Sturgis Bancorp, Inc.

2014 Annual Report



There's a Difference™

March 27, 2015

To My Fellow Stockholders,

On behalf of the Directors and employees of Sturgis Bancorp, Inc. and Sturgis Bank & Trust Company, I am pleased to provide a copy of our 2014 Annual Report. In this Annual Report you will find many key ratios and measures of performance. I encourage you to study this information and participate as a shareholder. If you do not understand information contained in this Annual Report, or have suggestions, do not hesitate to contact me or our CFO Brian Hoggatt at (269)651-9345.

By the time you receive this letter, the Bank should have completed the acquisition of West Michigan Savings Bank (WMSB) in Bangor. All Regulatory approvals are in place and we simply need to finalize the closing statements. WMSB was approximately $36.4 million in total assets. The ever increasing demands imposed by the Dodd/Frank Act were largely responsible for WMSB's inability to continue as an independent organization. WMSB will be integrated as a branch into our existing branch network. This is the first whole bank acquisition in our history. The Bank expects this transaction will result in an increase in net income and franchise value. The conservative financial projections utilized to determine the purchase price did not assume aggressive future earnings from offering expanded loan products, Trust and Investment Services to this customer base. However we expect additional income potential from these additional services that West Michigan Savings Bank did not offer.

Our Bank continues to be focused on growing shareholder value, being a responsible corporate citizen, and providing a work environment based on integrity and service. We look forward to our continuing role as the leading financial institution in St. Joseph County, Michigan and growing our presence in the Van Buren and Branch County markets.

I wish to thank the members of our Board of Directors for their guidance and counsel. I also wish to recognize the talented staff of Sturgis Bank & Trust Company for their hard work and edication to you, our shareholders.

In closing I would ask each of you to consider our products and services when choosing your financial service provider. After all, you are contributing to your own success, while receiving top-notch service, when you do business with your community Bank. Thank you for your continuing support and investment in Sturgis Bancorp, Inc.

I hope to see you at our annual meeting.

Sincerely,



Eric L. Eishen President/CEO

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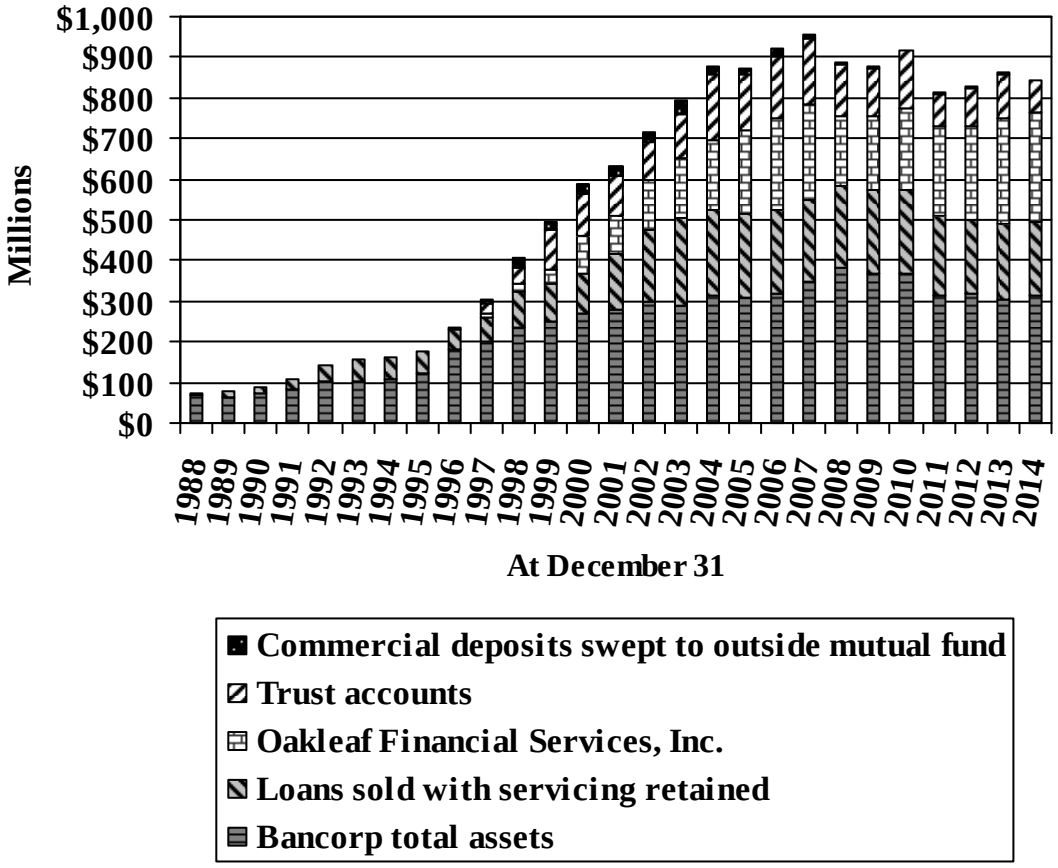
SELECTED FINANCIAL DATA

	(Dollars in Thousands) At December 31,				
	2014	2013	2012	2011	2010
Total assets	$312,445	$304,980	$317,045	$314,258	$369,961
Cash and investment securities	31,197	37,363	33,286	27,765	36,362
Loans and loans held for sale, net	238,087	235,583	250,781	252,987	263,607
Mortgage -backed securities (1)	10,263	-	-	-	34,619
Allowance for loan losses	3,437	4,146	5,138	5,875	6,691
Deposits	234,290	229,020	234,923	234,599	265,951
Short-term borrowings	-	-	-	75	-
Long-term borrowings	44,218	44,585	52,440	52,500	53,000
Repurchase agreements	-	-	-	-	25,000
Stockholders' equity	30,350	28,535	26,924	24,910	23,315
Book Value per share	14.66	13.89	13.21	12.34	11.56
Shares outstanding	2,069,891	2,055,025	2,038,395	2,019,345	2,017,245

	(Dollars in Thousands) Year Ended December 31,				
	2014	2013	2012	2011	2010
Interest income	$11,737	$11,922	$12,679	$13,817	$15,779
Interest expense	2,094	2,578	3,035	4,036	5,726
Provision (benefit) for loan losses	104	(489)	545	1,608	5,385
Noninterest income	5,201	5,336	4,728	4,546	5,661
Noninterest expense	12,410	13,291	11,457	12,415	11,818
Provision for income taxes	448	251	504	(197)	(780)
Net income (loss)	1,882	1,627	1,866	501	(709)
Earnings (loss) per share (basic and diluted)	0.91	0.80	0.92	0.25	(0.34)
Cash dividends per share	0.09	-	-	0.03	0.12
Dividend payout ratio	9.86%	-	-	12.07%	(34.14%)
Equity/Assets ratio	9.71%	9.36%	8.49%	7.93%	6.30%
Return on assets	0.60%	0.52%	0.59%	0.14%	(0.19%)
Return on equity	6.46%	5.87%	7.18%	2.11%	(2.78%)
Weighted average shares outstanding:					
Basic and diluted	2,061,666	2,045,430	2,028,547	2,017,257	2,017,245

(1) This amount includes the carrying value of mortgage-backed securities and collateralized mortgage obligations. For information regarding fair values, see NOTE 2 - SECURITIES in the financial statements.

Gross Assets Managed



Despite decreases in total assets since 2010, this graph illustrates the stability of relationships for the Company since 1988. Each of these relationships indicates a point of contact with customers.

Branch acquisitions with related deposits assumed are shown below:

Seller Name	Date	Branch Locations	Total Deposits
First Federal of Michigan	March 12, 1988	Three Rivers	$10,354,773
Fidelity Federal	June 29, 1990	Three Rivers	3,068,392
Standard Federal Bank	July 6, 1991	Sturgis	9,755,357
Great Lakes Bancorp	March 15, 1996	Coldwater and South Haven	24,016,569
KeyBank	December 8, 1997	Bronson and Constantine	16,883,609
First of America Bank	September 11, 1998	Centreville, Climax, Covert, and South Haven	45,140,000

The graph shows growth, even after the most recent branch acquisitions in 1998, to over 200% of the 1998 sum.

CORPORATE REVIEW

On December 11, 2001, the shareholders of Sturgis Bank & Trust Company (the "Bank") approved the reorganization of the Bank to become a wholly owned subsidiary of Sturgis Bancorp, Inc. (the "Bancorp"), a financial holding company. This reorganization was effective January 1, 2002. As a result, historical information in this Annual Report for periods before the January 1, 2002 effective date relate to the Bank. Throughout this Annual Report Sturgis Bancorp, Inc. will be referred to as Bancorp and Sturgis Bank & Trust Company will be referred to as the Bank.

The Bank, a Michigan savings bank, was founded in 1905 as a state chartered mutual building and loan. The original mission of the Bank was to promote personal savings and provide financing for the purchase of homes. Today we remain committed to the same objectives by offering consumer, educational, and property improvement loans, along with a large selection of investment opportunities to our community.

Although the Bank's primary business has historically been and will continue to be the origination of first mortgage loans on 1-4 family unit homes, it has implemented strategies in the last few years that have increased commercial real estate and small business loans within its primary market area. As a result, the commercial real estate and commercial loan segments grew in 2014.

The Bank has its main office in Sturgis and branch offices in Bronson, Centreville, Climax, Colon, South Haven, Sturgis, Three Rivers and White Pigeon, Michigan. The Bank's market area includes all of St. Joseph County and parts of Cass, Branch, Calhoun, Van Buren, Allegan, Hillsdale and Kalamazoo Counties in Michigan.

In 2012, the Bancorp converted from a financial holding company to a bank holding company under the Bank Holding Company Act of 1956, as amended. In 2014, the Bancorp converted back to a financial holding company.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward Looking Statements

This report contains statements that constitute forward-looking statements. These statements appear in several places in this report and include statements regarding intent, belief, outlook, objectives, efforts, estimates or expectations of Bancorp, primarily with respect to future events and the future financial performance of Bancorp. Any such forward-looking statements are not guarantees of future events or performance and involve risks and uncertainties, and actual results may differ materially from those in the forward-looking statement. Factors that could cause a difference between an ultimate actual outcome and a preceding forward-looking statement include, but are not limited to, changes in interest rates and interest rate relationships; demand for products and services; the degree of competition by traditional and non-traditional competitors; changes in banking laws and regulations; changes in tax laws; changes in prices, levies, and assessments; the impact of technological advances; government and regulatory policy changes; the outcome of any pending and future litigation and contingencies; trends in consumer behavior and ability to repay loans; and changes of the world, national and local economies. Bancorp undertakes no obligation to update, amend or clarify forward-looking statements as a result of new information, future events, or otherwise.

Results of Operations

Bancorp reported net income for the year ended December 31, 2014 of $1.9 million, or $0.91 per share compared to net income of $1.6 million, $0.80 per share, for the year ended December 31, 2013. The primary component of the increase in net income was a reduction in noninterest expense. The provision for loan losses was $104,000 in 2014, compared to a benefit of $489,000 in 2013. Net interest income increased 3.2% to $9.6 million, from $9.3 million for 2013. The increase in net interest income is primarily due to the decrease in average rate paid on interest-bearing liabilities to 0.89% in 2014 from 1.07% in 2013. The tax equivalent net interest margin was 3.59% in 2014, compared to 3.42% in 2013.

Interest Income

Interest income decreased $185,000 to $11.7 million in 2014 from $11.9 million in 2013. This decrease is primarily due to the decrease in average interest rate earned on interest-earning assets 4.30% in 2014 from 4.39% in 2013. The average interest rate earned on loans decreased to 4.69% in 2014 from 4.78% in 2013. This decrease in the average interest rate earned is primarily due to new loans at the lower 2014 market rates. Most commercial loans are priced on a variable basis and the expansion of non-interest bearing commercial deposit accounts helps to reduce the average funding costs.

Interest Expense

Interest expense decreased $484,000 to $2.1 million in 2014 from $2.6 million in 2013. This was primarily due to the decrease in average borrowings to $44.4 million in 2014 from $50.8 million in 2013. Interest rates paid on interest-bearing deposits decreased to 0.43% in 2014 from 0.52% in 2013. Average interest-bearing liabilities decreased $5.8 million to $235.2 million in 2014 from $241.0 million in 2013. The average rate paid on borrowed funds decreased to 2.87% in 2014 from 3.12% in 2013, primarily due to prepayment of higher rate advances in the fourth quarter of 2013.

Net Interest Income

Net interest income for the year ended December 31, 2014 was $9.6 million compared to $9.3 million for the year ended December 31, 2013, an increase of $299,000. This increase was caused primarily by the decrease in interest rates paid on interest-bearing liabilities. The net interest margin increased to 3.54% in 2014 from 3.44% in 2013.

Average Balances, Interest Rates and Yields. Net interest income is affected by the difference ("interest rate spread") between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities and the relative amounts of interest-bearing liabilities and interest-earning assets. When the total of interest-earning assets approximates or exceeds the total of interest-bearing liabilities, any positive interest rate spread will generate net interest income. Financial institutions have traditionally used interest rate spreads as a measure of net interest income. Another indication of an institution's net interest income is its "net yield on interest-earning assets" or "net interest margin," which is net interest income divided by average interest-earning assets. The Bank's net interest margin for 2014 and 2013 was 3.54% and 3.44%, respectively. The Bank has generally positioned itself for net interest income to increase with rising interest rates, with most loans adjusting with changes in related indices. The Bank's interest-earning assets reprice at a faster pace than interest-bearing liabilities. A benefit to the positive gap strategy is the protection from unusually high market interest rates. The most significant risk to the positive gap strategy is decreases in market interest rates.

(In thousands)

Average Balances and Interest Rates
Year Ended December 31,

	2014			2013		
	Average Outstanding Balance	**Interest Earned/ Paid**	**Yield/ Rate**	**Average Outstanding Balance**	**Interest Earned/ Paid**	**Yield/ Rate**
Interest-Earning Assets:						
Loans (1)	$ 236,533	$ 11,101	4.69%	$ 240,664	$ 11,500	4.78%
Mortgage-backed securities (2)	5,835	142	2.44%	-	-	-
Investment securities (3)	6,510	250	3.85%	5,636	214	3.80%
Interest-bearing deposits	23,796	244	1.02%	25,191	208	0.83%
Total interest-earning assets	$ 272,674	$ 11,737	4.30%	$ 271,491	$ 11,922	4.39%
Interest-Bearing Liabilities:						
Deposits	$ 190,761	$ 820	0.43%	$ 190,161	$ 992	0.52%
FHLB advances and repurchase agreements	44,443	1,274	2.87%	50,831	1,586	3.12%
Total interest-bearing liabilities	$ 235,204	$ 2,094	0.89%	$ 240,992	$ 2,578	1.07%
Net interest income		$ 9,643			$ 9,344	
Interest rate spread			3.41%			3.32%
Net interest-earning assets	$ 37,470			$ 30,499		
Net interest margin			3.54%			3.44%

(1) Interest on loans includes fees. Nonaccrual loans and loans held for sale have been included in the average balances of loans.
(2) Mortgage backed securities includes collateralized mortgage obligations
(3) Yield on investment securities is reported on an actual and not a tax equivalent basis

The following table presents information regarding the weighted average yields received on loans and other assets and the weighted average rates paid on deposits and borrowings on the last day of the years indicated. Non-accruing loans have been included in the table as loans carrying a zero yield.

	December 31,	
	2014	**2013**
Weighted average rate:		
Loans	4.57%	4.65%
Mortgage-backed securities	3.02%	-
Investments(1)	3.51%	3.38%
Interest-bearing deposits	1.23%	1.11%
All interest-earning assets	4.24%	4.34%
Weighted average cost:		
Deposits (interest-bearing)	0.27%	0.39%
FHLB advances other borrowings	2.82%	2.83%
All interest-bearing liabilities	0.68%	0.79%
Interest rate spread	3.56%	3.55%

(1) Yield on investment securities is reported on an actual and not a tax equivalent basis.

Rate/Volume Analysis. The following table sets forth certain information regarding changes in interest income and interest expense of Bancorp for the periods indicated. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to: (i) changes in volume (change in volume multiplied by the prior year rate) and (ii) changes in rate (change in rate multiplied by the prior year volume). Rate/volume variances have been allocated proportionately to the change due to rate and the change due to volume.

	(In thousands)					
	Year Ended December 31, 2014 vs 2013 Increase (Decrease) Due To:			Year Ended December 31, 2013 vs 2012 Increase (Decrease) Due To:		
Interest Income:	Volume	Rate	Total	Volume	Rate	Total
Loans	$ (196)	$ (203)	$ (399)	$ (542)	$ (505)	$ (1,047)
Mortgage-backed securities	142	-	142	-	-	-
Investment securities	33	3	36	24	16	40
Interest-bearing deposits	(11)	47	36	46	18	64
Total interest-earning assets	(32)	(153)	(185)	(472)	(471)	(943)
Interest Expense:						
Deposits	4	(176)	(172)	(52)	(296)	(348)
FHLB advances and borrowings	(189)	(123)	(312)	(57)	(50)	(107)
Total interest-bearing liabilities	(185)	(299)	(484)	(109)	(346)	(455)
Net Interest Income	$ 153	$ 146	$ 299	$ (363)	$ (125)	$ (488)

Provision for Loan Losses

The provision for loan losses was an expense of $104,000 for the year ended December 31, 2014 and a benefit of $489,000 for the year ended December 31, 2013, an increase of $593,000. The provision for loan losses was based upon management's assessment of relevant factors, including types and amounts of non-performing loans, historical and anticipated loss experience on such types of loans, and economic conditions. Loans charged off during 2014, net of recoveries, were $813,000, compared to $503,000 during 2013.

The recorded investment in nonperforming loans decreased to $4.2 million at December 31, 2014 from $6.2 million at December 31, 2013. At December 31, 2013, the Bank had another $8.6 million of troubled debt restructured loans in addition to the nonperforming loans, compared to $9.5 million at December 31, 2013. The Bank restructures loans when such restructures are expected to minimize the Bank's losses on the loans.

The allowance for loan losses as a percentage of total (gross) loans decreased to 1.43% in 2014 from 1.74% in 2013. This decrease is primarily due to Management's assessment of credit losses and exposure on loans specifically analyzed. Management monitors the increasing exposure to commercial lending and economic developments in the Bank's market area, among other factors, in determining appropriate provisions to the allowance for loan losses.

Noninterest Income

Noninterest income was $5.2 million in 2014, compared to $5.3 million in 2013. Investment brokerage commission income increased $216,000 to $2.3 million, due to better market performance and annuity sales. Mortgage banking activities decreased $485,000 to $652,000, as loan sale volume decreased.

Noninterest Expense

Noninterest expense was $12.4 million in 2014, compared to $13.3 million in 2013. The largest component of noninterest expense is salaries and employee benefits, which increased $65,000, partially due to higher brokerage commissions paid on the higher commission income. Real estate owned expense decreased $271,000. Bancorp incurred $192,000 professional fees and other expenses in 2014, related to the pending acquisition of another financial institution. Federal Home Loan Bank advances of $7.5 million were prepaid in 2013, incurring a prepayment penalty that year of $668,000. These prepayments reduce future interest expense. Management actively minimizes noninterest expense, although certain noninterest expenses are outside of Management's direct control.

The effective federal income tax rate was 19.4% in 2014 and 13.4% in 2013.

Financial Condition

General. Bancorp's total assets at December 31, 2014 were $312.5 million compared to $305.0 million at December 31, 2013. Most of the increase was in securities.

Loans. Net loans increased to $236.4 million at December 31, 2014 from $234.5 million at December 31, 2013. The largest loan segment is residential mortgages, which decreased $1.2 million. The Bank generally sells long-term, fixed rate, residential mortgages in the secondary market. The primary buyers of these loans are Federal Home Loan Mortgage Corporation (FHLMC) and FHLB. Commercial real estate loans and other commercial loans increased to $101.1 million, or 42.1% of gross loans on December 31, 2014 from $94.8 million, or 39.7% of gross loans, at December 31, 2013. The proceeds from sales of loans were $17.3 million and $38.2 million for the years ended December 31, 2014 and 2013, respectively. The mortgage loans originated for sale ($17.7 million in 2014 and $36.6 million in 2013) were primarily funded by the secondary mortgage market sales. The decision to sell most fixed-rate mortgages with original maturities of 10-years or greater protects the Bank from the interest rate risk inherent in holding these longer term, fixed-rate loans and provides a source of liquidity to fund loan demand. Reductions in market interest rates generally increase the pace of refinance activity in the residential loan portfolio.

At December 31, 2014, outstanding commitments to originate loans were $6.7 million and $39.0 million on fixed and variable-rate loans, respectively. Of these loan commitments, Management expects $4.4 million to be disbursed for new loans during the first half of 2015. The additional loan commitments are unused lines of credit, which may be drawn at any time by the borrower. These loan commitments will be funded by interest-bearing deposits, maturing

assets, and additional FHLB borrowings, if required.

Loans serviced for others were $181.3 million and $185.0 million at December 31, 2014 and 2013, respectively. This servicing portfolio includes $172.6 million of residential mortgages originated by the Bank and sold in the secondary mortgage market with servicing retained by the Bank. The Bank also services $8.7 million of commercial loans originated by the Bank and sold to other financial institutions. Management believes retaining servicing provides the Bank with a competitive advantage in its market, because many consumers have discovered the difficulties encountered when loan servicing is sold. The retention of servicing also allows the Bank to cross-sell other banking products and services to these customers. The retention of servicing requires the Bank to keep a higher staffing level than if the servicing would be sold The value of the right to service is appraised quarterly and any temporary impairment of the value of servicing rights is recognized quarterly. The originated mortgage servicing rights asset required a valuation allowance of $101,000 at December 31, 2014. The Bank will continue to monitor the valuation of the servicing rights asset. If subsequent analysis shows changes in the appraised impairment, the valuation allowance will be adjusted to match the impairment.

Bancorp has no purchased mortgage servicing portfolio.

The following table provides an analysis of the allowance for loan losses:

	(Dollars in thousands) Year Ended December 31,	
	2014	2013
Ratio of net charge-offs during the period to average loans outstanding during the period	0.34%	0.21%
Allowance for loan losses to total (gross) loans	1.43%	1.74%
Nonperforming assets to total assets	1.80%	2.18%
Allowance for loan losses to nonperforming assets	61.06%	62.33%

Loans in nonaccrual status at December 31, 2014 were $3.7 million, down from $5.7 million at December 31, 2013. The following table presents the aggregate amount of troubled asset categories as of the dates indicated:

	(Dollars in thousands) December 31,	
	2014	2013
Past due – 90 days or greater	$ 287	$ 312
Nonaccrual loans	3,733	5,710
Real estate owned	1,608	630
Total nonperforming assets	5,628	6,652
Restructured assets	8,551	9,462
Total troubled assets	$14,179	$16,114
Ratio of troubled assets to total loans	6.00%	6.87%
Ratio of troubled assets to total assets	4.54%	5.28%

Interest-earning Deposits in Banks. Interest-bearing deposits in banks were $16.6 million at December 31, 2014, compared to $14.9 million at December 31, 2013, an increase of $1.7 million.

Securities – Available for sale. Investment securities available for sale were $7.0 million at December 31, 2014 and $1.6 million at December 31, 2013. The increase in 2014 was primarily in commercial mortgage-backed securities issued by entities sponsored by the U.S. Government.

Securities – Held-to-maturity. At December 31, 2014, the Bank had $5.8 million of collateralized mortgage obligations issued by entities sponsored by the U.S. Government. At December 31, 2013, the Bank had no held-to-maturity investment securities.

Deposits and Borrowed Funds. Deposits were $234.3 million at December 31, 2014 compared to $229.0 million at December 31, 2013, an increase of $5.3 million. Interest-bearing deposits decreased to $182.9 million at December 31, 2014 from $187.3 million at December 31, 2013. The decrease in interest-bearing deposits includes $4.8 million in brokered deposits and $324,000 in non-brokered certificates of deposit with balance greater than $100,000 (commonly referred to as jumbo certificates). Non-brokered jumbo certificates decreased to $11.1 million at December 31, 2014 from $11.4 million at December 31, 2013. Brokered certificates of deposit, mostly included in the certificates under $100,000, decreased to $2.7 million at December 31, 2014 from $7.6 million at December 31, 2013. The Bank uses brokered and jumbo certificates as sources of liquidity. Interest-bearing transaction savings accounts and checking accounts increased $3.8 million, or 2.7%, from December 31, 2013 to December 31, 2014. Transaction savings accounts and checking accounts represent 60.46% of deposits at December 31, 2014,

compared to 60.21% of deposits at December 31, 2013. Bank management is actively attempting to increase core deposit account relationships. Transaction savings accounts and checking accounts provide relatively inexpensive funding for future growth, compared to alternative certificates of deposit and borrowed funds at higher interest rates. The Bank offers competitive rates on its time deposits and uses jumbo certificates or borrowed funds, when that strategy enhances net interest income.

The Bank has an available six-month line of credit with FHLB which provides for advances up to $4.0 million and matures in May 2015. The Bank anticipates renewal of the line of credit at maturity. All borrowings from FHLB are collateralized by certain residential and commercial mortgage loans.

Long-term advances were $41.0 million at December 31, 2014 and December 31, 2013. At December 31, 2014, Bancorp had $3.3 million outstanding on an amortizing loan with another financial institution, compared to $3.2 million outstanding at December 31, 2013. The loan requires amortizing payments quarterly on a 10-year schedule, with final balloon payoff at maturity in July 2015. Bancorp anticipates refinance of the loan at maturity.

Capital Resources

The stockholders' equity of Bancorp was $30.4 million at December 31, 2014 compared to $28.5 million at December 31, 2013, an increase of $1.9 million, or 6.36%. The primary component of this increase was retained earnings. Cash dividends of $186,000 were paid in 2014, and no cash dividend was paid in 2013. The stockholders' equity was 9.71% of total assets at December 31, 2014. Management continues to monitor and evaluate the best capital structure of Bancorp. A structure that provides sufficient capital to fund future growth, yet maximizes earnings per share, is deemed optimal. Management does not project a need for capital beyond what can be provided by retained earnings.

The Federal Reserve Board ("FRB")'s risk-based capital guidelines are inapplicable to Bancorp, due to Bancorp qualifying as a "small bank holding company". However, if Bancorp's total assets exceed $500 million, the guidelines will then apply to Bancorp. The guidelines require that financial holding companies with over $500 million in total assets maintain capital no less than that required by subsidiary banks.

Management deems the current capitalization level adequate for current and anticipated strategies. Management does not expect Bancorp to grow in the foreseeable future to the $500 million asset level.

Although not currently required by FRB, the following table summarizes the capital ratios of Bancorp at the dates indicated:

		December 31, 2014	December 31, 2013
Equity to assets		9.7%	9.4%
Tier I leverage		8.8%	8.3%
Risk-based:	Tier I capital	13.3%	12.5%
	Total capital	14.5%	13.7%

Asset/Liability Management

The primary component of Bancorp's earnings is net interest income of the Bank. The Bank's asset/liability management strategy is to maximize net interest income over time by reducing the impact of fluctuating interest rates. This is accomplished by matching the mix and maturities of its assets and liabilities. At the same time, the Bank's asset/liability strategies for managing interest rate risk must also accommodate customer demands for particular types of deposit and loan products. The Bank uses asset/liability management techniques in an attempt to maintain a profitable mix of financial assets and liabilities, provide deposit and loan products that meet the needs of its market area, and maintain control over interest rate risk resulting from changes in interest rates.

Net interest income, the primary component of the Bank's net income, is derived from the difference or "spread" between the yield on interest-earning assets and the cost of interest-bearing liabilities. The Bank has sought to reduce its exposure to changes in interest rates by matching more closely the effective maturities and repricings of its interest-sensitive assets and liabilities. At the same time, the Bank's asset/liability management strategies must also accommodate customer demands for particular types of deposit and loan products.

While much of the Bank's asset/liability management efforts involve strategies that manage the rate sensitivity of its loans and investments, such as the sale of long-term fixed rate loans, originations of adjustable rate loans and purchases of adjustable rate mortgage-backed securities or relatively short average life fixed-rate investments, it also uses techniques to manage the rate sensitivity of its deposits and borrowed money. Those techniques include attracting longer-term certificates of deposit at rates lower than borrowing rates, when the market will permit. The Bank emphasizes core deposits, which are less sensitive to changes in interest rates, and borrowing through long-term FHLB advances or brokered certificates of deposit. The Bank's asset/liability management strategy adjusts, when market interest rates and customer demand change.

The Bank measures its exposure to interest rate fluctuations primarily by using a computer modeling software designed for financial institutions, such as the Bank. The model uses assumptions which Management believes are reasonable for the analysis. These assumptions include (but are not limited to) prepayment and decay rates. Because of the Bank's smaller loan population, these assumptions are based on national statistics and may not reflect the Bank's own experience. It allows the Bank to simulate its asset-liability sensitivity based on the interest rate risk identified. The analysis estimates the changes in the market value of the Bank's equity using immediate and permanent interest rate change scenarios ranging from +4% to –4%, in 1% increments from current market rates. The software also allows simulation for unlimited additional market interest rate scenarios. At December 31, 2014, the following table illustrates the interest rate sensitivity of the Bank's consolidated equity to immediate and permanent changes in market interest rates.

	(in Thousands of Dollars)
Book value of Bank's equity	$33,464

4% increase in market rates	33,228
3% increase in market rates	35,795
2% increase in market rates	38,004
1% increase in market rates	40,235
No change (current market value of equity)	41,696
1% decrease in market rates	N/A
2% decrease in market rates	N/A
3% decrease in market rates	N/A
4% decrease in market rates	N/A

As the table shows, the Bank's estimated market value of equity remains relatively stable when interest rates rise. Market rate decreases are not relevant because resulting rates would be below 0%. That indicates that the Bank is able to withstand fluctuations in market interest rates without posing a significant threat to either the Bank's stockholders' equity or the federal deposit insurance system, and therefore, the Bank can be deliberate in its actions to adjust the asset-liability mix. The Bank would meet the regulatory minimum capital requirements in all of the interest-rate scenarios.

The Bank has an Asset-Liability Management Committee (ALCO) that meets as needed. The purpose of this Committee is to communicate, coordinate, and monitor asset-liability management procedures. The Committee establishes and monitors the volume and mix of both assets and funding sources. The objective is to manage assets and funding sources to produce results consistent with the Bank's liquidity requirements, capital adequacy, growth, and profitability goals. To accomplish this objective, the ALCO uses internal budget variance reports, forecasts for changes in interest rates and consumer deposit activity, as well as forecasts of loan demand in each of the Bank's loan types, investment maturities and new investment alternatives, and various other internal and external reports.

Effect of Interest Rate Fluctuations

Bancorp's consolidated results of operations depend, to a large extent, on the Bank's level of net interest income, which is the difference between interest income earned on its loan and investment portfolios versus the interest paid on deposits and borrowed funds. If the cost of funds increases faster than the yield on its interest-earning assets, net interest income will be reduced.

Bancorp measures its interest rate risk primarily using simulation analysis. This analysis is prepared by the Chief Financial Officer and reviewed by the ALCO. ALCO is comprised of the Chief Executive Officer, Chief Financial Officer, Executive Vice President and Senior Officers of the Bank. Bancorp's Board of Directors reviews quarterly reports that estimate Bancorp's sensitivity to changes in interest rates. Sensitivity is estimated for net interest income and market value of portfolio equity.

While Bancorp uses various tools to monitor interest rate risk, it is unable to predict future fluctuations in interest rates or the specific impact thereof. The market value of most of

Bancorp's financial assets is sensitive to fluctuations in market interest rates. Fixed-rate investments and mortgage loans decline in value as interest rates rise. Adjustable-rate investments and loans generally have less market value volatility than fixed-rate assets.

Liquidity

Bancorp maintains certain levels of liquid assets (the most liquid of which are cash and investment securities) in order to meet demands from loan commitments, deposit withdrawals and other obligations. Bancorp manages liquidity by maintaining a portion of its liquid assets in overnight accounts and by staggering maturities in its portfolio of investment securities. The primary sources of liquidity are loan repayments, loan sales, maturing investments, deposit accounts, and other borrowed funds, such as FHLB borrowings.

Through recent volatile equity markets, deposit customers have been attracted to Bank deposits from uninsured alternatives, such as money market accounts or other investments. If market interest rates remain historically low, Management expects depositors might unwisely look to more risky investments than Bank deposits to increase their return.

Contractual Obligations

The long-term debt obligations consist of certificates of deposit, advances from the Federal Home Loan Bank, and a loan from another financial institution. The following schedule represents only scheduled principal payments as of December 31, 2014.

	Payments Due by Period (in thousands)				
	Total	Less than 1 year	1 – 3 years	4 – 5 Years	After 5 years
Certificates of deposit	$41,257	$14,796	$14,667	$11,622	$ 172
FHLB advances	41,000	20,500	20,500	-	-
Other borrowings	3,218	3,218	-	-	-
Total contractual obligations	$85,475	$38,514	$35,167	$11,622	$ 172

Off-balance Sheet Activities

Other Commercial Credits – The Bank is a party to credit related financial instruments with off-balance sheet risks in the normal course of business to meet the financing needs of its customers. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet of the Bank.

Commitments to extend credit are agreements to lend to a customer, as long as there are no violations of any condition established in the contract. Commitments for equity lines of credit or overdraft protection may expire without being drawn. Therefore, total commitments do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on Management's credit evaluation of the customer and the related loans. 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, may not contain a specified maturity date and may be drawn to the total extent of the Bank's commitment.

Commercial and standby letters of credit are a conditional commitment issued by the Bank to guarantee the performance of a customer to a third party. The letters of credit are primarily used to support public and private borrowing arrangements. All letters of credit have expiration dates within one year.

At December 31, 2014, the Bank had total commitments to originate loans of $6.7 million and $39.0 million on fixed rate and variable rate loans, respectively.

All of the commercial credits are underwritten using the commercial loan underwriting guidelines.

Collateral Requirements – To reduce credit risks related to the use of credit-related financial instruments, the Bank might deem it necessary to obtain collateral. The amount and nature of the collateral obtained are based on the Bank's credit evaluation of the borrower and related loans. Collateral secured varies, but may include cash, investment securities, accounts receivable, inventory, property, plant and equipment and real estate. Although these items are used to secure loans, they are not included on the balance sheet of Bancorp.

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

Impact of Inflation

The majority of assets and liabilities of financial institutions are monetary in nature. Generally, changes in interest rates have a more significant impact on earnings of the Bank than inflation. Although influenced by inflation, changes in rates do not necessarily move in either the same magnitude or direction as changes in the price of goods and services. Inflation could impact the growth of total assets, creating a need to increase equity capital at a higher rate to maintain an adequate equity to assets ratio, which in turn reduces the amount of earnings available for cash dividends. Through 2014 and 2013, inflation did not have a material impact on the Bancorp.

DIRECTORS OF BANCORP – December 31, 2014

John R. Dresser	President, Dresser, Dresser, Haas & Caywood, P.C. Retained Counsel
Eric L. Eishen	President and Chief Executive Officer, Sturgis Bancorp, Inc and Sturgis Bank & Trust Company
David L. Franks	President and COO, Oak Press Solutions *- Retired effective January 2, 2015*
Donald L. Frost	Chairman of the Board Chief Executive Officer, LTi Printing, Inc.
Michael R. Frost	President, LTi Printing, Inc.
Jeffrey M. Mohney	Owner, A. W. Ayres Agency, Inc.
John T. Wiedlea	President, Automation Plus, Inc.

OFFICERS OF BANCORP

Eric L. Eishen	President, Chief Executive Officer
Ronald W. Scheske	Vice President
Brian P. Hoggatt	Chief Financial Officer, Secretary/Treasurer

DIRECTORS OF THE BANK – DECEMBER 31, 2014

John R. Dresser	President, Dresser, Dresser, Haas & Caywood, P.C. Retained Counsel
Eric L. Eishen	President and Chief Executive Officer
David L. Franks	President and COO, Oak Press Solutions *- Retired effective January 2, 2015*
Donald L. Frost	Chairman of the Bank Board Chief Executive Officer, LTi Printing, Inc.
Michael R. Frost	President, LTi Printing, Inc.
Jeffrey M. Mohney	Owner, A. W. Ayres Agency, Inc.
John T. Wiedlea	President, Automation Plus, Inc.

OFFICERS OF THE BANK – DECEMBER 31, 2014

Eric L. Eishen	President, Chief Executive Officer
Steven G. Gage	Senior Vice President, Commercial Lending
Brian P. Hoggatt	Senior Vice President, Chief Financial Officer, Treasurer
Jason J. Hyska	Vice President, Retail Lending
Tracey L. Parker	Senior Vice President, Chief Credit Officer
Ronald W. Scheske	Executive Vice President, Chief Operating Officer
Christine M. Moline	First Vice President, Private Banking Officer
Jose D. Albarran	Vice President
Robby S. Beachy	Vice President
Sandra J. Cagle	Vice President
Debora L. Capman	Vice President, Senior Trust Officer
Emily D. Frohriep	Vice President, Human Resources
Kurt A. Inman	Vice President, Director of Marketing
John D. Johnson	Vice President
Margaret M. Kunce	Vice President, Compliance BSA/OFAC Officer
Heather J. Myers	Corporate Secretary
Matthew D. Scheske	Vice President
Jason A. Wagner	Vice President
Elizabeth M. Weinberg	Vice President
Camille M. Wilson	Vice President
Tamera J. De Mara	Assistant Vice President
Joel T. Fowler	Assistant Vice President
Trudy R. Gloy	Assistant Vice President
Mary F. Hooley	Assistant Vice President
Stephen E. Merchant	Assistant Vice President
Pamela A. Norgan	Assistant Vice President

BANK CORPORATE INFORMATION

Location	Address	City, ST ZIP	Telephone	Fax
Sturgis (Main Office)	113-125 East Chicago Road	Sturgis, MI 49091	(269) 651-9345	(269) 651-5512 (269) 651-8263 (269) 865-5902
Sturgis–Trust Dept.	113-125 East Chicago Road	Sturgis, MI 49091	(269) 651-1380	(269) 659-6848
Branch Offices				
Bronson	863 West Chicago Road	Bronson, MI 49028	(517) 369-7322	(517) 369-2347
Centreville	158 West Main	Centreville, MI 49032	(269) 467-8525	(269) 467-4180
Climax	125 North Main	Climax, MI 49034	(269) 746-4256	(269) 746-4108
Colon	110 South Blackstone Street	Colon, MI 49040	(269) 432-3229	(269) 432-2971
South Haven	1121 LaGrange Street	South Haven, MI 49090	(269) 637-8444	(269) 637-5560
South Haven	365 Center Street	South Haven, MI 49090	(269)-637-6644	(269) 637-6645
Sturgis	1001 South Centerville Road	Sturgis, MI 49091	(269) 651-9379	(269) 651-1514
Sturgis	1501 East Chicago Road	Sturgis, MI 49091	(269) 651-9345	(269) 651-5609
Three Rivers	115 North Main Street	Three Rivers, MI 49093	(269) 273-8481	(269) 273-1732
White Pigeon	122 West Chicago Road	White Pigeon, MI 49099	(269) 483-9668	(269) 483-2725
Oakleaf Financial Services	113-125 East Chicago Road	Sturgis, MI 49091	(269) 651-2475	(269) 651-7273

MARKET INFORMATION

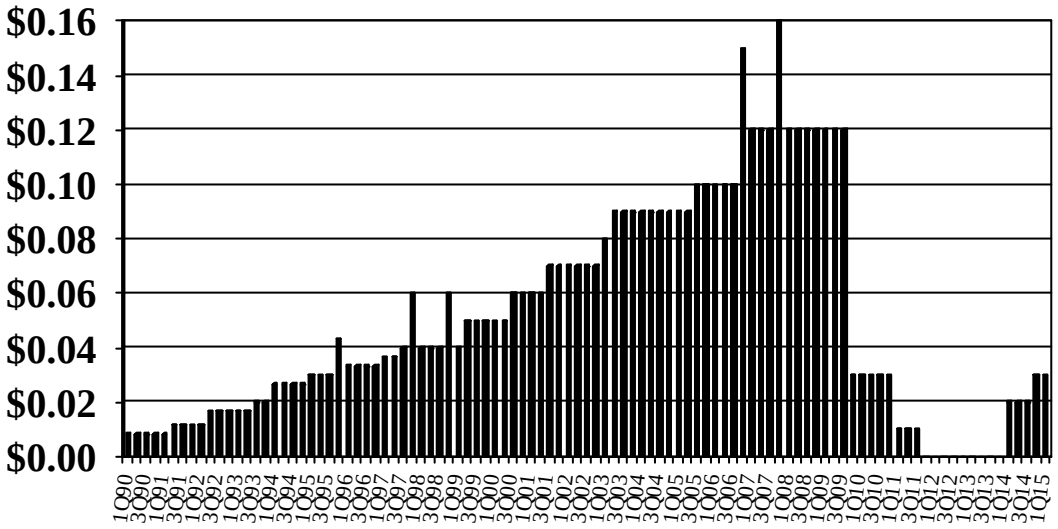
Shares of common stock of Bancorp were held by 116 holders of record as of December 31, 2014. Bancorp's shares are traded on the OTCQX network under the symbol of "STBI". Trading activity has been infrequent.

The range of high and low trade prices for each quarterly period during the past two years is presented below:

	Year ended December 31,			
	2014		2013	
	High	Low	High	Low
First quarter	$8.95	$8.00	$8.00	$6.69
Second quarter	8.99	7.62	8.00	7.14
Third quarter	8.70	8.05	8.75	7.86
Fourth quarter	8.90	8.28	8.25	7.86

The trade prices listed above are based on actual transactions obtained from public Internet sources obtained by Bancorp.

Cash Dividends Per Share



On December 11, 2001, the shareholders of the Bank approved the reorganization of the Bank to become a wholly owned subsidiary of Sturgis Bancorp, Inc., a financial holding company. Sturgis Bancorp, Inc. was a financial holding company under the Bank Holding Company Act of 1956, as amended. This reorganization was approved at a special meeting of the shareholders of the Bank on December 11, 2001. Bancorp received all of the various federal and state regulatory approvals for this reorganization. In 2012, Bancorp converted to a bank holding company under the Bank Holding Company Act of 1956, as amended. In 2014, Bancorp converted back to a financial holding company.

This reorganization became effective as of the opening of business on January 1, 2002. Bancorp is a legal entity separate and distinct from its subsidiaries. Substantially all of Bancorp's revenues result from dividends paid to it by the Bank and from earnings on investments. There are statutory and regulatory requirements applicable to the payment of dividends by the Bank to Bancorp, as well as by Bancorp to its shareholders.

Under the Michigan Savings Bank Act, Bancorp may not declare a cash dividend or a dividend of any kind except out of net income then on hand after deducting all losses and bad debts, and then only if it will have a surplus amounting to not less than 20% of its capital after the payment of the dividend. Moreover, the Bank may not declare or pay any cash dividend or dividend in kind until the cumulative dividends on its preferred stock, if any, have been paid in full. Further, if the surplus of the Bank is at any time less than the amount of its capital, before the declaration of a cash dividend or dividend in kind, it must transfer to surplus not less than 10% of its net income for the preceding 6 months (in the case of quarterly or semi-annual dividends) or the preceding two consecutive 6 month periods (in the case of annual dividends).

Pursuant to the Michigan Business Corporation Act, Bancorp may not make distributions to its shareholders if, after giving effect to the distribution, the corporation would not be able to pay its debts as they become due in the usual course of business, or the corporation's total assets would be less than the sum of it total liabilities plus, unless the corporation's articles of incorporation permit otherwise, the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution.

The payment of dividends by Bancorp and its subsidiaries may also be affected or limited by other factors, such as the requirements to maintain adequate capital above regulatory guidelines. In addition, if, in the opinion of the applicable regulatory authority, a bank under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice (which, depending on the financial condition of the Bank, could include the payment of dividends), such authority may require, after notice and hearing, that such bank cease and desist from such practice or prohibit the payment of future dividends. The Federal Reserve has indicated that paying dividends that deplete a bank's capital base to an inadequate level would be an unsafe and unsound banking practice. The Federal Reserve, the FDIC and the Division of Financial Institutions of the Michigan Department of Consumer & Industry Services Office of Financial and Insurance Services have issued policy statements which provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.

INDEPENDENT AUDITORS

Bancorp employed the accounting firm of Crowe Horwath LLP as Independent Auditors for the years ended December 31, 2014 and December 31, 2013. There have been no disagreements on accounting or financial disclosure matters within these time periods.

Crowe Horwath LLP
Independent Member Crowe Horwath International

INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders
Sturgis Bancorp, Inc.
Sturgis, Michigan

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Sturgis Bancorp, Inc., which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

(Continued)

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sturgis Bancorp, Inc. as of December 31, 2014 and 2013, 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.

Crowe Horwath LLP

Crowe Horwath LLP

Grand Rapids, Michigan
March 23, 2015

STURGIS BANCORP, INC.

CONSOLIDATED BALANCE SHEETS

December 31, 2014 and 2013

(Amounts in thousands, except share and per share data)

	2014	2013
ASSETS		
Cash and due from banks	$ 7,680	$ 14,236
Other short-term investments	4,369	6,638
Total cash and cash equivalents	12,049	20,874
Interest-earning deposits in banks	16,575	14,914
Securities - available for sale	7,044	1,575
Securities - held to maturity	5,792	-
Federal Home Loan Bank stock, at cost	3,409	4,064
Loans held for sale, at fair value	1,716	1,034
Loans, net of allowance of $3,437 and $4,146	236,371	234,549
Premises and equipment, net	7,504	7,113
Goodwill	5,109	5,109
Originated mortgage servicing rights	1,413	1,501
Real estate owned	1,608	630
Bank-owned life insurance	9,808	9,537
Accrued interest receivable	868	828
Other assets	3,189	3,252
Total assets	$ 312,455	$ 304,980
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Deposits		
Noninterest-bearing	$ 51,383	$ 41,706
Interest-bearing	182,907	187,314
Total deposits	234,290	229,020
Federal Home Loan Bank advances and other borrowings	44,218	44,585
Accrued interest payable	238	272
Other liabilities	3,359	2,568
Total liabilities	282,105	276,445
Stockholders' equity		
Preferred stock - $1 par value: authorized - 1,000,000 shares issued and outstanding – 0 shares	-	-
Common stock – $1 par value: authorized – 9,000,000 shares issued and outstanding 2,069,891 shares at December 31, 2014 and 2,055,025 at December 31, 2013	2,070	2,055
Additional paid-in capital	7,204	7,094
Retained earnings	21,276	19,580
Accumulated other comprehensive loss	(200)	(194)
Total stockholders' equity	30,350	28,535
Total liabilities and stockholders' equity	$ 312,455	$ 304,980

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME

Years ended December 31, 2014 and 2013

(Amounts in thousands, except share and per share data)

	2014	2013
Interest income		
Loans	$ 11,101	$ 11,500
Investment securities:		
Taxable	386	208
Tax-exempt	80	61
Dividends	170	153
Total interest income	11,737	11,922
Interest expense		
Deposits	820	992
Borrowed funds	1,274	1,586
Total interest expense	2,094	2,578
Net interest income	9,643	9,344
Provision (benefit) for loan losses	104	(489)
Net interest income after provision (benefit) for loan losses	9,539	9,833
Noninterest income:		
Service charges and other fees	946	1,005/
Interchange income	630	560
Investment brokerage commission income	2,254	2,038
Mortgage banking activities	652	1,137
Trust fee income	379	364
Increase in cash value of bank owned life insurance	271	278
Gain (loss) on sale of real estate owned	41	(53)
Other income	28	7
Total noninterest income	5,201	5,336
Noninterest expenses:		
Salaries and employee benefits	6,948	6,883
Occupancy and equipment	1,543	1,508
Interchange expenses	379	285
Data processing	648	605
Professional services	554	372
Real estate owned expense	322	593
Advertising	159	119
FDIC premiums	235	426
Prepayment penalty on borrowings	-	668
Other	1,622	1,832
Total noninterest expenses	12,410	13,291
Income before income tax expense	2,330	1,878
Income tax expense	448	251
Net income	$ 1,882	$ 1,627
Earnings per share	$ 0.91	$ 0.80

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years ended December 31, 2014 and 2013

(Amounts in thousands, except share and per share data)

	2014	2013
Net income	$ 1,882	$ 1,627
Other comprehensive income (loss):		
Unrealized holding gain (loss) arising during the period	222	(192)
Tax effect	(75)	65
Net of tax	147	(127)
Change in post-retirement obligation	(242)	(43)
Reclassification adjustment for amortization of prior service cost and net loss included in net periodic pension cost	10	10
Tax effect	79	12
Net of tax	(153)	(21)
Total other comprehensive income (loss)	(6)	(148)
Comprehensive income	$ 1,876	$ 1,479

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years ended December 31, 2014 and 2013
(Amounts in thousands, except share and per share data)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance – January 1, 2013	$ 2,038	$ 6,979	$ 17,953	$ (46)	$ 26,924
Net income for the year ended December 31, 2013	-	-	1,627	-	1,627
Other comprehensive loss, net of tax effect of $(77)	-	-	-	(148)	(148)
Common stock issued (16,630 shares)	17	115	-	-	132
Balance – December 31, 2013	2,055	7,094	19,580	(194)	28,535
Net income for the year ended December 31, 2014	-	-	1,882	-	1,882
Other comprehensive loss, net of tax effect of $(4)	-	-	-	(6)	(6)
Common stock issued (14,866 shares)	15	110	-	-	125
Cash dividends ($0.09 per share)	-	-	(186)	-	(186)
Balance – December 31, 2014	$ 2,070	$ 7,204	$ 21,276	$ (200)	$ 30,350

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2014 and 2013
(Amounts in thousands)

	2014	2013
Cash flows from operating activities		
Net income	$ 1,882	$ 1,627
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	509	504
Amortization of mortgage servicing rights	311	290
Provision for loan losses	104	(489)
Accretion and amortization of securities	40	4
Gain on sale of loans	(469)	(732)
Proceeds from the sale of loans held for sale	17,279	38,249
Loans originated for sale	(17,678)	(36,578)
Impairment of mortgage servicing rights	(37)	(232)
(Gain) loss on sale of real estate owned	(41)	53
Write-down of real estate owned	126	416
Loss of equity in limited partnership	159	196
Increase in cash value of bank-owned life insurance	(271)	(278)
Changes in assets and liabilities:		
Decrease in accrued interest and other assets	(115)	751
Increase in accrued interest and other liabilities	512	128
Net cash provided by operating activities	2,311	3,909
Cash flows from investing activities		
Net change in interest-earning deposits in banks	(1,661)	(2,718)
Maturities of securities available for sale	10	10
Purchase of securities available-for-sale	(5,262)	(539)
Principal reductions on securities held-to-maturity	889	-
Purchase of securities held-to-maturity	(6,703)	-
Purchase of loans	(3,962)	(1,290)
Net (decrease) increase in loans	(338)	14,023
Proceeds from sale of real estate owned	1,294	1,831
Proceeds from redemption of FHLB stock	655	-
Additions to premises and equipment, net	(900)	(574)
Net cash provided by (used in) investing activities	(15,978)	10,743
Cash flows from financing activities		
Net increase (decrease) in deposits	5,270	(5,903)
Repayment of FHLB advances and other borrowings	(367)	(7,855)
Cash dividends paid on common stock	(186)	-
Issuance of common stock	125	132
Net cash provided by (used in) financing activities	4,842	(13,626)
Net change in cash and cash equivalents	(8,825)	1,026
Cash and cash equivalents - beginning of year	20,874	19,848
Cash and cash equivalents - end of year	$ 12,049	$ 20,874
Supplemental information		
Cash paid (refunded) for:		
Interest	$ 2,128	$ 2,639
Income taxes	520	367
Noncash investing and financing activities		
Loans transferred to real estate owned	2,357	1,677

See accompanying notes to consolidated financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation: The consolidated financial statements include the accounts of Sturgis Bancorp, Inc. (Bancorp), Sturgis Bank & Trust Company (Bank) and the Bank's wholly owned subsidiaries. The Bank's wholly owned subsidiaries include Oakleaf Financial Services, Inc., Oak Mortgage, LLC, and First Michiana Development Corporation of Sturgis, Inc. All significant intercompany transactions and balances have been eliminated in consolidation.

The Bank, which has been in continuous operation since 1905, formed Bancorp on January 1, 2002 via an equal exchange of common stock of Bank for common stock of Bancorp.

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 balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates and assumptions.

Nature of Operations: Bancorp operates predominantly in the southwestern portion of Michigan's Lower Peninsula. Its primary services include accepting deposits, making commercial and mortgage loans, engaging in mortgage banking activities, and providing investment brokerage advisory services.

Significant Group Concentrations of Credit Risk: Most of Bancorp's activities are with customers located within southwestern Michigan. Note 2 discusses the types of securities in which Bancorp invests. Note 3 discusses the types of lending in which Bancorp engages. Bancorp's loan portfolio is concentrated in residential and commercial mortgage loans. Bancorp does not have any significant concentrations to any one industry or customer.

Subsequent Events: Bancorp has evaluated subsequent events for recognition and disclosure through March 23, 2015, which is the date the financial statements were available to be issued.

Cash Flows: For the purpose of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, federal funds sold, and other short-term time and investment accounts at the Federal Home Loan Bank, all of which mature within 90 days. Net cash flows are reported for customer loan and deposit transactions, interest bearing deposits in banks, other short term investment, and repurchase agreements.

Interest-Earning Deposits in Banks: Interest-earning deposits in banks mature within five years and are carried at cost.

Securities: Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Securities not classified as held to maturity are classified as available for sale and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

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 held to maturity and available for sale securities below their cost, that are deemed to be other than temporary, are reflected in earnings as realized losses. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. In determining OTTI for debt securities, management considers many factors, including: (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, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Bancorp has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

Federal Home Loan Bank Stock: Bancorp's minimum investment in the stock of the Federal Home Loan Bank of Indianapolis (FHLB) is an amount equal to at least 1.0% of the unpaid principal balances of Bancorp's residential mortgage loans or 0.3% of its total assets, whichever is greater. Purchases and sales of stock are made directly with the FHLB at par value. The stock is recorded at cost and classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value.

Loans Held for Sale: Loans originated and intended for sale in the secondary market are carried at fair value. The fair value includes the servicing value of the loans as well as any accrued interest. Net unrealized losses, if any, are recognized in a valuation allowance by charges to income.

Mortgage loans held for sale are generally sold with servicing rights retained. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loans sold. The carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right.

Loans: Bancorp grants mortgage, commercial, and consumer loans to customers. Loans are reported at their outstanding unpaid principal balances, adjusted for amounts charged off, nonaccrual interest paid, 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 to the related loan yield using the interest method. Recorded investment in loans includes unpaid principal balances, adjusted for amounts charged off, nonaccrual interest paid, unamortized deferred fees and costs, accrued interest receivable, and negative escrow balances.

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 the process of collection. Past due status is based on the contractual terms of the loan. In all cases, if collection of principal and interest is considered doubtful, loans are placed on nonaccrual, charged off, or charged down to the fair value of collateral.

When a loan is placed in nonaccrual status, all interest accrued but not collected is reversed against interest income. Interest payments received on loans in nonaccrual status are accounted for as reductions to the carrying value of the principal. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses: The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance, when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision with any new information.

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

A loan is considered impaired, based on current information and events, when it is probable Bancorp will be unable to collect the scheduled payments of principal or interest in accordance with 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 are not generally 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, reasons for the delay, the borrower's prior payment history, and the amount of the shortfall in relation to the amount due and collateral value. Impairment on a loan is generally measured on a loan-by-loan basis for commercial, commercial real estate, and residential troubled debt restructurings.

Large groups of homogenous loans, such as consumer and residential mortgages, are collectively evaluated for impairment. Accordingly, Bancorp does not separately identify individual consumer and residential mortgage loans for impairment disclosures.

The general component of the allowance for loan losses 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 Bancorp over the most recent three years. This 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:

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 borrower's business and industry as repayment is typically dependent on cash flows generated from the underlying business.

Commercial Real Estate and Commercial Construction - Loans to individuals or businesses that are secured by improved and unimproved vacant land, farmland, commercial real property, multifamily residential properties, and all other conforming, nonresidential properties. The risk characteristics are similar to commercial loans, but these loan segments may also be dependent on real estate sales or rental income. For commercial construction, proceeds may be used for land acquisition, development or construction.

Consumer - Term loans or lines of credit for the purchase of consumer goods, vehicles or home improvement. The risks characteristics of this loan segment vary depending on the type of collateral but general repayment is expected from an individual continuing to generate a cash flow that supports the calculated payment obligation.

Residential and Residential Construction - Loans to purchase or refinance single family residences. The risks associated with these segments are similar to the risks for consumer loans regarding individual payment obligations however the underlying collateral is the real estate. Real estate is subject to changes in market valuation and can be unstable for a variety of reasons. For residential construction, proceeds may be used for land acquisition, development, or construction of residential properties.

Home equity – Loans to purchase consumer goods or home improvements. The risks associated with this segment are similar to residential loans, however typically these loans are secured by second lien positions in real estate.

For the commercial and commercial real estate portfolio segments, the historical loss is tracked by year of charge off and segregated by a grading system. Grades are assigned to each commercial and commercial real estate loan by accessing information about the specific borrower's situation and the estimated collateral values. The description of the loan grade criteria is included in Note 3.

Loans, for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. 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 Bancorp determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Servicing: Servicing rights are recognized separately when they are acquired through sales of loans. When mortgage loans are sold, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. Bancorp compares the valuation model inputs and results to published industry data in order to validate the model results and assumptions. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets 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 individual groupings, to the extent that fair value is less than the carrying amount. Changes in valuation allowances are reported with mortgage banking activities on the income statement. 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, which is reported on the income statement as mortgage banking activities, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income. Servicing fees totaled $457 and $464 for the years ended December 31, 2014 and 2013 respectively. Late fees and ancillary fees related to loan servicing were not material for presentation.

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 Bancorp, 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 Bancorp does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Premises and Equipment: Land is carried at cost. Premises and equipment are carried at cost, less accumulated depreciation computed on the straight-line method over the estimated useful lives of the assets. Buildings and related components are depreciated with useful lives ranging from 5 to 50 years. Furniture, fixtures and equipment are depreciated with useful lives ranging from 3 to 15 years.

Real Estate Owned: Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value at the date of foreclosure, less costs to sell when acquired, 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 costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in real estate owned expense.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Bank-Owned Life Insurance: Bancorp has purchased life insurance policies on certain key officers. Bank-owned 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.

Goodwill: Generally, intangible assets that meet certain criteria are recognized and subsequently amortized over their estimated useful lives. Goodwill with indefinite lives are not amortized. However, such assets are tested for impairment at least annually thereafter. The impairment test is generally performed in the fourth quarter of each year. There has been no impairment of goodwill.

Long-Term Assets: Premises and equipment 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.

Loan Commitments and Related Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial 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.

Income Taxes: Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the various temporary differences between the book and the tax bases of the various balance sheet assets and liabilities. This method gives current recognition to changes in tax rates and laws. When necessary, valuation allowances are established to reduce 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.

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

Earnings Per Share: Basic earnings per share represents income available to common stockholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share includes outstanding additional common shares that would have been outstanding, if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. As of December 31, 2014 and 2013, there were no dilutive common shares. As of December 31, 2014 and 2013 weighted average shares used in computing earnings per share were 2,061,666 and 2,045,430.

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 and changes in the post retirement benefit obligation, which are also recognized as separate components of equity.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loss Contingencies: Loss contingencies, including claims and legal action arising in the normal 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 are now such matters that will have a material effect on Bancorp's consolidated financial statements.

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.

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

Adoption of New Accounting Standards:
In January 2014, the FASB issued ASU 2014-01, *"Accounting for Investments in Qualified Affordable Housing Projects."* ASU 2014-01 applies to all reporting entities that invest in qualified affordable housing projects through limited liability entities. The pronouncement permits reporting entities to make an accounting policy election to account for these investments using the proportional amortization method if certain conditions exist. The pronouncement also requires disclosure that enables users of its financial statements to understand the nature of these investments. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The pronouncement should be applied retrospectively for all periods presented, effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. Early adoption is permitted. The Company did not elect to adopt it early.

In January 2014, the FASB issued ASU 2014-04, "*Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*." The objective of the amendments in ASU 2014-04 to Topic 310, "*Receivables - Troubled Debt Restructurings by Creditors,"* is to reduce diversity by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The amendments are effective for fiscal years beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. An entity can elect to adopt the amendments using either a modified retrospective transition method or a prospective transition method. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company's Consolidated Financial Statements.

(Continued)

NOTE 2 – SECURITIES

The amortized cost and fair value of securities with gross unrealized / unrecognized gains and losses follow:

2014	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
Available-for-sale securities:				
Obligations of states and political subdivisions	$ 2,520	$ 53	$ -	$ 2,573
Mortgage-backed securities-commercial	4,482	-	(11)	4,471
	$ 7,002	$ 53	$ (11)	$ 7,044

2014	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
Held-to-maturity securities:				
Collateralized mortgage obligations	$ 5,792	$ 108	$ (49)	$ 5,851

2013	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
Available-for-sale securities:				
Obligations of states and political subdivisions	$ 1,755	$ -	$ (180)	$ 1,575

Securities with an amortized cost of $10,274 (fair value of $10,435) were pledged at December 31, 2014 to secure FHLB advances. No securities were pledged at December 31, 2013.

(Continued)

NOTE 2 – SECURITIES (Continued)

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

	Held-to-Maturity		Available-for-Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ -	$ -	$ 10	$ 10
Due after one through five years	-	-	45	45
Due after five through ten years	-	-	370	385
Due after ten years	-	-	2,095	2,133
	-	-	2,520	2,573
Mortgage-backed securities - commercial	-	-	4,482	4,471
Collateralized mortgage obligations	5,792	5,851	-	-
	$ 5,792	$ 5,851	$ 7,002	$ 7,044

Securities with unrealized losses at year end 2014 and 2013, aggregated by investment category and length of time that individual securities have been in an unrealized loss position, are as follows:

	Less than 12 Months		12 Months or More		Total	
Description	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
2014						
Available-for-sale securities:						
Mortgage-backed securities-commercial	$ 4,471	$ (11)	$ -	$ -	$ 4,471	$ (11)
Held-to-maturity						
Collateralized mortgage obligations	$ 860	$ (49)	$ -	$ -	$ 860	$ (49)
2013						
Available-for-sale securities:						
Obligations of states and political subdivisions	$ 1,575	$ (180)	$ -	$ -	$ 1,575	$ (180)

Unrealized losses have not been recognized into income because the securities are of high credit quality, management does not intend to sell and it is not more likely than not that management would be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in market interest rates. The fair value is expected to recover as the securities approach their maturity date and/or market rates decline.

For the years ended December 31, 2014 and 2013, there were no sales of securities.

(Continued)

NOTE 3 – LOANS

A summary of the balances of loans follows:

	2014	2013
Residential loans:		
Residential	$ 92,573	$ 93,769
Home equity	38,590	39,638
Residential construction	2,822	2,677
Total residential loans	133,985	136,084
Commercial real estate loans:		
Commercial real estate	74,354	71,915
Commercial construction	-	3,348
Total commercial real estate loans	74,354	75,263
Commercial loans	26,739	22,858
Consumer loans	4,642	4,390
	239,720	238,595
Less:		
Allowance for loan losses	3,437	4,146
Add:		
Deferred loan origination and other costs, net of fees	88	100
Loans, net	$ 236,371	$ 234,549

(Continued)

NOTE 3 – LOANS (Continued)

The following table presents the activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2014 and 2013:

	Residential	Home Equity	Residential Construction	Commercial Real Estate	Commercial Construction	Commercial	Consumer	Total
December 31, 2014								
Allowance for loan losses:								
Beginning balance	$ 1,623	$ 519	$ 202	$ 1,483	$ 97	$ 191	$ 31	$ 4,146
Provision for loan losses	288	153	(192)	17	(97)	(60)	(5)	104
Loans charged-off	(441)	(227)	-	(213)	-	-	(10)	(891)
Recoveries	12	23	-	25	-	14	4	78
Total ending allowance balance	$ 1,482	$ 468	$ 10	$ 1,312	$ -	$ 145	$ 20	$ 3,437
December 31, 2013								
Allowance for loan losses:								
Beginning balance	$ 1,884	$ 689	$ 18	$ 1,935	$ -	$ 578	$ 34	$ 5,138
Provision for loan losses	46	(102)	184	(339)	97	(378)	3	(489)
Loans charged-off	(312)	(87)	-	(211)	-	(17)	(9)	(636)
Recoveries	5	19	-	98	-	8	3	133
Total ending allowance balance	$ 1,623	$ 519	$ 202	$ 1,483	$ 97	$ 191	$ 31	$ 4,146

(Continued)

NOTE 3 – LOANS (Continued)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and class and based on impairment method as of December 31, 2014 and 2013:

	Residential	Home Equity	Residential Construction	Commercial Real Estate	Commercial Construction	Commercial	Consumer	Total
2014								
Allowance for loan losses:								
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	$ 105	$ 9	$ -	$ 498	$ -	$ 1	$ -	$ 613
Collectively evaluated for impairment	1,377	459	10	814	-	144	20	2,824
Total ending allowance balance	$ 1,482	$ 468	$ 10	$ 1,312	$ -	$ 145	$ 20	$ 3,437
Loans:								
Loans individually evaluated for impairment	$ 5,969	$ 160	$ -	$ 6,959	$ -	$ 136	$ 20	$ 13,244
Loans collectively evaluated for impairment	86,475	38,776	2,828	67,859	-	26,782	4,612	227,332
Total ending recorded investment in loans	$ 92,444	$ 38,936	$ 2,828	$ 74,818	$ -	$ 26,918	$ 4,632	$ 240,576
2013								
Allowance for loan losses:								
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	$ 97	$ 9	$ -	$ 606	$ -	$ 1	$ -	$ 713
Collectively evaluated for impairment	1,526	510	202	877	97	190	31	3,433
Total ending allowance balance	$ 1,623	$ 519	$ 202	$ 1,483	$ 97	$ 191	$ 31	$ 4,146
Loans:								
Loans individually evaluated for impairment	$ 7,655	$ 196	$ -	$ 8,665	$ -	$ 114	$ 30	$ 16,660
Loans collectively evaluated for impairment	85,969	39,788	2,684	63,296	3,353	23,375	4,347	222,812
Total ending recorded investment in loans	$ 93,624	$ 39,984	$ 2,684	$ 71,961	$ 3,353	$ 23,489	$ 4,377	$ 239,472

(Continued)

NOTE 3 – LOANS (Continued)

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2014 and 2013. For purposes of this disclosure, unpaid principal balance has been reduced by partial charge offs, if any.

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash basis Interest Income Recognized
2014						
With no related allowance recorded:						
Residential	$ 5,036	$ 5,081	$ -	$ 5,400	$ 233	$ 233
Home equity	61	61	-	63	3	3
Commercial real estate	2,684	2,727	-	3,123	113	113
Commercial	92	93	-	97	6	6
Consumer	4	5	-	8	-	-
	7,877	7,967	-	8,691	355	355
With an allowance recorded:						
Residential	882	888	105	885	34	34
Home equity	99	99	9	102	6	6
Commercial real estate	4,037	4,232	498	4,264	116	116
Commercial	42	43	1	44	2	2
Consumer	16	15	-	17	1	1
	5,076	5,277	613	5,312	159	159
	$ 12,953	$ 13,244	$ 613	$ 14,003	$ 514	$ 514
2013						
With no related allowance recorded:						
Residential	$ 5,825	$ 5,878	$ -	$ 6,367	$ 260	$ 260
Home equity	73	75	-	77	5	5
Commercial real estate	5,505	5,606	-	5,798	281	281
Commercial	70	70	-	55	4	4
Consumer	11	11	-	13	1	1
	11,484	11,640	-	12,310	551	551
With an allowance recorded:						
Residential	1,769	1,778	97	1,815	75	75
Home equity	120	121	9	122	5	5
Commercial real estate	2,964	3,058	606	3,092	65	65
Commercial	44	44	1	47	3	3
Consumer	18	19	-	20	1	1
	4,915	5,020	713	5,096	149	149
	$ 16,399	$ 16,660	$ 713	$ 17,406	$ 700	$ 700

(Continued)

NOTE 3 – LOANS (Continued)

The following table presents the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of December 31, 2014 and 2013:

	2014		2013	
	Nonaccrual	Loans Past Due Over 90 Days Still Accruing	Nonaccrual	Loans Past Due Over 90 Days Still Accruing
Residential	$ 552	$ 288	$ 1,736	$ 305
Home equity	92	5	10	15
Commercial real estate	3,197	-	4,101	-
Consumer	52	-	11	-
Total	$ 3,893	$ 293	$ 5,858	$ 320

The following table presents the aging of the recorded investment in past due loans as of December 31, 2014 and 2013 by class of loans:

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans not Past Due	Total
2014						
Residential	$ 800	$ 323	$ 439	$ 1,562	$ 90,882	$ 92,444
Home equity	176	77	62	315	38,621	38,936
Residential construction	-	-	-	-	2,828	2,828
Commercial real estate	-	92	120	212	74,606	74,818
Commercial construction	-	-	-	-	-	-
Commercial	29	-	-	29	26,889	26,918
Consumer	122	4	-	126	4,506	4,632
Total recorded investment	$ 1,127	$ 496	$ 621	$ 2,244	$ 238,332	$ 240,576

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans not Past Due	Total
2013						
Residential	$ 924	$ 487	$ 1,862	$ 3,273	$ 90,351	$ 93,624
Home equity	387	160	15	562	39,422	39,984
Commercial real estate	44	44	610	698	71,263	71,961
Residential construction	-	-	-	-	2,684	2,684
Commercial construction	-	-	-	-	3,353	3,353
Commercial	40	-	-	40	23,449	23,489
Consumer	8	62	-	70	4,307	4,377
Total recorded investment	$ 1,403	$ 753	$ 2,487	$ 4,643	$ 234,829	$ 239,472

(Continued)

NOTE 3 – LOANS (Continued)

Troubled Debt Restructurings:

Bancorp has allocated $612 and $625 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2014 and 2013. Bancorp has committed to lend $17 as of December 31, 2014 and $1 as of December 31, 2013 to customers with outstanding loans that are classified as troubled debt restructurings.

During the years ended December 31, 2014 and 2013, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk.

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 1 years to 30 years. Modifications involving an extension of the maturity date were for periods ranging from 1 year to 30 years.

The following table presents loans by class modified as troubled debt restructurings that occurred during the years ended December 31, 2014 and 2013:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
2014			
Troubled Debt Restructurings:			
Residential	3	$ 2,639	$ 2,639
Commercial	2	57	57
Total	5	$ 2,696	$ 2,696

The troubled debt restructurings described above increased the allowance for loan losses by $33 and resulted in charge offs of $10 during the year ended December 31, 2014.

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
2013			
Troubled Debt Restructurings:			
Residential	9	$ 568	$ 568
Home equity	2	51	51
Consumer	1	11	11
Total	12	$ 630	$ 630

The troubled debt restructurings described above increased the allowance for loan losses by $26 and resulted in charge offs of $12 during the year ended December 31, 2013.

(Continued)

NOTE 3 – LOANS (Continued)

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within the twelve months following the modification during the years ended December 31, 2014 and 2013:

	2014		2013	
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Residential	1	$ 41	5	$ 420
Home equity	-	-	1	7
Commercial real estate	-	-	1	73
Commercial	-	-	1	70
Total	1	$ 41	8	$ 570

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

The troubled debt restructurings that subsequently defaulted described above did not materially increase the allowance for loan losses during the years ended December 31, 2014 or 2013. These did not result in material charge offs during the years ended December 31, 2014 or 2013.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under Bancorp's internal underwriting policy.

Credit Quality Indicators:

Bancorp categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. Bancorp analyzes loans individually by classifying the loans as to credit risk. This analysis includes loans with an outstanding balance greater than $250 and non-homogeneous loans, such as commercial and commercial real estate loans, unless such loans have a government guaranty. This analysis is performed on a quarterly basis. Bancorp uses the following definitions for risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

(Continued)

NOTE 3 – LOANS (Continued)

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, condition, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. Loans listed as not rated are either less than $250 or are included in groups of homogeneous loans. Management monitors loans reported to be not rated by segregating between performing and nonperforming loans, which generally uses delinquency statistics. As of December 31, 2014 and 2013, and based on the most recent analysis performed, the risk category of loans (recorded investment) is as follows:

	Pass	Special Mention	Substandard	Doubtful	Not Rated	Total
2014						
Residential	$ 13,536	$ 804	$ 6,111	$ -	$ 71,993	$ 92,444
Home equity	3,498	-	-	-	35,438	38,936
Residential construction	26	-	-	-	2,802	2,828
Commercial real estate	60,323	8,241	6,254	-	-	74,818
Commercial	14,688	1,127	35	-	11,068	26,918
Consumer	400	-	-	-	4,232	4,632
Total	$ 92,471	$ 10,172	$ 12,400	$ -	$ 125,533	$ 240,576

	Pass	Special Mention	Substandard	Doubtful	Not Rated	Total
2013						
Residential	$ 15,475	$ 1,709	$ 3,799	$ -	$ 72,641	$ 93,624
Home equity	3,810	-	-	-	36,174	39,984
Commercial real estate	54,145	9,820	7,899	-	97	71,961
Residential construction	-	-	-	-	2,684	2,684
Commercial construction	3,353	-	-	-	-	3,353
Commercial	12,806	1,502	71	-	9,110	23,489
Consumer	358	-	-	-	4,019	4,377
Total	$ 89,947	$ 13,031	$ 11,769	$ -	$ 124,725	$ 239,472

(Continued)

NOTE 4 – PREMISES AND EQUIPMENT

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

	2014	2013
Land	$ 1,404	$ 1,387
Land improvements	153	153
Office buildings	8,648	8,579
Furniture, fixtures and equipment	5,303	5,136
Leasehold improvements	50	-
Construction in progress	598	-
Total premises and equipment	16,156	15,255
Less accumulated depreciation	(8,652)	(8,142)
Net carrying amount	$ 7,504	$ 7,113

Depreciation expense for the years ended December 31, 2014 and 2013 amounted to $509 and $504, respectively.

NOTE 5 – SERVICING

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balance of mortgages and other loans serviced for others approximated $181,270 and $184,993 at December 31, 2014 and 2013, respectively.

The fair values of the rights to service these loans were $1,672 and $1,777 at December 31, 2014 and 2013. The fair value of servicing rights at December 31, 2014 was determined using a discount rate of 8% and prepayment speeds ranging from 148 PSA to 495 PSA. The fair value of servicing rights at December 31, 2013 was determined using a discount rate of 8% and prepayment speeds ranging from 159 PSA to 494 PSA.

The following summarizes the activity in mortgage servicing rights and the related valuation allowance:

	2014	2013
Mortgage servicing rights:		
Balance at beginning of year	$ 1,501	$ 1,273
Mortgage servicing rights capitalized	186	286
Mortgage servicing rights amortized	(311)	(290)
Change in valuation allowance	37	232
Balance at end of year	$ 1,413	$ 1,501
Valuation allowance:		
Balance at beginning of year	$ 138	$ 370
Additions	28	41
Reductions	(65)	(273)
Write-downs	-	-
Balance at end of year	$ 101	$ 138

(Continued)

NOTE 6 – EQUITY AND LIMITED PARTNERSHIP INVESTMENTS

The Bancorp has various equity and limited partnership investments. The following table summarizes the Bancorp's investments recorded as of December 31, 2014 and 2013:

			December 31, 2014			December 31, 2013		
Investment	Year Invested	Ownership %	Asset (a)	Unfunded Commitment (b)	Amortization/ Impairment (c)	Asset (a)	Unfunded Commitment (b)	Amortization/ Impairment (c)
Pedcor	2003	24.75%	$ -	$ -	$ 70	$ 70	$ -	$ 112
TGap	2003	1.23	103	-	17	141	25	3
TGap 2	2008	.95	239	80	(16)	222	130	6
Great Lakes XX	2010	4.878	414	21	37	452	22	36
Great Lakes XX-2	2012	4.546	409	22	49	442	278	39
Great Lakes XX-3	2014	7.692	1,000	923	2	-	-	-
Totals			$ 2,165	$ 1,046	$ 159	$ 1,327	$ 455	$ 196

(a) Investments are included in other assets on the consolidated balance sheets at December 31, 2014 and 2013.

(b) Unfunded commitments are included in other liabilities on the consolidated balance sheets at December 31, 2014 and 2013.

(c) Amortization / impairment expense is included in other noninterest expense on the consolidated income statements at December 31, 2014 and 2013.

The Pedcor investment represents an interest in a limited partnership operating in Elkhart County, Indiana. The limited partnership was formed to construct and operate multi-family housing units. All income, expenses and tax credits will be allocated to Bancorp based upon ownership percentage. As an investor, Bancorp is able to exercise influence over operating and financial policies of the management through provisions of the partnership agreement that require a majority approval of the limited partners. At such time as the project is sold, the limited partners will receive a share of the net proceeds proportionate to each limited partner's outstanding capital balance. Under the terms of the limited partnership agreement, Bancorp is allocated tax losses and affordable housing federal income tax credits.

The TGap investments represent investments in venture capital limited partnerships that mostly invest in medical research companies Bancorp anticipates receiving income in the future from the sale of these medical research companies to a third party. There were no distributions from the venture capital limited partnerships in 2014 and 2013.

The Great Lakes investments represent interests in limited partnerships operating in St. Joseph County, Michigan. The limited partnerships were formed to rehabilitate and operate multi-family housing units. All income, expenses and tax credits will be allocated to Bancorp based upon ownership percentage. As an investor, Bancorp is able to exercise influence over operating and financial policies of the management through provisions of the partnership agreements that require a majority approval of the limited partners. At such time as the projects are sold, the limited partners will receive a share of the net proceeds proportionate to each limited partner's outstanding capital balance. Under the terms of the limited partnership agreements, Bancorp is allocated tax losses and affordable housing federal income tax credits.

(Continued)

NOTE 6 – EQUITY AND LIMITED PARTNERSHIP INVESTMENTS (Continued)

Bancorp's share of tax credits generated by the above partnerships totaled $169 in 2014 and $215 in 2013.

NOTE 7 – DEPOSITS

Interest-bearing deposit balances at December 31 are summarized as follows:

	2014	2013
Savings accounts	$ 72,518	$ 69,833
NOW accounts	69,132	68,052
Time:		
$250,000 and over	1,793	1,967
Under $250,000	39,464	47,462
	$ 182,907	$ 187,314

At December 31, 2014, the scheduled maturities of time deposits are as follows:

Maturing in the Year Ending December 31,	Under $250,000	$250,000 and Over
2015	$ 14,795	$ -
2016	6,952	-
2017	7,270	446
2018	6,537	334
2019	3,738	1,013
Thereafter	172	-
	$ 39,464	$ 1,793

(Continued)

NOTE 8 – FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS

The Bank had advances from the Federal Home Loan Bank of Indianapolis (FHLB) of $41,000 at December 31, 2014 and December 31, 2013, which mature through 2017. At December 31, 2014 and 2013, the interest rates ranged from 2.56% to 2.97%. The advances are subject to prepayment penalties as defined in the credit policy of FHLB. During 2013, the Bank prepaid $7,500 in advances and paid $668 in prepayment penalties.

The Bank has an available six-month line of credit with the FHLB which provides for advances up to $4,000 and matures in May 2015. There were no balances outstanding on this line of credit at December 31, 2014 or 2013.

The advances and 6-month line of credit are collateralized by performing non-employee residential and commercial mortgage loans. The unpaid principal balance of pledged loans was approximately $72,324 and $88,480 at December 31, 2014 and 2013, respectively.

Annual payments of FHLB advances are as follows:

2015	$ 20,500
2016	-
2017	20,500
	$ 41,000

At December 31, 2014 and 2013 the Bank had a $4,000 term loan outstanding with a financial institution which has a 10-year amortization, with a balloon payoff at maturity in July 2015. The outstanding balance of the loan was $3,218 and $3,585 at December 31, 2014 and 2013, respectively. The fixed interest rate on the loan was 3.55% at December 31, 2014 and 2013.

NOTE 9 – FEDERAL INCOME TAXES

Sturgis Bancorp, Inc. and Subsidiaries file a consolidated federal income tax return. The following is a summary of the provision for income taxes for the two years ended December 31:

	2014	2013
Current expense	$ 49	$ (141)
Deferred expense	399	392
	$ 448	$ 251

A reconciliation of the difference between total federal income tax expense and the amount computed by applying the statutory tax rates to income before income taxes is as follows:

	2014	2013
Amount computed at statutory rate	$ 792	$ 639
Tax-exempt income from Bank-owned life insurance	(92)	(95)
Tax-exempt interest income	(90)	(78)
Low-income housing tax credits	(169)	(215)
Other, net	7	-
	$ 448	$ 251

(Continued)

NOTE 9 – FEDERAL INCOME TAXES (Continued)

The components of the net deferred tax asset (liability) are as follows:

	2014	2013
Deferred tax assets:		
Allowance for loan losses	$ 504	$ 677
Unfunded pension liability	117	38
Deferred compensation	322	285
Low-Income housing tax credits	485	556
Alternative minimum tax credits	146	35
Nonaccrual interest income	161	109
Other real estate	70	80
Net operating loss carryforwards	-	423
Unrealized loss on available-for-sale securities	-	61
Other	71	124
	1,876	2,388
Deferred tax liabilities:		
Deferred loan fees	(36)	(46)
Mortgage servicing rights	(484)	(516)
Amortization	(1,748)	(1,744)
Depreciation	(233)	(269)
FHLB stock dividends	(115)	(138)
Unrealized gain on available-for-sale securities	(14)	-
Other	(65)	(98)
	(2,695)	(2,811)
Net deferred tax asset (liability)	$ (819)	$ (423)

At December 31, 2014, Bancorp has a low income housing tax credit carryforward of $485 that begins to expire if unused in the year 2029. The net operating loss carry forward was fully utilized in 2014. The AMT credits do not expire.

Bancorp and its subsidiaries are subject to U.S. federal income tax as well as income tax to the state of Indiana. Bancorp is no longer subject to examination by taxing authorities for years before 2011.

There were no unrecognized tax benefits at December 31, 2014 and Bancorp does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months.

For the years ended 2014 and 2013, interest and penalties related to income tax matters were not material.

(Continued)

NOTE 10 – RETIREMENT BENEFITS

The Bancorp participates in the Pentegra Defined Benefit Plan for Financial Institutions (Pentegra DB Plan), which is a tax-qualified, multi-employer defined benefit pension plan, covering substantially all of the officers and employees of the Bank and its subsidiaries. The defined benefit plan provided benefits to all full-time employees with one year of service, based on basic compensation and years of service. Bancorp contributions are determined by the Plan and generally represent the normal cost of the Plan. Specific Plan assets and accumulated benefit information for Bancorp's portion of the fund are not available. Under the Employee Retirement Income Security Act (ERISA), a contributor to a multi-employer pension plan may be liable in the event of complete or partial withdrawal for the benefit payments guaranteed under ERISA. Bancorp has no present intention to withdraw from the fund, although Bancorp froze future benefits to participants effective March 2, 2011. The Pentegra DB Plan's Employee Identification Number is 13-5645888 and the Plan Number is 333.

The Pentegra DB Plan is a single plan under Internal Revenue Code Section 413(c) and, as a result, all of the assets stand behind all of the liabilities. Accordingly, under the Pentegra DB Plan, contributions made by a participating employer may be used to provide benefits to participants of other participating employers. Total contributions received by the Pentegra DB Plan, as reported on Form 5500, for the plan years ending June 30, 2013 and 2012 totaled $196,473 and $299,729, respectively.

Employer contributions and administrative expenses charged to operations for the years ended December 31, 2014 and 2013 totaled $86 and $76, respectively. Bancorp contributions for 2014 and 2013 were not more than 5% of the total contributions made to the Pentegra DB Plan. There are no collective bargaining agreements in place that require contributions to the plan. The funded status of the plan as of July 1, 2014 and 2013 was 110% and 102%, respectively.

The Bancorp sponsors a non-qualified defined benefit (DB) to provide supplemental retirement benefits for certain executives. These benefits include pre-retirement disability and death benefits, as well as post-retirement payments for 15 years. The following table sets forth the DB activity and other information as of and for the years ended December 31, 2014 and 2013.

	2014	2013
Plan assets at fair value	$ -	$ -
Projected benefit obligation	1,287	942
Underfunded status	$ (1,287)	$ (942)
Accumulated benefit obligation	$ 915	$ 682

(Continued)

NOTE 10 – RETIREMENT BENEFITS (Continued)

Components of Net Periodic Benefit Cost:

	2014	2013
Service cost	$ 54	$ 42
Interest cost	49	44
Amortization of prior service cost	10	10
Amortization of net (gain) loss	(1)	11
Net periodic benefit cost	112	107
Net loss	242	42
Amortization of prior service cost	(10)	(10)
Total recognized in other comprehensive income	232	32
Total recognized in net periodic benefit cost and other comprehensive income	$ 344	$ 139

Amounts reported in accumulated other comprehensive income at December 31 consist of:

	2014	2013
Net actuarial loss (gain)	$ 226	$ (16)
Prior service cost	119	129
	$ 345	$ 113
Actuarial assumptions:		
Weighted average discount rate	4.19%	5.11%
Increase in future compensation levels	2.25	2.25

The Bancorp does not expect to contribute to the plan in 2014.

The estimated net loss and prior service cost for the plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost during the year ending December 31, 2014 are not significant.

To fund the DB obligation and other employee benefits, Bancorp has purchased insurance policies on the lives of certain officers of the Bank. Bancorp is owner and beneficiary of these policies. At December 31, 2014 and 2013, the cash value of all bank-owned life insurance policies was $9,808 and $9,537, respectively. The cash value is available to fund future benefit obligations. There were no supplemental retirement benefits paid by the DB during 2014 or 2013. The Bancorp does not anticipate paying benefits in connection with this plan over the next five years, with $27 anticipated to be paid in 2020 and $46 anticipated to be paid in 2021.

(Continued)

NOTE 11 – MINIMUM REGULATORY CAPITAL REQUIREMENTS

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. 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.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios, as set forth in the following table. Total capital, Tier 1 capital, risk-weighted assets and average assets are measures used to analyze capital adequacy. These measures are defined in federal banking regulations. Ratios must be met regarding total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets.

At December 31, 2014 and 2013, the Federal Deposit Insurance Corporation categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since December 31, 2014 that management believes have changed the Bank's well-capitalized status.

The Bank's actual capital amounts and ratios at December 31, 2014 and 2013 were as follows:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2014						
Total capital (to risk weighted assets)	$ 32,861	16.1%	$ 16,368	8.0%	$ 20,460	10.0%
Tier 1 capital (to risk weighted assets)	30,292	14.8	8,184	4.0	12,276	6.0
Tier 1 capital (to adjusted total assets)	30,292	9.8	12,340	4.0	15,425	5.0
December 31, 2013						
Total capital (to risk weighted assets)	$ 31,485	15.5%	$ 16,255	8.0%	$ 20,319	10.0%
Tier 1 capital (to risk weighted assets)	28,925	14.2	8,128	4.0	12,191	6.0
Tier 1 capital (to adjusted total assets)	28,925	9.4	12,261	4.0	15,326	5.0

NOTE 12 – OFF-BALANCE-SHEET ACTIVITIES

Credit-Related Financial Instruments: Bancorp 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. To various degrees, such commitments involve elements of credit and interest rate risk in excess of the amount recognized on the consolidated balance sheet.

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

(Continued)

NOTE 12 – OFF-BALANCE-SHEET ACTIVITIES (Continued)

At December 31, 2014 and 2013, the following financial instruments with credit risk were outstanding:

	2014	2013
Commitments to grant loans	$ 4,434	$ 1,318
Unfunded commitments under lines of credit	38,990	35,053
Commercial and standby letters of credit	1,130	880

Commitments to extend credit are agreements to lend to a customer, as long as there are no violations of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of fees. These commitments, especially related to equity lines of credit, may expire without being drawn. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral secured by Bancorp is based on management's credit evaluation of the customer.

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. The equity and commercial lines of credit are collateralized, may not have a specified maturity date, and may be drawn to the full extent of Bancorp's commitment.

Commercial and standby letters of credit are conditional commitments issued by Bancorp to guarantee the performance of a customer to a third party. The letters of credit are primarily used to support public and private borrowing arrangements. All letters of credit issued by Bancorp have expiration dates within one year.

NOTE 13 – RELATED PARTY TRANSACTIONS

In the ordinary course of business, Bancorp has granted loans to principal officers, directors and affiliates. A summary of the related party loan transactions for the years ended December 31, 2014 and 2013 is as follows:

	2014	2013
Related party loans - beginning of the year	$ 887	$ 2,262
Advances	1,590	362
Changes in related parties	355	-
Principal repayments	(216)	(1,737)
Related party loans – end of the year	$ 2,616	$ 887

(Continued)

NOTE 13 – RELATED PARTY TRANSACTIONS (Continued)

Deposits from related parties held by the Bank at December 31, 2014 and 2013 approximated $5,861 and $2,229, respectively.

A director of Bancorp is a stockholder in a law firm that provides legal counsel to Bancorp and its subsidiaries. Legal fees and disbursements to the law firm totaled $201 and $151 for 2014 and 2013, respectively.

NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

> Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
>
> Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
>
> Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of securities are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

The fair value of loans held for sale is based upon binding quotes from third party investors. (Level 2 inputs).

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments can be significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

(Continued)

NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments can be significant and typically result in a Level 3 classification of the inputs for determining fair value. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Appraisals for both collateral-dependent impaired loans and real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Bancorp. Once received, an officer reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, the Bancorp compares the actual selling price of collateral that has been sold to the most recent appraised value to determine what additional adjustment should be made to the appraisal value to arrive at fair value.

Assets and liabilities measured at fair value on a recurring basis, including financial assets and liabilities for which the Bancorp has elected the fair value option, are summarized below:

		Fair Value Measurements at December 31, 2014 Using:		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Obligations of states and political subdivisions	$ 2,573	$ -	$ 2,573	$ -
Mortgage-backed securities - commercial	4,471	-	4,471	-
Total investment securities available-for-sale	$ 7,044	$ -	$ 7,044	$ -
Loans held for sale	$ 1,716	$ -	$ 1,716	$ -

(Continued)

NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

		Fair Value Measurements at December 31, 2013 Using:		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Obligations of states and political subdivisions	$ 1,575	$ -	$ 1,575	$ -
Total investment securities available-for-sale	$ 1,575	$ -	$ 1,575	$ -
Loans held for sale	$ 1,034	$ -	$ 1,034	$ -

Financial Instruments Recorded Using Fair Value Option

The Bancorp has elected the fair value option for loans held for sale. These loans are intended for sale and the Bancorp believes the fair value is the best indicator of the resolution of these loans. Interest income is recorded based on the contractual terms of the loan and in accordance with the Bancorp's policy on loans held for investment. None of these loans are 90 days or more past due or on nonaccrual as of December 31, 2014 and 2013.

As of December 31, 2014 and 2013, the aggregate fair value, contractual balance (including accrued interest), and gain or loss was as follows:

	2014	2013
Aggregated fair value	$ 1,716	$ 1,034
Contractual balance	1,697	1,017
Gain	19	17

The total amount of gains and losses from changes in fair value included in earnings for the years ended December 31, 2014 and 2013 for loans held for sale were:

	2014	2013
Interest income	$ 4	$ 45
Interest expense	-	-
Change in fair value	2	(19)

(Continued)

NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

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

		Fair Value Measurements at December 31, 2014 Using:		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Real estate owned:				
Residential	$ 1,200	$ -	$ -	$ 1,200
Commercial real estate	408	-	-	408

		Fair Value Measurements at December 31, 2013 Using:		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Real estate owned:				
Residential	$ 275	$ -	$ -	$ 275
Commercial real estate	355	-	-	355

Other 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 Bancorp'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.

The following methods and assumptions were used by Bancorp in estimating fair value disclosures for financial instruments unless previously described:

Cash and Cash Equivalents: The carrying amounts of cash and short-term instruments approximate fair values.

(Continued)

NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

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

FHLB stock: It was not practicable to estimate the fair value of FHLB stock due to restrictions 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, as adjusted for estimated credit losses. Fair values for other loans (e.g., commercial real estate and investment property mortgage loans, commercial and industrial 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 for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Deposits: The fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings, and certain types of money market accounts) 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.

FHLB Advances and Other Borrowings: The carrying amount of short-term FHLB advances, federal funds purchased, and other borrowings is a reasonable estimate of their fair value due to their variable interest rates and short-term maturities. The estimated fair value of long-term FHLB is determined by discounting the future cash flows of outstanding advances using rates currently available on advances from the FHLB with similar characteristics.

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

Off-Balance-Sheet Instruments: Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of off-balance sheet items is not considered material.

(Continued)

NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The estimated fair values and related carrying or notional amounts of Bancorp's financial instruments that are not previously presented are as follows:

	2014		2013	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	$ 12,049	$ 12,049	$ 20,874	$ 20,874
Interest-earning deposits in banks	16,575	16,703	14,914	15,018
Securities – held to maturity	5,792	5,851	-	-
FHLB stock	3,409	N/A	4,064	N/A
Loans in portfolio, net (including impaired)	236,371	237,654	234,549	235,783
Accrued interest receivable	868	868	828	828
Financial liabilities:				
Deposits	$ 234,290	$ 225,784	$ 229,020	$ 216,050
Accrued interest payable	238	238	272	272
FHLB advances and other borrowings	44,218	45,457	44,585	46,365

NOTE 15 – GOODWILL

Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value, which is determined through an impairment test that is performed at least annually or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed. The Bancorp performed a qualitative assessment to determine if it was more likely than not that the fair value of the reporting unit exceeds its carrying value, including goodwill at December 31, 2014. The results of the qualitative assessment indicated that the fair value of the reporting unit exceeded its carrying amount. Consequently, no additional impairment testing was necessary.

NOTE 16 – RESTRICTIONS ON DIVIDENDS

Banking regulations place certain restrictions on dividends paid and loans or advances made by the Bank to Bancorp. The total amount of dividends that may be paid at any date is generally limited to the retained earnings of the Bank. However, 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. At December 31, 2014, the Bank's retained earnings available for the payment of dividends was $7,332. Accordingly, approximately $26,132 of Bancorp's investment in the Bank was restricted at December 31, 2014.

Loans or advances made by the Bank to Bancorp are generally limited to 10% of the Bank's capital stock and surplus and require the pledging of collateral.

(Continued)

NOTE 17 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following tables present changes in accumulated other comprehensive income (loss) by component, net of tax, for the years ended December 31, 2014 and 2013:

	Unrealized Gains and Losses On Available-for-Sale Securities	Defined Benefit Pension Items	Total
2014			
Beginning balance	$ (119)	$ (75)	$ (194)
Other comprehensive income before reclassification	147	(160)	(13)
Amounts reclassified from accumulated other comprehensive income	-	7	7
Net current period other comprehensive income (loss)	147	(153)	(6)
Ending balance	$ 28	$ (228)	$ (200)
2013			
Beginning balance	$ 8	$ (54)	$ (46)
Other comprehensive income before reclassification	(127)	(28)	(155)
Amounts reclassified from accumulated other comprehensive income	-	7	7
Net current period other comprehensive income (loss)	(127)	(21)	(148)
Ending balance	$ (119)	$ (75)	$ (194)

NOTE 18 - ACQUISITION

On November 12, 2014, the Company announced the signing of a definitive agreement to acquire West Michigan Savings Bank ("WMSB"). WMSB operates one location in Bangor, Michigan with December 31, 2014 total assets of $35.9 million (unaudited), deposits of $32.4 million (unaudited), and equity of $3.1 million (unaudited). Under the terms of the agreement, WMSB will be consolidated into Sturgis Bank & Trust Company in an all-cash transaction valued at $4.0 million. The ultimate purchase price is subject to adjustment in the event that WMSB does not maintain a specified level of shareholders' equity when the transaction closes or if the costs of funding and terminating WMSB's pension plan exceed a specified amount. During 2014, the Company realized $192 of expenses related to this acquisition, primarily in professional services. The transaction is expected to close near the end of the first quarter of 2015.

Sturgis Bancorp, Inc.

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John R. Dresser
Eric L. Eishen
David L. Franks
Michael R. Frost
Jeffrey M. Mohney
John T. Wiedlea

Executive Officers

Eric L. Eishen, President, Chief Executive Officer
Brian P. Hoggatt, CFO, Treasurer
Ronald W. Scheske, Executive Vice President, COO

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Sturgis Bank
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South Haven	**Sturgis**	**Three Rivers**	**White Pigeon**	
269-637-8444	269-651-9345	269-273-8481	269-483-9668	
269-637-6644	269-651-9379			

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