's qualifying real estate loans under a blanket collateral agreement. The advances are collateralized by approximately \$18,545 and \$18,104 of mortgage loans as of December 31, 2017 and 2016, respectively. The Bank had no advances outstanding as of December 31, 2017 and 2016.

FHLB advances are subject to prepayment penalties and the provisions and conditions of the credit policy of the Federal Home Loan Bank.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 9 – INCOME TAXES

On December 22, 2017, H.R.1, commonly known as the Tax Cuts and Jobs Act (the “Act”) was signed into law. Among other things, the Act reduces our corporate federal tax rate from 34% to 21% effective January 1, 2018. As a result we are required to re-measure, through income tax expense, our deferred tax assets and liabilities using the enacted rate at which we expect them to be recovered or settled. The re-measurement of our net deferred tax asset resulted in additional income tax expense of \$295.

The components of the net deferred tax asset, included in other assets, are as follows:

	<u>2017</u>	<u>2016</u>
Deferred tax assets		
Allowance for loan losses	\$ 202	\$ 344
Accrued employee benefits	263	419
Nonaccrual loans	28	42
Other real estate	97	187
Net unrealized loss on securities available for sale	39	-
Other	<u>46</u>	<u>55</u>
	675	1,047
Deferred tax liabilities		
Prepaid assets	32	39
Net unrealized gain on securities available for sale	-	13
Servicing rights	62	113
Depreciation	93	81
Other	<u>11</u>	<u>17</u>
	198	263
Net deferred tax assets	<u>\$ 477</u>	<u>\$ 784</u>

Allocation of income taxes between current and deferred portions is as follows:

	<u>2017</u>	<u>2016</u>
Current	\$ 426	\$ 416
Deferred	88	76
Expense due to enactment of federal tax reform	<u>295</u>	<u>-</u>
	<u>\$ 809</u>	<u>\$ 492</u>

The reasons for the differences between the income tax expense at the federal statutory income tax rate and the recorded income tax expense are summarized as follows:

	<u>2017</u>	<u>2016</u>
Income before income taxes	\$ 2,070	\$ 1,924
Increase tax expense at federal statutory rate of 34%	\$ 704	\$ 654
Increases resulting from nondeductible expenses	5	4
Decreases resulting from nontaxable income	(159)	(138)
Expense due to enactment of federal tax reform	295	-
Other	<u>(36)</u>	<u>(28)</u>
	<u>\$ 809</u>	<u>\$ 492</u>

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 9 – INCOME TAXES (Continued)

At December 31, 2017 and December 31, 2016, the Corporation had no unrecognized tax benefits recorded. The Corporation does not expect the amount of unrecognized tax benefits to significantly change within the next twelve months. No amounts have been recorded for interest or penalties for the years ending December 31, 2017 or 2016. The Corporation is subject to U.S. federal income tax and is no longer subject to examination by the taxing authorities for years before 2014.

NOTE 10 – BENEFIT PLAN

The Corporation has a 401(k) plan whereby a certain percentage of employees' contributions can be matched with discretionary contributions by the Corporation. Contributions to the plan for the years ended December 31, 2017 and 2016 were \$63 and \$62, respectively.

NOTE 11 – FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Corporation's various financial instruments. 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. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Certain financial instruments and all nonfinancial instruments are excluded from disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Corporation. See Note 16 for the disclosure related to fair value measurements.

The following methods and assumptions were used by the Corporation in estimating fair value disclosures for financial instruments:

Cash and Cash Equivalents - The carrying amounts of cash and cash equivalents approximate fair values.

Deposits in Other Financial Institutions - The carrying amounts of interest-bearing deposits maturing within 90 days approximate their fair values. Fair values of other interest-bearing deposits are estimated using discounted cash flow analyses based on current rates for similar types of deposits.

Securities - Fair values of securities are based on quoted market prices. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. It was not practicable to estimate the fair value of Federal Home Loan Bank and Federal Reserve Bank stock as a result of restrictions placed on its transferability.

Loans Receivable - For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values of nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 11 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Deposit Liabilities - The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Short-term Borrowings - The carrying amounts of borrowings under repurchase agreements maturing within 90 days approximate their fair values. Fair values of other short-term borrowings are estimated using discounted cash flow analyses based on the Corporation's current incremental borrowing rates for similar types of borrowing arrangements.

Borrowings - The fair values of the Corporation's other borrowings are estimated using discounted cash flow analyses based on the Corporation's current incremental borrowing rates for similar types of borrowing arrangements.

Accrued Interest - The carrying amounts of accrued interest approximate fair value.

Other Financial Instruments - The fair value of other financial instruments, including loan commitments and unfunded letters of credit, based on discounted cash flow analyses, is not material.

The estimated fair values and related carrying or notional amounts of the Corporation's financial instruments are as follows:

	<u>2017</u>		<u>2016</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets				
Cash and cash equivalents	\$ 4,377	\$ 4,377	\$ 12,296	\$ 12,296
Investment securities	48,804	48,804	29,722	29,722
Other securities	877	NA	877	N/A
Loans, net	134,689	134,686	140,659	141,286
Accrued interest receivable	505	505	433	433
Financial liabilities				
Demand deposits	\$ 42,831	\$ 42,831	\$ 37,684	\$ 37,684
Interest-bearing deposits	125,958	126,094	125,005	125,129
Short-term borrowings	7,091	7,091	8,808	8,808
Accrued interest payable	18	18	19	19

NOTE 12 – STOCK-BASED COMPENSATION

Options - As of December 31, 2017, the Corporation has four share-based compensation plans which are described below. Options available for grant under the 1997 Nonemployee Director Discretionary Stock Option Plan, 2005 Nonemployee Director Stock Option Plan, and the 2005 Employee Stock Option Plan have been issued. Some of the options issued under the 1997 and 2005 plans are exercisable by the participants until the end of the contractual terms.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 12 – STOCK-BASED COMPENSATION (Continued)

The Corporation's 2005 Nonemployee Director Stock Option Plan, 2005 Nonemployee Director Discretionary Stock Option Plan, 2005 Employee Stock Option Plan, and 2014 Stock Incentive Plan (the "Plans"), permit the grant of stock options for up to 15,000 shares, 25,000 shares, 35,000, and 50,000 shares of common stock, respectively. The Corporation believes that such awards better align the interests of its employees with those of its stockholders. Option awards are generally granted with an exercise price equal to the market price of the entity's stock at the date of grant; those option awards generally vest immediately for nonemployees and over three years for employees and have 10-year contractual terms. Certain option awards provide for accelerated vesting if there is a change in control (as defined in the Plans). The compensation cost that has been charged against income for the Plans was approximately \$18 and \$16 for 2017 and 2016, respectively. As of December 31, 2017, there were 28,300 shares available for grant in the 2014 Stock Incentive Plan. In accordance with the respective Plan agreements, subsequent to November 2015, incentive stock options were no longer permitted to be granted from the 2005 Nonemployee Director Stock Option Plan or the 2005 Employee Stock Option Plan.

The Corporation uses a Black-Scholes formula to estimate the calculated value of its share-based payments. The volatility assumption used in the Black-Scholes formula is based on the historic volatility of the Corporation's stock price and dividend payments throughout the year. The Corporation calculated the historical volatility using the monthly closing total stock price for the one year immediately prior.

The weighted average assumptions used in the Black-Scholes model for 2017 grants are noted in the following table. The Corporation uses historical data to estimate option exercise and employee termination within the valuation model. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

Volatility	10.00%
Dividend rate	2.50%
Expected term (in years)	7
Risk free rate	2.27%

A summary of option activity under the Plans for 2017 presented below:

	Number of Shares	Weighted Average Exercise Price
Options outstanding – beginning of year	39,233	\$ 47.95
Options granted	7,850	52.50
Options exercised	(200)	46.00
Options forfeited	-	-
Options expired	<u>(2,950)</u>	<u>53.75</u>
Options outstanding – end of year	<u>43,933</u>	<u>\$ 48.38</u>
Exercisable at year end	<u>35,433</u>	<u>\$ 47.56</u>

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 12 – STOCK-BASED COMPENSATION (Continued)

The grant-date fair value of options granted during 2017 was \$4.33 per option.

The aggregate intrinsic value of the outstanding options represents the total pretax intrinsic value (i.e., the difference between the Corporation's stock price of \$52.50 and the exercise price, times the number of shares outstanding that would have been received by the option holder had all option holders exercised their options on December 31, 2017). The aggregate intrinsic value on outstanding options as of December 31, 2017, was \$175. The weighted average remaining contractual term (in years) for options outstanding as of December 31, 2017, was 5.92.

As of December 31, 2017, there was approximately \$35 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Plans. That cost is expected to be recognized over a weighted average period of 1.8 years.

Restricted Share Units - In 2017 and 2016, 1,350 and 900 restricted shares were awarded to certain key employees in accordance with the 2014 Stock Incentive Plan. As of December 31, 2017, zero restricted shares were vested and 100 shares had been forfeited. All restricted share units vest 3 years from date of award and will begin to vest December 2018. Expense recognized in 2017 and 2016 was \$28 and \$12 and unearned compensation cost which will be recognized over the next three years was \$111.

NOTE 13 – OFF-BALANCE-SHEET ACTIVITIES

Credit-related Financial Instruments - The Corporation is a party to credit-related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit, and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet.

The Corporation's exposure to credit loss is represented by the contractual amount of these commitments. The Corporation follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

At December 31, 2017 and 2016, the following financial instruments were outstanding whose contract amounts represent credit risk:

	<u>2017</u>	<u>2016</u>
Commitments to grant loans	\$ 3,325	\$ 5,415
Unfunded commitments	21,634	19,934
Commercial and standby letters of credit	33	31

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Corporation, is based on management's credit evaluation of the customer.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 13 – OFF-BALANCE-SHEET ACTIVITIES (Continued)

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

Commercial and standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those letters of credit are used primarily to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved is extending loan facilities to customers. The Corporation generally holds collateral supporting those commitments if deemed necessary.

Collateral Requirements - To reduce credit risk related to the use of credit-related financial instruments, the Corporation might deem it necessary to obtain collateral. The amount and nature of the collateral obtained are based on the Corporation's credit evaluation of the customer. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant, equipment, and real estate.

If the counterparty does not have the right and ability to redeem the collateral or the Corporation is permitted to sell or repledge the collateral on short notice, the Corporation records the collateral in its consolidated balance sheet at fair value with a corresponding obligation to return it.

Legal Contingencies - Various legal claims also arise from time to time in the normal course of business which, in the opinion of management, will have no material effect on the Corporation's consolidated financial statements.

NOTE 14 – RESTRICTIONS ON DIVIDENDS, LOANS AND ADVANCES

Banking regulations place certain restrictions on dividends paid and loans or advances made by the Bank to the Corporation.

Prior approval of the Bank's federal regulator is required if the total dividends declared by the Bank in a calendar year exceed the sum of the net profits of the Bank for the preceding three years, less any required transfers to surplus. In addition, dividends paid by the Bank would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum standards.

Loans or advances made by the Bank to the Corporation are generally limited to 10 percent of the Bank's capital stock and surplus.

NOTE 15 – MINIMUM REGULATORY CAPITAL REQUIREMENTS

The Bank is subject to various regulatory capital requirements administered by the federal 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 Bank's operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, 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.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 15 – MINIMUM REGULATORY CAPITAL REQUIREMENTS (Continued)

Beginning in 2015, banks transitioned to new capital rules which incorporated certain changes to the Basel capital framework, including Basel III and other elements. These regulations are considered in the ratios below and include several provisions such as the implementation of a common equity tier ratio, modifications to risk weightings of certain assets, and threshold deductions of certain instruments inclusion in capital. In addition, the new rules establish a phased in capital buffer which effectively increases all of the minimum risk based capital ratios presented below. This 2.50% buffer is phased in, in equal increments, over four years (2016-2019), at a rate of 0.625% per year and is 1.25% at year-end 2017.

Management believes, as of December 31, 2017 and 2016, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2017, the most recent notification from the Bank's primary regulator categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk based, common equity Tier 1 risk based, Tier 1 risk based, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category. The Bank's actual capital amounts and ratios as of December 31, 2017 and 2016 are presented in the following table.

	<u>Actual</u>		<u>Minimum Required For Capital Adequacy Purposes</u>		<u>Minimum Required To Be Well Capitalized Under Prompt Corrective Action Requirements</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>2017</u>						
Total capital (to risk weighted assets)	\$ 25,332	17.4%	\$ 11,648	8.0%	\$ 14,650	10.0%
Tier 1 capital (to risk weighted assets)	23,511	16.1	8,736	6.0	11,648	8.0
Common equity Tier 1 (to risk weighted assets)	23,511	16.1	6,552	4.5	9,464	6.5
Tier 1 capital (to average assets)	23,511	11.3	5,275	4.0	10,344	5.0
<u>2016</u>						
Total capital (to risk weighted assets)	\$ 24,777	16.7%	\$ 11,806	8.0%	\$ 14,758	10.0%
Tier 1 capital (to risk weighted assets)	22,931	15.5	8,855	6.0	11,806	8.0
Common equity Tier 1 (to risk weighted assets)	22,931	15.5	6,641	4.5	9,593	6.5
Tier 1 capital (to average assets)	22,931	11.4	7,999	4.0	9,998	5.0

NOTE 16 – FAIR VALUE MEASUREMENTS

Accounting standards require certain assets and liabilities be reported at fair value in the financial statements and provide a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritizes the inputs and valuation techniques used to measure fair value.

The following tables present information about the Corporation's assets measured at fair value on a recurring basis at December 31, 2017 and 2016 and the valuation techniques used by the Corporation to determine those fair values.

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 16 – FAIR VALUE MEASUREMENTS (Continued)

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets that the Corporation has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets in active markets and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset. These Level 3 fair value measurements are based primarily on management's own estimates using pricing models, discounted cash flow methodologies, or similar techniques taking into account the characteristics of the asset.

In instances whereby inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Corporation's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset.

Assets Measured on a Recurring Basis

Assets measured at fair value on a recurring basis are summarized below:

	Fair Value Measurements at December 31, 2017:		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available for sale:			
U.S. government and federal agency	\$ -	\$ -	\$ -
State and municipal	-	20,907	-
Corporate bonds	-	2,858	-
Deposits with other financial institutions	-	16,194	-
Mortgage-backed securities	-	5,176	-
Collateralized mortgage obligations	-	3,669	-
Total securities available for sale	\$ -	\$ 48,804	\$ -

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 16 – FAIR VALUE MEASUREMENTS (Continued)

	Fair Value Measurements at December 31, 2016:		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available for sale:			
U.S. government and federal agency	\$ -	\$ 501	\$ -
State and municipal	-	13,548	-
Corporate bonds	-	3,794	-
Deposits with other financial institutions	-	3,323	-
Mortgage-backed securities	-	6,222	-
Collateralized mortgage obligations	-	2,334	-
Total securities available for sale	\$ -	\$ 29,722	\$ -

The fair value of available-for-sale securities at December 31, 2017 and 2016 was determined primarily based on Level 2 inputs. The Corporation estimates the fair value of these investment inputs include quoted prices for similar assets in active markets and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

The Corporation also has assets that under certain conditions are subject to measurement at fair value on a nonrecurring basis. These assets include impaired loans and other real estate-owned.

The change in fair value of impaired loans is recorded through the allowance for loan losses. The Corporation estimates the fair value of impaired loans based on Level 3 inputs which include the present value of expected future cash flows using management's best estimate of key assumptions. These assumptions include future payment ability, timing of payment streams, and estimated realizable values of available collateral (typically based on outside appraisals).

Other real estate-owned assets are reported in the following table at initial recognition of impairment and on an ongoing basis until recovery or charge-off. At the time of foreclosure or repossession, real estate-owned and repossessed assets are adjusted to fair value less estimated costs to sell, establishing a new cost basis. At that time, they are reported in the Corporation's fair value disclosures in the following nonrecurring tables:

(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 16 – FAIR VALUE MEASUREMENTS (Continued)

Assets Measured on a Non-Recurring Basis

Assets measured at fair value on a non-recurring basis are summarized below:

	Fair Value Measurements at December 31, 2017:		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans			
Real estate – commercial	\$ -	\$ -	\$ 273
Real estate – residential	-	-	29
Foreclosed assets			
Real estate – commercial	-	-	-
Real estate – residential	-	-	158

Impaired loans measured had a fair value of \$302 at year-end 2017 after a valuation allowance of \$59. Impairment charges recognized during the year resulted in additional provisions for loan losses of \$0. Foreclosed assets measured at fair value had a net carrying amount of \$158, after write-downs of \$58 for the year. Quantitative information about these fair value estimates at year-end 2017 is not material to the financial statements.

	Fair Value Measurements at December 31, 2016:		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans			
Real estate – commercial	\$ -	\$ -	\$ 274
Real estate – residential	-	-	33
Foreclosed assets			
Real estate – commercial	-	-	95
Real estate – residential	-	-	133

Impaired loans measured had a fair value of \$307 at year-end 2016 after a valuation allowance of \$76. Impairment charges recognized during the year resulted in additional provisions for loan losses of \$70. Foreclosed assets measured at fair value had a net carrying amount of \$228, after write-downs of \$55 for the year. Quantitative information about these fair value estimates at year-end 2016 is not material to the financial statements.

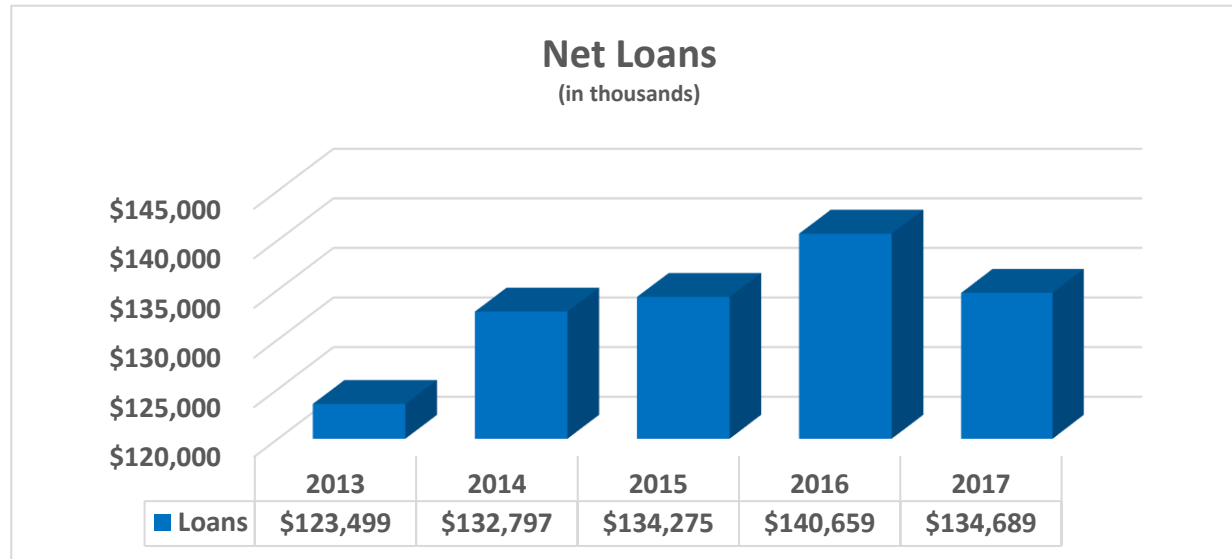
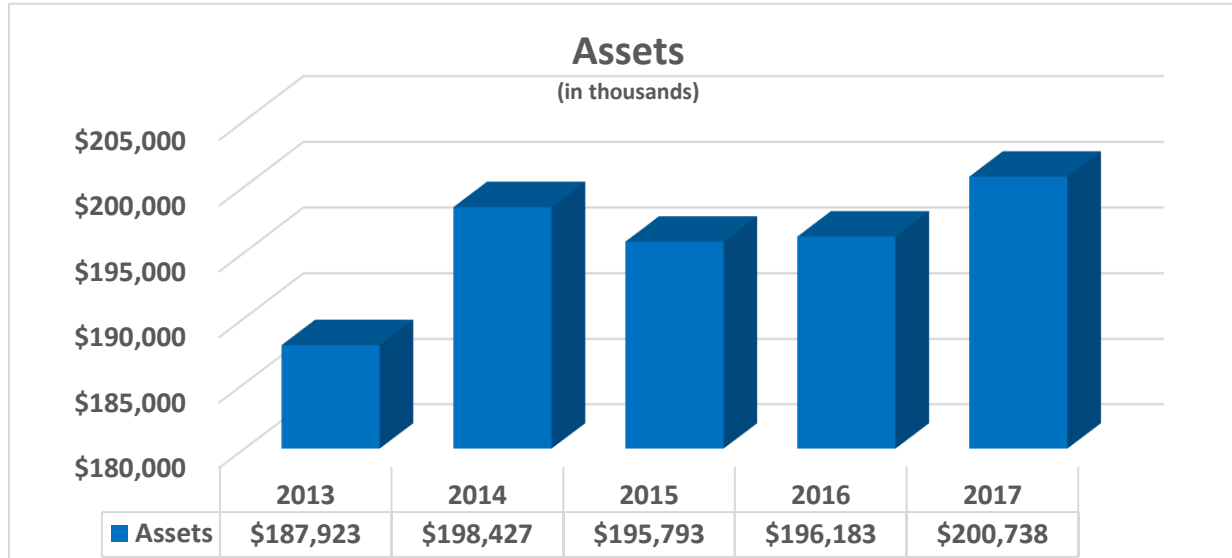
(Continued)

HURON COMMUNITY FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2017 and 2016
(000's omitted, except share and per share data)

NOTE 17 – ACQUISITION

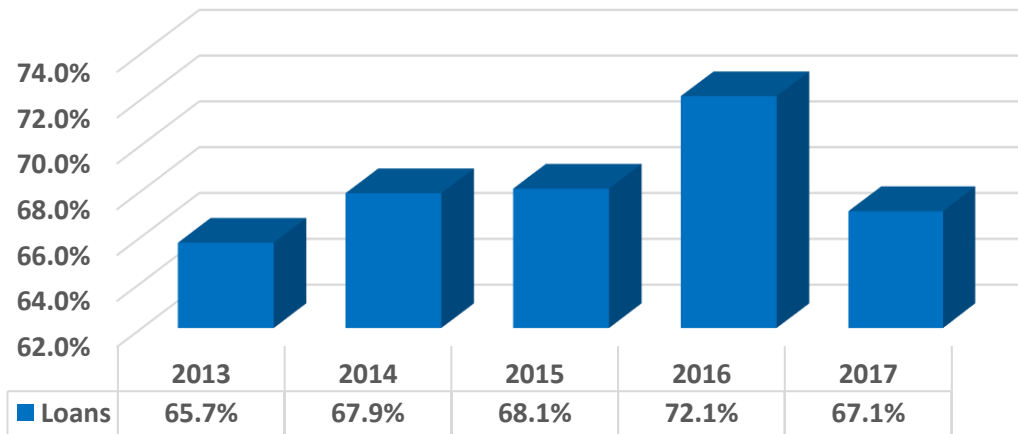
In September 2017, Huron Community Bank entered into a Purchase of Assets and Assumption of Liabilities Agreement with First Federal Bank of Northern Michigan – Oscoda Branch. In this agreement, Huron Community Bank would assume \$7,589 in deposit accounts, acquire \$1,479 in loan accounts, and receive \$5,893 in cash. Huron Community Bank would pay First Federal of Northern Michigan a premium of 3% based upon net deposits or approximately \$228, amortized over the life of the deposits of approximately 7 years. This acquisition was approved by the Federal Reserve in January 2018 and was finalized February 9, 2018.

Huron Community Financial Services, Inc.



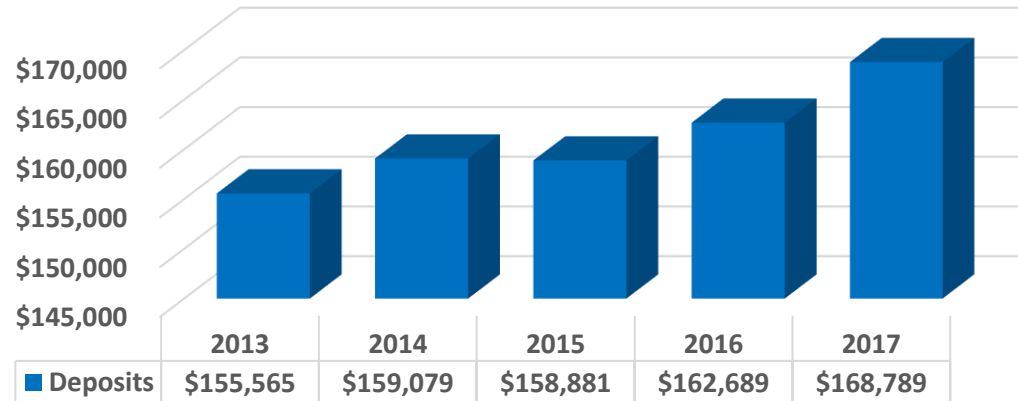
Huron Community Financial Services, Inc.

Loans (% of Assets)

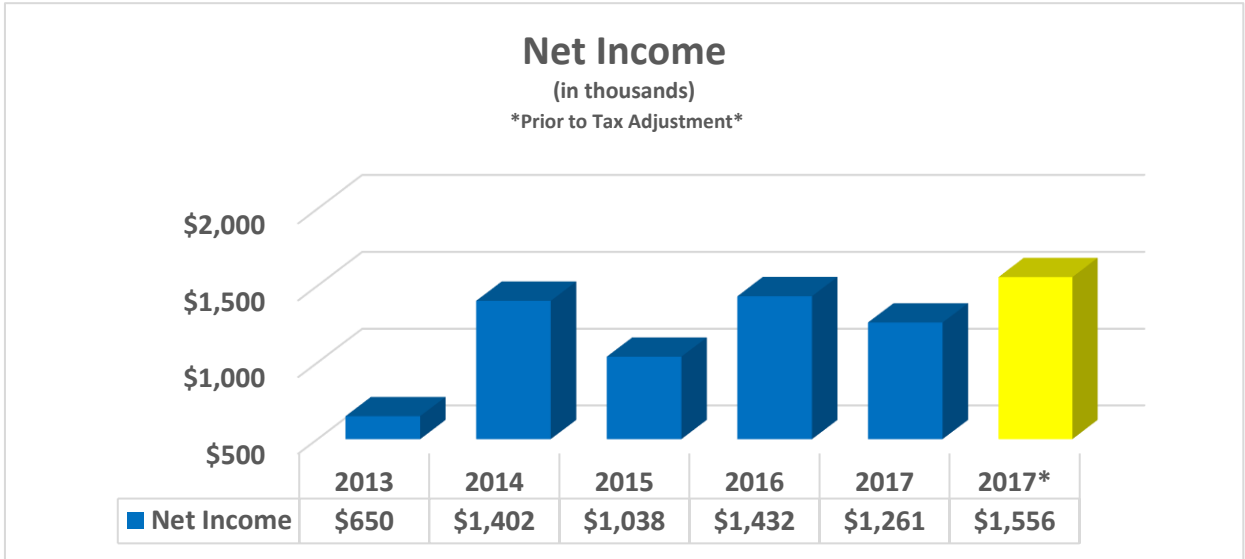
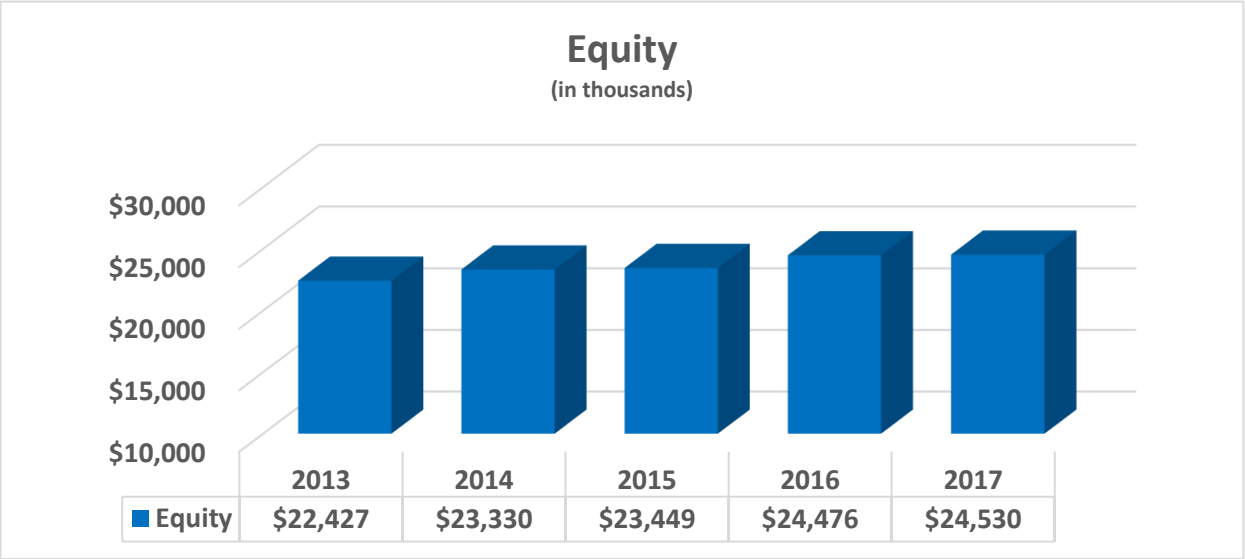


Deposits

(in thousands)



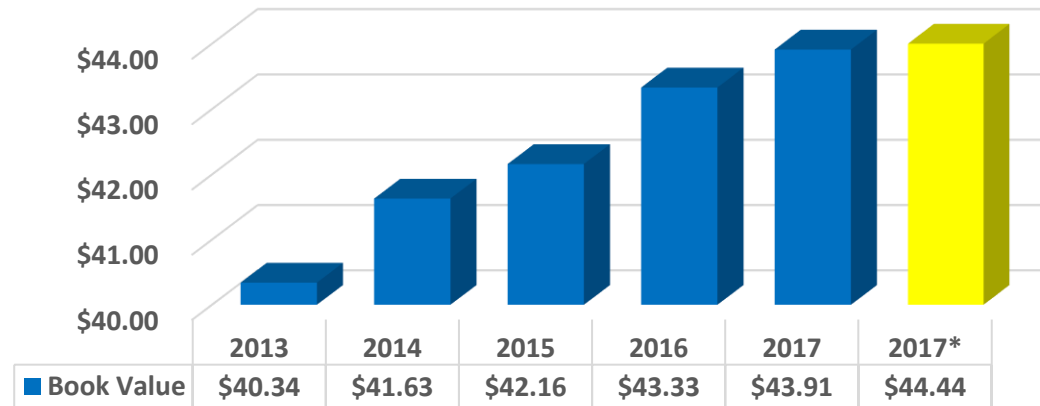
Huron Community Financial Services, Inc.



Huron Community Financial Services, Inc.

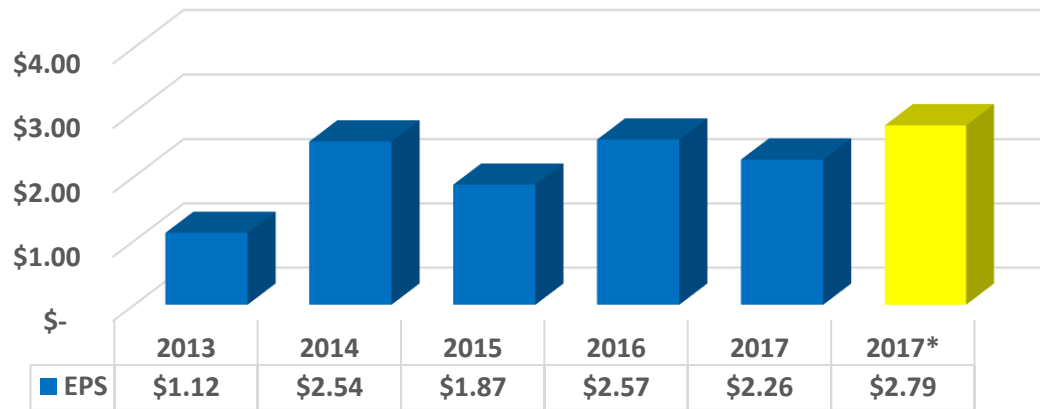
Book Value per Share

Prior to Tax Adjustment



Earnings per Share

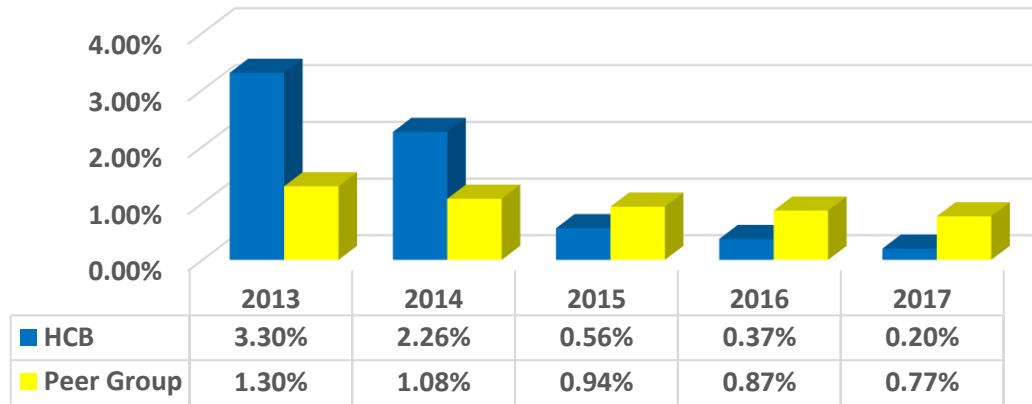
Prior to Tax Adjustment



Huron Community Bank - Asset Quality

Non-Performing Loans (% of Gross Loans)

(Peer Group Data from December 31 UBPR)



Net Charge Offs (% of Avg Loans)

(Peer Group Data from December 31 UBPR)

