

# 2015 ANNUAL REPORT



*Helping good people make good decisions.*

# LEADERSHIP

## DIRECTORS

CROGHAN BANCSHARES, INC  
CROGHAN COLONIAL BANK

James E. Bowlus, Lead Director  
Retired

Michael D. Allen Sr.  
Executive Vice President/General Manager  
International Metal Hose Company

John J. Caputo  
Co-Owner/Vice President  
Jack Bradley Realty Company

James C. Dunn  
Co-Owner  
Dunn Chevrolet Buick

James R. Faist  
Retired

Claire F. Johansen  
Co-Owner  
Lane of Dreams Farm,, LLC

Stephen A. Kemper  
Owner  
Kemper Iron & Metal Company

Daniel W. Lease  
Retired

Thomas W. McLaughlin  
President/CEO  
Wall Street Consulting, Inc.

Allan E. Mehlow  
Chief Financial Officer  
The Mosser Group/WMOG, Inc.

Rick M. Robertson  
President/CEO  
Croghan Colonial Bank

Gary L. Zimmerman  
Owner/Partner  
Swint-Reineck Company

## OFFICERS

CROGHAN BANCSHARES, INC

Rick M. Robertson  
President/CEO

Kendall W. Rieman  
Vice President/Treasurer

Barry F. Luse  
Vice President/Secretary

Stacy A. Cox  
Vice President

Daniel N. Schloemer  
Vice President

## SENIOR MANAGEMENT

CROGHAN COLONIAL BANK

Rick M. Robertson  
President/CEO

Kendall W. Rieman  
Executive Vice President/CFO

Stacy A. Cox  
Senior Vice President/COO

Carrie L. Dickinson  
Senior Vice President/CCO

Barry F. Luse  
Senior Vice President/Trust Officer

Daniel N. Schloemer  
Senior Vice President/CLO

Jodi A. Albright  
Vice President/Main Office Manager

Charles T. Barteck  
Vice President/Retail Sales Manager

Melissa A. Walker  
Vice President/Retail Operations Manager

Laura M. Whipple  
Vice President/Human Resource Manager

## DIRECTORS EMERITI

Steven C. Futrell

Ted L. Hilty

Don W. Miller

Robert H. Moyer

J. Terrence Wolfe

# CROGHAN BANCSHARES, INC.

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### **Investor Relations**

Croghan Bancshares, Inc.  
Amy LeJeune  
323 Croghan Street  
Fremont, OH 43420  
419-332-7301  
1-888-276-4426  
[www.croghan.com](http://www.croghan.com)

### **Availability of More Information**

To obtain a free copy of the Corporation's Annual Report for the year ended December 31, 2015, or for other information, contact us by one of the methods noted above.

### **Market Maker**

Boenning & Scattergood  
9916 Brewster Lane  
Powell, Ohio 43065  
Toll-Free: 1-866-326-8113

### **Annual Meeting**

The Annual Meeting of Shareholders will be held on Tuesday, May 10, 2016 1:00 pm (local time) at Terra State Community College Neeley Conference Center 2830 Napoleon Road Fremont, Ohio 43420

## A Message from CEO Rick Robertson

2015 was a very successful year for our company. I am pleased to be able to share positive news regarding our financial performance, dividends and equity position, our growing loan portfolio, our continuing strong credit quality, geographic expansion, and advances in technology for our customers.

Highlights for 2015 include:

- Net Income of \$8.4 million, a 1.07% ROA
- Loans are up \$44.9 million, an increase of 9%
- Dividends declared in 2015 totaled \$1.37 per share, a 4.6% increase over the \$1.31 per share in 2014

Our 2015 Net Income was \$8.4 million compared to \$8.6 million in 2014 and \$4.4 million in 2013. Net Interest Margin in 2015 was 3.94%, which is above the 3.92% in 2014 and 3.30% in 2013. Non-Interest Expenses were \$22.9 million in 2015 and increased a modest 4.3% over 2014. Our improving credit quality and relatively low charge offs allowed us to reduce our provision for loan loss expense to \$350,000 in 2015 from \$740,000 in 2014. Both a 1.07% Return on Average Assets in 2015 and a 1.08% Return on Average Assets in 2014 provide us a good earning base. Having a return of those levels helps us to be a high performing community bank, a goal we have, and continue to have for the future.

Our Stockholders' Equity ended 2015 at \$98.8 million which certainly helps maintain our well capitalized position. The \$0.35 quarterly dividend declared in December 2015 (and paid in January 2016) brought our total dividends declared in 2015 to \$1.37 per share. This annual dividend amount represents a 4.6% increase over the \$1.31 declared in 2015 and a 7.0% increase over the \$1.28 in dividends declared in 2014. Our Board has also authorized a stock buyback plan for a number of potentially beneficial reasons, including the benefit of increased earnings per share to shareholders.

The \$44.9 million growth in the loan portfolio was critical for us to maintain our high performance expectations. While commercial real estate provided the largest growth category for our lending team, we also had important growth in our commercial lending, auto lending, and other consumer lending. Residential real estate lending has also been an important component of our lending program. In addition, our credit quality metrics improved including net charge offs of \$157,000 in 2015, compared to net charge offs of \$518,000 in 2014.

Croghan Colonial Bank has a long and rich history of community support. From our beginning in 1888 to 2015, the bank and our employees have donated money and time to enrich our communities. I believe this is a part of our cultural makeup and we plan for that to continue. I do not have space in this letter to list all of our involvement, but I thought a partial listing of major items of financial support would provide an important perspective.

- Fremont R. B. Hayes Presidential Library
- Port Clinton Athletic Complex
- Norwalk All-Sports Athletic Complex
- Bellevue Central Park Pavilion
- Clyde Flier Football Foundation
- Monroeville Athletic Complex
- Tiffin Ritz Theater

We have been fortunate to work with many dedicated community groups to advance a number of projects.

Bank technology is rapidly changing and we have committed to provide enhancements to our customers. Our 2015 progress includes a number of electronic banking additions including Croghan Alerts, which allow customers to receive real time activity alerts on their accounts. Loan e-Statements are now available similar to the very popular Deposit e-Statements already in place. New EMV Chip credit and debit cards are available and are being issued as new or replacement cards are issued. The introduction of our branded Mobile Banking app has made it easy to find the Croghan Colonial Bank app on your phone or tablet. This app continues to offer easy access to your bank information 24/7/365.

On the front cover of this Annual Report you will see our tagline "Helping Good People Make Good Decisions." This just seems to fit who we are. In addition to providing additional technology, we continue to care about relationship banking, providing the financial help our customers need. In support of that, we have also added our newest branch in Port Clinton and have expanded and moved our loan production office to Maumee.

We believe we are well positioned for the future. On behalf of our Board and our employees, thank you for your continued support.



Rick Robertson  
President & CEO

# CROGHAN BANCSHARES, INC.

## DESCRIPTION OF THE CORPORATION

Croghan Bancshares, Inc. ("Croghan"), an Ohio corporation, is a bank holding company incorporated in 1983 with \$797,412,000 in total assets as of December 31, 2015. Croghan owns all of the outstanding shares of The Croghan Colonial Bank ("Bank"), an Ohio state-chartered bank incorporated in 1888 and headquartered in Fremont, Ohio.

The Bank offers a diverse range of commercial and retail banking services through its 17 banking centers located in Bellevue, Clyde, Curtice, Fremont, Green Springs, Monroeville, Norwalk, Oak Harbor, Oregon, Port Clinton, and Tiffin Ohio, as well as one Loan Production office located in Maumee Ohio. Products are comprised of traditional banking services such as consumer, commercial, agricultural and real estate loans, personal and business checking accounts, savings accounts, time deposit accounts, safe deposit box services, and trust department services. Investment products bearing no FDIC insurance are offered through the Bank's Trust and Investment Services Division.

## MARKET PRICE AND DIVIDENDS ON COMMON SHARES

Croghan's common shares are quoted on the OTCQX under the symbol "CHBH." The following shows the range of high and low price quotations, as reported on the OTCQX, for Croghan's common shares for each quarterly period during 2015 and 2014. OTCQX quotations reflect inter-dealer prices, without mark-up, mark-down, or commission and may not necessarily represent actual transactions.

	2015		2014	
	Low	High	Low	High
First Quarter	\$32.89	\$34.37	\$34.40	\$35.12
Second Quarter	32.91	35.79	32.65	35.20
Third Quarter	33.36	35.79	33.19	36.00
Fourth Quarter	33.35	35.50	34.05	36.00

Net income, basic net income per share data, and dividends declared by Croghan on its common shares during the past two years are as follows (dollars in thousands, except per share data):

2015	Net income	Basic net income per share	Dividend per share
First quarter	\$2,149	\$ .94	\$ .34
Second quarter	1,970	.86	.34
Third quarter	2,202	.97	.34
Fourth quarter	<u>2,079</u>	<u>.91</u>	<u>.35</u>
Total	<u>\$8,400</u>	<u>\$3.68</u>	<u>\$1.37</u>
2014	Net income	Basic net income per share	Dividend per share
First quarter	\$2,204	\$ .97	\$ .32
Second quarter	2,222	.98	.32
Third quarter	2,251	.99	.33
Fourth quarter	<u>1,940</u>	<u>.85</u>	<u>.34</u>
Total	<u>\$8,617</u>	<u>\$3.79</u>	<u>\$1.31</u>

The ability of Croghan to declare and pay dividends on its common shares is dependent, in large part, on dividends received from the Bank. The ability of the Bank to pay dividends is subject to certain legal and regulatory limitations described in Note 17 to the consolidated financial statements contained in the Annual Report.

# CROGHAN BANCSHARES, INC.

## THREE YEAR SUMMARY OF SELECTED FINANCIAL DATA

Years ended December 31,  
2015      2014      2013  
(Dollars in thousands, except share data)

Statements of operations:			
Total interest income	\$30,043	\$30,652	\$21,456
Total interest expense	<u>2,208</u>	<u>2,418</u>	<u>2,194</u>
Net interest income	27,835	28,234	19,262
Provision for loan losses	<u>350</u>	<u>740</u>	<u>275</u>
Net interest income, after provision for loan losses	27,485	27,494	18,987
Total non-interest income	6,479	5,817	5,919
Total non-interest expenses	<u>22,881</u>	<u>21,929</u>	<u>19,567</u>
Income before federal income taxes	11,083	11,382	5,339
Federal income taxes	<u>2,683</u>	<u>2,765</u>	<u>892</u>
Net income	<u>\$ 8,400</u>	<u>\$ 8,617</u>	<u>\$ 4,447</u>
Per share of common stock:			
Net income - Basic	\$ 3.68	\$ 3.79	\$ 2.58
Net income - Diluted	3.67	3.78	2.57
Dividends	1.37	1.31	1.28
Book value	<u>43.22</u>	<u>41.01</u>	<u>37.45</u>
Average shares of common stock outstanding	<u>2,284,718</u>	<u>2,275,666</u>	<u>1,720,807</u>
Year-end balances:			
Loans, net	\$524,527	\$479,788	\$470,706
Securities	195,961	225,407	257,509
Total assets	797,412	779,425	817,860
Deposits	650,445	649,270	688,921
Stockholders' equity	<u>98,792</u>	<u>93,619</u>	<u>85,048</u>
Selected ratios:			
Net yield on average interest-earning assets	3.94%	3.92%	3.30%
Return on average assets	1.07	1.08	.69
Return on average stockholders' equity	8.72	9.52	6.60
Net loan charge-offs as a percent of average outstanding net loans	.07	.24	.17
Allowance for loan losses as a percent of year-end loans	.84	.88	.85
Stockholders' equity as a percent of total year-end assets	12.39	12.01	10.40
Number of stockholders of record	994	1,001	994
Number of full-time equivalent employees	205	203	190

### Notes:

- 1) Financial Data for 2015, 2014, and 2013 includes the impact of the December 2013 acquisition of Indebancorp and its bank subsidiary, The National Bank of Ohio, Oak Harbor, Ohio, and the 2013 sale of the Custar branch.

To the Board of Directors  
Croghan Bancshares, Inc.

We have audited the accompanying consolidated financial statements of Croghan Bancshares, Inc. and its subsidiary, which comprise the consolidated balance sheet as of December 31, 2015 and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

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

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

### ***Auditor's Responsibility***

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

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

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

To the Board of Directors  
Croghan Bancshares, Inc.

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Croghan Bancshares, Inc. and its subsidiary as of December 31, 2015 and the results of its operations and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

**Report on Prior Year Financial Statements**

The financial statements of Croghan Bancshares, Inc. and its subsidiary as of December 31, 2014 were audited by other auditors, whose report dated March 10, 2015 expressed an unqualified opinion on those statements.

*Plante & Morse, PLLC*

February 16, 2016



**CROGHAN BANCSHARES, INC.**  
**CONSOLIDATED BALANCE SHEETS**

ASSETS	Years ended December 31,	
	2015	2014
(Dollars in thousands, except per share data)		
CASH AND CASH EQUIVALENTS	\$ 18,101	\$ 13,647
SECURITIES		
Available-for-sale, at fair value	190,089	219,544
Restricted stock	<u>5,872</u>	<u>5,863</u>
Total securities	<u>195,961</u>	<u>225,407</u>
LOANS	528,984	484,052
Less: Allowance for loan losses	<u>4,457</u>	<u>4,264</u>
Net loans	<u>524,527</u>	<u>479,788</u>
PREMISES AND EQUIPMENT, NET	9,950	9,700
CASH SURRENDER VALUE OF LIFE INSURANCE	17,380	17,085
GOODWILL	22,416	22,416
CORE DEPOSIT INTANGIBLE ASSETS, NET	3,163	4,042
ACCRUED INTEREST RECEIVABLE	2,751	2,757
OTHER REAL ESTATE OWNED	287	865
OTHER ASSETS	<u>2,876</u>	<u>3,718</u>
TOTAL ASSETS	<u>\$797,412</u>	<u>\$779,425</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
LIABILITIES		
Deposits:		
Demand, non-interest bearing	\$158,433	\$135,295
Savings, NOW, and Money Market deposits	341,896	331,591
Time	<u>150,116</u>	<u>182,384</u>
Total deposits	650,445	649,270
Federal funds purchased and securities sold under repurchase agreements	22,869	22,450
Borrowed funds	19,362	8,821
Dividends payable	800	776
Other liabilities	<u>5,144</u>	<u>4,489</u>
Total liabilities	<u>698,620</u>	<u>685,806</u>
STOCKHOLDERS' EQUITY		
Common stock, \$12.50 par value. Authorized 6,000,000 shares; issued 2,506,208 shares in 2015 and 2014	31,328	31,328
Surplus	13,219	13,241
Retained earnings	58,362	53,092
Accumulated other comprehensive income	3,463	3,637
Treasury stock, 220,613 shares in 2015 and 223,348 in 2014, at cost	<u>(7,580)</u>	<u>(7,679)</u>
Total stockholders' equity	<u>98,792</u>	<u>93,619</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$797,412</u>	<u>\$779,425</u>

*The accompanying notes are an integral part of the consolidated financial statements.*

# CROGHAN BANCSHARES, INC.

## CONSOLIDATED STATEMENT OF INCOME AND COMPREHENSIVE INCOME

	Years ended December 31,	
	2015	2014
	(Dollars in thousands, except per share data)	
INTEREST INCOME		
Loans, including fees	\$ 25,052	\$24,343
Securities:		
Obligations of U.S. Government agencies and corporations	1,752	3,019
Obligations of states and political subdivisions	2,935	3,002
Other	284	264
Deposits in other banks	<u>20</u>	<u>24</u>
Total interest income	<u>30,043</u>	<u>30,652</u>
INTEREST EXPENSE		
Deposits	1,861	2,045
Other borrowings	<u>347</u>	<u>373</u>
Total interest expense	<u>2,208</u>	<u>2,418</u>
Net interest income	27,835	28,234
PROVISION FOR LOAN LOSSES	<u>350</u>	<u>740</u>
Net interest income, after provision for loan losses	<u>27,485</u>	<u>27,494</u>
NON-INTEREST INCOME		
Trust income	1,474	1,330
Service charges on deposit accounts	2,172	2,200
Gain on sale of loans	676	699
Gain on sale of securities	436	14
Other	<u>1,721</u>	<u>1,574</u>
Total non-interest income	<u>6,479</u>	<u>5,817</u>
NON-INTEREST EXPENSES		
Salaries, wages, and employee benefits	13,011	12,366
Occupancy of premises	1,173	1,140
Amortization of core deposit intangible assets	879	1,011
Other operating	<u>7,818</u>	<u>7,412</u>
Total non-interest expenses	<u>22,881</u>	<u>21,929</u>
Income before federal income taxes	11,083	11,382
FEDERAL INCOME TAXES	<u>2,683</u>	<u>2,765</u>
NET INCOME	<u>\$ 8,400</u>	<u>\$ 8,617</u>
NET INCOME PER SHARE		
Basic	<u>\$ 3.68</u>	<u>\$ 3.79</u>
Diluted	<u>\$ 3.67</u>	<u>\$ 3.78</u>

*The accompanying notes are an integral part of the consolidated financial statements.*

# CROGHAN BANCSHARES, INC.

## CONSOLIDATED STATEMENT OF INCOME AND COMPREHENSIVE INCOME

	Years ended December 31,	
	2015	2014
	(Dollars in thousands)	
NET INCOME	<u>\$ 8,400</u>	<u>\$ 8,617</u>
OTHER COMPREHENSIVE INCOME		
Unrealized gains on available-for-sale securities	172	4,034
Reclassification adjustments for securities gains included in income	<u>(436)</u>	<u>(14)</u>
Net unrealized gains (losses)	<u>(264)</u>	<u>4,020</u>
Income tax effect	<u>(90)</u>	<u>1,366</u>
Other comprehensive income (loss)	<u>(174)</u>	<u>2,654</u>
TOTAL COMPREHENSIVE INCOME	<u>\$ 8,226</u>	<u>\$ 11,271</u>

*The accompanying notes are an integral part of the consolidated financial statements.*

**CROGHAN BANCSHARES, INC.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

Years ended December 31, 2015 and 2014

	Common stock	Surplus	Retained earnings	Accumulated other comprehensive income	Treasury stock	Total
(Dollars in thousands, except per share data)						
<b>BALANCE AT DECEMBER 31, 2013</b>	<b>\$31,328</b>	<b>\$13,361</b>	<b>\$47,460</b>	<b>\$ 983</b>	<b>\$(8,084)</b>	<b>\$85,048</b>
Net income	-	-	8,617	-	-	8,617
Shares issued in connection with exercise of stock options	-	(49)	-	-	226	177
Issuance of restricted stock, net of forfeitures (5,070 shares from treasury)	-	(179)	-	-	179	-
Other comprehensive income	-	-	-	2,654	-	2,654
Stock-based compensation expense	-	108	-	-	-	108
Cash dividends declared, \$1.31 per share	-	-	(2,985)	-	-	(2,985)
<b>BALANCE AT DECEMBER 31, 2014</b>	<b><u>\$31,328</u></b>	<b><u>\$13,241</u></b>	<b><u>\$53,092</u></b>	<b><u>\$3,637</u></b>	<b><u>\$(7,679)</u></b>	<b><u>\$93,619</u></b>
Net income	-	-	8,400	-	-	8,400
Issuance of restricted stock (2,735 shares from treasury)	-	(99)	-	-	99	-
Other comprehensive income	-	-	-	(174)	-	(174)
Stock-based compensation expense	-	77	-	-	-	77
Cash dividends declared, \$1.37 per share	-	-	(3,130)	-	-	(3,130)
<b>BALANCE AT DECEMBER 31, 2015</b>	<b><u>\$ 31,328</u></b>	<b><u>\$13,219</u></b>	<b><u>\$58,362</u></b>	<b><u>\$3,463</u></b>	<b><u>\$(7,580)</u></b>	<b><u>\$98,792</u></b>

*The accompanying notes are an integral part of the consolidated financial statements.*

# CROGHAN BANCSHARES, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,	
	2015	2014
	(Dollars in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 8,400	\$ 8,617
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	820	785
Loan discount accretion	(1,028)	(824)
Core deposit intangible amortization	879	1,010
Deposit premium amortization	451	601
Mortgage service right acquired amortization	162	162
Federal Home Loan Bank acquired accretion	-	83
Provision for loan losses	350	740
Deferred federal income taxes	385	439
Gain on sale of loans	(676)	(699)
Net loss on sale or write-down of other real estate owned	120	-
Increase in cash value of life insurance	(295)	(275)
Net amortization of security premiums and discounts	2,864	3,304
Stock-based compensation expense	77	108
Gain on sale of securities	(436)	(14)
Proceeds from sale of loans, net of originations	476	475
Decrease (increase) in accrued interest receivable	6	337
Decrease (increase) in other assets	775	(292)
Increase (decrease) in other liabilities	<u>270</u>	<u>(1,048)</u>
Net cash provided by operating activities	<u>13,600</u>	<u>13,509</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities of securities	47,898	50,769
Proceeds from sales of restricted stock	-	50
Proceeds from sales of available-for-sale securities	17,299	18,295
Purchases of available-for-sale securities	(38,439)	(35,405)
Purchases of restricted stock	(9)	(876)
Proceeds from sale of other real estate owned	893	931
Proceeds from disposal of premises	-	20
Net decrease (increase) in loans	(44,296)	(9,918)
Additions to premises and equipment	<u>(1,070)</u>	<u>(776)</u>
Net cash provided by (used in) investing activities	<u>(17,724)</u>	<u>23,090</u>

*The accompanying notes are an integral part of the consolidated financial statements.*

# CROGHAN BANCSHARES, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

	Year ended December 31,	
	2015	2014
	(Dollars in thousands)	
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in deposits	\$ 724	\$(40,252)
Increase (decrease) in federal funds purchased and securities sold under repurchase agreements	419	(2,127)
Proceeds from borrowings	12,000	-
Repayments of borrowings	(1,459)	(5,525)
Cash dividends paid	(3,106)	(2,935)
Cash received from exercising options	-	177
Net cash used in (provided by) financing activities	<u>8,578</u>	<u>(50,662)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	4,454	(14,063)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>13,647</u>	<u>27,710</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 18,101</u>	<u>\$ 13,647</u>
SUPPLEMENTAL DISCLOSURES		
Cash paid during the year for:		
Interest	<u>\$ 2,721</u>	<u>\$ 3,202</u>
Federal income taxes	<u>\$ 2,022</u>	<u>\$ 2,040</u>
Non-cash operating and investing activity:		
Transfer of loans to other real estate owned	<u>\$ 435</u>	<u>\$ 920</u>

*The accompanying notes are an integral part of the consolidated financial statements.*

# **CROGHAN BANCSHARES, INC.**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

### **NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Croghan Bancshares, Inc. (the "Corporation") was incorporated on September 27, 1983 in the State of Ohio. The Corporation is a bank holding company and has one wholly-owned subsidiary, The Croghan Colonial Bank (the "Bank"). The Corporation, through its subsidiary, operates in one industry segment, the commercial banking industry. The Bank, an Ohio chartered bank organized in 1888, has its main office in Fremont, Ohio and has branch offices located in Bellevue, Clyde, Curtice, Fremont, Green Springs, Monroeville, Norwalk, Oak Harbor, Oregon, Port Clinton, and Tiffin Ohio. The Bank's primary source of revenue is providing loans to clients primarily located in Huron, Lucas, Ottawa, Sandusky, Seneca, and Wood Counties. Such clients are predominantly small and middle-market businesses and individuals.

Significant accounting policies followed by the Corporation are presented below.

#### **Use of Estimates**

In preparing consolidated financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during each reporting period. Actual results could differ from those estimates. The most significant estimates susceptible to significant change in the near term relate to the determination of the allowance for loan losses, valuation of goodwill and intangible assets, and fair value of securities and other financial instruments.

#### **Principles of Consolidation**

The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation.

The Bank established a trust department in 1990 and the assets held by the Bank in fiduciary or agency capacities for its clients are not included in the consolidated balance sheets as such items are not assets of the Bank.

#### **Cash and Cash Equivalents**

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold which mature overnight or within 90 days.

#### **Restrictions on Cash**

The Bank was required to have a minimum daily average of \$3,150,000 and \$3,106,000 of non-interest bearing cash on hand or on deposit with the Federal Reserve Bank to meet regulatory reserve and clearing requirements at December 31, 2015 and 2014, respectively.

#### **Securities**

The Bank has designated all its securities as available-for-sale. Such securities are carried at fair value, with unrealized gains and losses, net of applicable income taxes, on such securities recognized as a separate component of stockholders' equity.

The cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion is included in interest income from securities, principally using the interest method over the terms of the securities. Declines in the fair value of securities below their cost that are deemed to be other than temporary ("OTTI") are reflected in earnings as realized losses. Management evaluates securities for OTTI at least on a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. Consideration is given to (1) the intent to sell the investment securities and whether it's more likely than not that the Corporation will be required to sell the investment securities prior to recovery, (2) the length of time and extent to which the fair value has been less than cost, and (3) the financial condition and near-term prospects of the issuer. Due to potential changes in conditions, it is at least reasonably possible that changes in management's assessment of OTTI will occur in the near term and that such changes could be material to the amounts reported in the Corporation's consolidated financial statements.

## **NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Restricted stock primarily consists of Federal Home Loan Bank of Cincinnati and Federal Reserve Bank of Cleveland stock. Such securities are carried at cost and evaluated for impairment on an annual basis. Members are required to own a certain amount of stock based on the level of borrowings and other factors and may invest in additional amounts.

Realized gains and losses on sales of securities are recorded on the trade date, using the specific identification method, and are included in non-interest income.

### **Loans**

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

The accrual of interest on real estate and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. Personal loans are typically charged-off no later than 120 days past due and credit card loans are typically charged-off no later than 180 days past due. All interest accrued but not collected for loans that are placed on nonaccrual or charged-off is reversed against interest income. The interest on nonaccrual loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

### **Acquired Loans**

Acquired loans: Purchased loans acquired in a business combination are segregated into three types: pass rated loans with no discount attributable to credit quality, non-impaired loans with a discount attributable at least in part to credit quality, and impaired loans with evidence of significant credit deterioration.

- Pass rated loans (typically performing loans) are accounted for in accordance with Account Standards Codification (ASC) 310-20 "Nonrefundable Fees and Other Costs" as these loans do not have evidence of credit deterioration since origination.

- Non-impaired loans (typically past-due loans, special mention loans, and performing substandard loans) are accounted for in accordance with ASC 310-30 "Receivables - Loans and Debt Securities Acquired with Deteriorated Credit Quality" as they display at least some level of credit deterioration since origination.

- Impaired loans (typically substandard loans on non-accrual status) are accounted for in accordance with ASC 310-30 as they display significant credit deterioration since origination. In accordance with ASC 310-30, for both purchased non-impaired loans and purchased impaired loans, the difference between contractually required payments at acquisition and the cash flows expected to be collected is referred to as the non-accretable difference. This amount is not recognized as a yield adjustment or as a loss accrual or a valuation allowance. Furthermore, any excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable yield and is recognized into interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows. Increases in expected cash flows subsequent to the initial investment are recognized prospectively through adjustment of the yield on the loan over its remaining estimated life. Decreases in expected cash flows are recognized immediately as impairment. If the Bank does not have the information necessary to reasonably estimate cash flows to be expected, it may use the cost recovery method or cash basis method of income recognition. Valuation allowances on these impaired loans reflect only losses incurred after the acquisition.

### **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 income. 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 collectability 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 as more information becomes available.



## **NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

The allowance consists of specific, general, and unallocated components. For loans that are classified as impaired, a specific reserve is established when the discounted cash flow (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers classified (i.e., substandard or special mention) loans which are not impaired, as well as non-classified loans and is generally based on historical loss experience adjusted for qualitative factors. The unallocated component is maintained to cover economic and other external factors that could affect management's estimate of probable losses and considers the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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

Under certain circumstances, the Bank may provide borrowers relief through loan restructurings. A restructuring of debt constitutes a troubled debt restructuring (TDR) if the Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. Concessions may include reduction of interest rates, extension of maturity dates, forgiveness of principal or interest due, or acceptance of other assets in full or partial satisfaction of the debt. TDR loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment, as previously described. TDR loans that have performed as agreed under the restructured terms for a period of 12 months or longer may cease to be reported as a TDR loan. However, the loan continues to be individually evaluated for impairment.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential mortgage loans for impairment disclosures.

### **Premises and Equipment**

Land is carried at cost. Premises and equipment is stated at cost, less accumulated depreciation. Depreciation is determined based on the estimated useful lives of the individual assets (typically 20 to 40 years for buildings and 3 to 10 years for equipment) and is computed primarily using the straight-line method. Upon the sale or disposition of the assets, the difference between the depreciated cost and proceeds is charged or credited to income.

### **Cash Surrender Value of Life Insurance**

Cash surrender value of life insurance is equal to the cash surrender value of the underlying policies or the policy death proceeds, less any obligation to provide benefit to the insured beneficiaries, if that value is less than the cash surrender value. Income on the investments in the policies, net of insurance costs, is recorded as non-interest income.

### **Goodwill and Other Intangible Assets**

Goodwill is not amortized, but rather is subject to impairment tests annually, or more frequently if triggering events occur and indicate potential impairment. The Corporation's annual impairment test was performed as of June 30, 2015. The Corporation has elected to perform a qualitative analysis that became acceptable as a result of ASU 2011-08, *Testing Goodwill for Impairment*. As a result of performing the qualitative analysis, the Corporation determined that it was not more likely than not that goodwill was impaired at June 30, 2015. The Corporation determined no triggering events occurred subsequent to the date of the annual impairment test that indicate goodwill was impaired as of December 31, 2015. Core deposit intangible assets arising from the branch acquisition of four Home Savings and Loan branches and the acquisition of Indebancorp is being amortized over ten years using the sum of the years digits amortization method.

Estimated future amortization of core deposit intangible assets is as follows: 2016, \$755,000; 2017, \$638,000; 2018, \$529,000; 2019, \$427,000; 2020, \$332,000; and \$482,000 thereafter.

## **NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

### **Other Real Estate Owned**

Assets acquired through or in lieu of foreclosure are initially recorded at fair value, less estimated costs to sell, and any loan balance in excess of fair value is charged to the allowance for loan losses. Subsequent valuations are periodically performed and any further write-downs are included in other operating expenses, as are gains or losses upon sale and expenses related to maintenance of the properties.

### **Servicing**

Mortgage servicing rights ("MSR") are recognized as an asset when acquired through sale of loans. Capitalized servicing rights are reported in other assets and amortized to expense in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. MSR are evaluated for impairment based upon the estimated fair value of the rights as compared to amortized cost. The fair value of MSRs was estimated by calculating the present value of estimated future net servicing cash flows, taking into consideration expected prepayment rates, discount rates, servicing costs, and other economic factors that are based on current market conditions. The prepayment rates and the discount rates are the most significant factors affecting valuation of the MSRs. Increases in mortgage loan prepayments reduce estimated future net servicing cash flows because the life of the underlying loan is reduced. Expected loan prepayment rates are validated by a third-party model. Impairment is recognized through a valuation allowance to the extent that fair value is less than the capitalized amount.

Servicing fee income is recorded for fees earned for servicing loans and is included in noninterest income, net of amortization of MSRs.

### **Federal Funds Purchased and Securities Sold under Repurchase Agreements**

Securities sold under agreements to repurchase with customers and federal funds purchased have scheduled maturities of one year or less. Securities sold under agreements are collateralized financing transactions and the obligations to repurchase securities sold are reflected as a liability in the accompanying consolidated statements of financial position. The dollar amount of the securities underlying the agreements remain in the Corporation's investment security portfolio.

### **Off-Balance Sheet Credit Related Financial Instruments**

In the ordinary course of business, the Bank has entered into commitments to extend credit, including commitments under credit card arrangements, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded when they are funded.

### **Transfers of Financial Assets**

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

The transfer of a participating interest in an entire financial asset must also meet the definition of a participating interest. A participating interest in a financial asset has all of the following characteristics: (1) from the date of transfer, it must represent a proportionate (pro rata) ownership interest in the financial asset, (2) from the date of transfer, all cash flows received, except any cash flows allocated as any compensation for servicing or other services performed, must be divided proportionately among participating interest holders in the amount equal to their share ownership, (3) the rights of each participating interest holder must have the same priority, and (4) no party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to do so.

### **Supplemental Retirement Benefits**

Annual provisions are made for the estimated liability for accumulated supplemental retirement benefits under agreements with various officers and employees. These provisions are determined based on the terms of the agreements, as well as certain assumptions, including estimated service periods and discount rates.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Advertising Costs

All advertising costs are expensed as incurred.

### Federal Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, deferred income taxes are provided on temporary differences between financial statement and income tax reporting. Temporary differences are differences between the amounts of assets and liabilities reported for financial statement purposes and their tax bases. Deferred tax assets are recognized for temporary differences that will be deductible in future years' tax returns and for operating loss and tax credit carryforwards. Deferred tax assets are reduced by a valuation allowance if it is deemed more likely than not that some or all of the deferred tax assets will not be realized. Deferred tax liabilities are recognized for temporary differences that will be taxable in future years' tax returns. Benefits from tax positions taken or expected to be taken in a tax return are not recognized if the likelihood that the tax position would be sustained upon examination by a taxing authority is considered to be 50% or less. Interest and penalties resulting from the filing of income tax returns is a component of income tax expenses.

The Bank is not currently subject to state and local income taxes.

### Comprehensive Income

Recognized revenue, expenses, and gains and losses are included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

### Per Share Data

Basic net income per share is computed based on the weighted average number of shares of common stock outstanding during each year. Diluted net income per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be used by the Corporation relate solely to outstanding stock options and are determined using the treasury stock method.

The weighted average number of shares outstanding for the years ended December 31, 2015 and 2014 are as follows:

	2015	2014
Basic	<u>2,284,718</u>	<u>2,275,666</u>
Diluted	<u>2,289,780</u>	<u>2,280,583</u>

Dividends per share are based on the number of shares outstanding at the declaration date.

### Subsequent Events

The financial statements and related disclosures include the evaluation of events up through and including February 16, 2016, which is the date the consolidated financial statements were available to be issued.

## NOTE 2 - NEW ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers* (Topic 606). The ASU adopts a standardized approach for revenue recognition and was a joint effort with the International Accounting Standards Board (IASB). The new revenue recognition standard is based on a core principle of recognizing revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU does not apply to financial instruments. The ASU was deferred and is now effective for public entities for periods beginning after December 15, 2017 and for nonpublic entities for annual reporting periods beginning after December 15, 2018 (therefore, for the year ending December 31, 2018 for the Corporation). Early adoption is permitted for nonpublic companies. Management is currently assessing the impact to the Corporation's consolidated financial statements.

**NOTE 2 - NEW ACCOUNTING PRONOUNCEMENTS (CONTINUED)**

The FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. The ASU covers various changes to the accounting, measurement, and disclosure related to certain financial instruments. The ASU eliminates the requirement for nonpublic business entities to disclose the fair value of certain financial instruments in the notes of their financial statements. The amendments are effective for annual reporting periods ending after December 15, 2018 (therefore, for the year ended December 31, 2019 for the Corporation). Early adoption is permitted as early as periods ending after December 31, 2017, with some additional options for early application such as the ability to elect to not disclose the information about fair value of financial instruments. The Corporation does not believe adopting the provisions of ASU 2016-01 will have a material impact on the consolidated financial statements.

**NOTE 3 - CASH AND CASH EQUIVALENTS**

Cash and cash equivalents as of December 31, 2015 and 2014 were as follows (dollars in thousands):

	2015	2014
Cash and due from banks	\$14,501	\$13,598
Interest-bearing deposits in other banks	<u>3,600</u>	<u>49</u>
Total	<u>\$18,101</u>	<u>\$13,647</u>

**NOTE 4 - SECURITIES**

The amortized cost and fair value of securities as of December 31, 2015 and 2014 were as follows (dollars in thousands):

	2015		2014	
	Amortized cost	Fair value	Amortized cost	Fair value
Available-for-sale:				
Obligations of U.S. Government agencies and corporations	\$ 88,161	\$ 88,942	\$122,030	\$123,643
Obligations of states and political subdivisions	96,332	100,797	91,654	95,551
Other	<u>350</u>	<u>350</u>	<u>350</u>	<u>350</u>
Total available-for-sale	184,843	190,089	214,034	219,544
Restricted stock	<u>5,872</u>	<u>5,872</u>	<u>5,863</u>	<u>5,863</u>
Total	<u>\$190,715</u>	<u>\$195,961</u>	<u>\$219,897</u>	<u>\$225,407</u>

A summary of gross unrealized gains and losses on securities at December 31, 2015 and 2014 follows (dollars in thousands):

	2015		2014	
	Gross unrealized gains	Gross unrealized losses	Gross unrealized gains	Gross unrealized losses
Available-for-sale:				
Obligations of U.S. Government agencies and corporations	\$ 1,045	\$ 264	\$ 1,982	\$ 369
Obligations of states and political subdivisions	<u>4,490</u>	<u>25</u>	<u>4,051</u>	<u>154</u>
Total available-for-sale	<u>\$ 5,535</u>	<u>\$ 289</u>	<u>\$ 6,033</u>	<u>\$ 523</u>

**NOTE 4 - SECURITIES (CONTINUED)**

The amortized cost and fair value of securities at December 31, 2015, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (dollars in thousands).

	<b><u>Available-for-sale</u></b>	
	<b><u>Amortized cost</u></b>	<b><u>Fair value</u></b>
Due in one year or less	\$ 14,944	\$ 15,031
Due after one year through five years	121,588	125,486
Due after five years through ten years	45,551	46,737
Due after ten years	2,410	2,485
Other equity security having no maturity date	<u>350</u>	<u>350</u>
Total	<b><u>\$ 184,843</u></b>	<b><u>\$ 190,089</u></b>

Securities with a carrying value of \$127,285,000 at December 31, 2015 and \$119,895,000 at December 31, 2014 were pledged to secure public deposits and for other purposes as required or permitted by law. Securities with a carrying value of \$23,834,000 at December 31, 2015 and \$18,087,000 at December 31, 2014 were pledged to secure accounts with overnight sweep repurchase agreements.

Restricted stock primarily consists of investments in Federal Home Loan Bank of Cincinnati and Federal Reserve Bank of Cleveland stock. The Bank's investment in Federal Home Loan Bank of Cincinnati stock amounted to \$3,342,000 at December 31, 2015 and December 31, 2014. The Bank's investment in Federal Reserve Bank of Cleveland stock amounted to \$2,335,000 at December 31, 2015 and \$2,326,000 at December 31, 2014.

Gross gains realized from sales of securities available-for-sale amounted to \$458,000 in 2015 and \$234,000 in 2014 with the income tax provision applicable to such gains amounting to \$156,000 in 2015 and \$80,000 in 2014. Gross realized losses from sales of securities available-for-sale amounted to \$22,000 in 2015 and \$220,000 in 2014 with the income tax provision applicable to such losses amounting to \$7,000 in 2015 and \$75,000 in 2014.

The following presents gross unrealized losses and fair value of securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2015 and 2014 (dollars in thousands):

	<b><u>Securities in a continuous unrealized loss position</u></b>					
	<b><u>Less than 12 months</u></b>		<b><u>12 months or more</u></b>		<b><u>Total</u></b>	
	<b><u>Unrealized losses</u></b>	<b><u>Fair value</u></b>	<b><u>Unrealized losses</u></b>	<b><u>Fair value</u></b>	<b><u>Unrealized losses</u></b>	<b><u>Fair value</u></b>
<b>2015</b>						
Obligations of U.S. Government agencies and corporations	\$ 215	\$ 27,677	\$ 49	\$ 4,480	\$ 264	\$ 32,157
Obligations of states and political subdivisions	<u>9</u>	<u>2,297</u>	<u>16</u>	<u>1,889</u>	<u>25</u>	<u>4,186</u>
Total temporarily impaired securities	<b><u>\$ 224</u></b>	<b><u>\$ 29,974</u></b>	<b><u>\$ 65</u></b>	<b><u>\$ 6,369</u></b>	<b><u>\$ 289</u></b>	<b><u>\$ 36,343</u></b>
<b>2014</b>						
Obligations of U.S. Government agencies and corporations	\$ 279	\$ 31,479	\$ 90	\$ 5,474	\$ 369	\$ 36,953
Obligations of states and political subdivisions	<u>8</u>	<u>2,616</u>	<u>146</u>	<u>10,350</u>	<u>154</u>	<u>12,966</u>
Total temporarily impaired securities	<b><u>\$ 287</u></b>	<b><u>\$ 34,095</u></b>	<b><u>\$ 236</u></b>	<b><u>\$ 15,824</u></b>	<b><u>\$ 523</u></b>	<b><u>\$ 49,919</u></b>



#### **NOTE 4 - SECURITIES (CONTINUED)**

At December 31, 2015, there were 35 securities in an unrealized loss position, with 9 being in a continuous unrealized loss position for twelve months or more. When evaluating these securities for impairment, management considers the issuer's financial condition, whether the securities are issued by federally-sponsored government agencies or political subdivisions, whether downgrades by the bond rating agencies have occurred, industry analyst reports, and volatility in the bond market. Management has concluded that the unrealized losses as of December 31, 2015 were primarily the result of customary and expected fluctuations in the bond market related to changes in interest rates. As management has the ability and intent to hold debt securities until recovery and meets the more likely than not requirement regarding the ability to hold securities for a period of time sufficient to allow for any anticipated recovery in fair value for securities classified as available-for-sale, all security impairments as of December 31, 2015 are considered temporary.

#### **NOTE 5 - LOANS**

Most of the Bank's lending activity is with clients primarily located within Huron, Lucas, Ottawa, Sandusky, Seneca, and Wood Counties. Credit concentrations, as determined using the North American Industry Classification System, that exceeded 25% of tier one capital at December 31, 2015 and 2014 include \$69,888,000 and \$67,818,000 respectively, to borrowers in residential and investment properties, \$90,181,000 and \$63,756,000 respectively, to borrowers in Non-Residential Buildings, \$35,951,000 and \$40,204,000 respectively, to borrowers in the accommodation and food service industry, \$21,090,000 and \$18,893,000 respectively, to borrowers in the construction industry, \$32,674,000 and \$29,777,000 respectively, to borrowers in the manufacturing industry, new categories to concentrations in 2015 include \$27,491,000 in the retail trade industry, and \$21,411,000 in the health care and social assistance industry. Industries that were concentrations in 2014 include \$18,885,000 to borrowers in the Arts, Entertainment, and Recreation industry.

The construction industry concentration includes loans to residential and commercial contractors who construct or install roads, sewers, bridges, homes, hotels, motels, apartment or commercial buildings, electrical and plumbing infrastructure, and air comfort systems. These loans are generally secured by real property, equipment, and receivables. Repayment is expected from cash flow from providing such services. The accommodation and food service industry concentration includes loans for the construction, purchase, and operation of hotels, restaurants, lounges, and campgrounds. These loans are generally secured by real property and equipment. Repayment is expected from cash flow from providing accommodations and food service to tourists, primarily visiting the Lake Erie region. The manufacturing industry concentration includes loans to local manufacturers who produce goods for a wide variety of industries, including chemical, automotive, and food processing. These loans are generally secured by real property, equipment, and receivables. Repayment is expected from cash flows generated from these operations. The Residential and Investment Property concentration includes loans to residential and apartment or buildings. These loans are generally secured by real property. Repayment is expected from personal cash flow or from providing such services. The Non-Residential Buildings concentration includes loans on office buildings, strip centers, or other industrial buildings. These loans are generally secured by real property. Repayment is expected from rent or cash flow from operations in such services. The Arts, Entertainment, and Recreation concentration includes loans to raceways or marinas. These loans are generally secured by real property. Repayment is expected from cash flow in such services.

Commercial, construction, and agricultural real estate loans are subject to underwriting standards and processes similar to commercial and agricultural operating loans, in addition to those unique to real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial and agricultural real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Loan-to-value is generally 75% of the cost or value of the assets. Appraisals on properties securing these loans are generally performed by appraisers approved by the Board of Directors. Because payments on commercial and agricultural real estate loans are often dependent on the successful operation or management of the properties, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. Management monitors and evaluates commercial and agricultural real estate loans based on collateral and risk rating criteria. The Bank generally requires guarantees on these loans. The Bank's commercial and agricultural real estate loans are secured primarily by properties located in its primary market area.

## **NOTE 5 - LOANS (CONTINUED)**

Commercial and agricultural operating loans are underwritten based on the Bank's examination of current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. This underwriting standard includes the evaluation of cash flows of the borrower, underlying collateral, if applicable, and the borrower's ability to manage its business activities. The cash flows of borrowers and the collateral securing these loans may fluctuate in value after the initial evaluation. A first priority lien on the general assets of the business normally secures these types of loans. Loan-to-value limits vary and are dependent upon the nature and type of the underlying collateral and the financial strength of the borrower. Crop and hail insurance is recommended for most agricultural borrowers. Loans are generally guaranteed by the principal owner. The Bank's commercial and agricultural operating loan lending is primarily in its market area.

Land development loans are underwritten utilizing independent appraisals, sensitivity analysis of absorption, vacancy, lease rates, and financial analysis of the developers and property owners. Land development loans are generally based upon estimates of costs and values associated with the completed project, and are subjective by nature. Land development loans often involve the disbursement of funds with repayment substantially dependent on the success of the ultimate project. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, general economic conditions, and the availability of long-term financing. The Bank generally requires guarantees on these loans. The Bank's land development loans are secured primarily by properties located in its primary market area.

The Bank originates 1 to 4 family real estate and consumer loans utilizing credit reports to supplement the underwriting process. The Bank's underwriting standards for 1 to 4 family loans are generally in accordance with FHLMC and FNMA underwriting guidelines. Properties securing 1 to 4 family real estate loans are appraised by appraisers who are independent of the loan origination function and have been approved by the Board of Directors. The loan-to-value ratios normally do not exceed 80% without credit enhancements such as mortgage insurance. The Bank will lend up to 100% of the lesser of the appraised value or purchase price for conventional 1 to 4 family real estate loans, provided private mortgage insurance is obtained. The underwriting standards for consumer loans include a determination of the applicant's payment history on other debts and an assessment of their ability to meet existing obligations and payments on the proposed loan. To monitor and manage loan risk, policies and procedures are developed, and modified as needed by management. This activity, coupled with smaller loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, market conditions are reviewed by management on a regular basis. The Bank's 1 to 4 family real estate loans are secured primarily by properties located in its primary market area.

The Bank maintains an internal credit analysis department that reviews and validates the credit risk program on a periodic basis, as well as an external loan review performed annually or semi-annually. Results of these reviews are presented to management and the Audit Committee of the Board of Directors. The credit analysis and loan review processes compliment and reinforce the risk identification and assessment decisions made by lenders and credit personnel, as well as the Bank's policies and procedures.

**NOTE 5 - LOANS (CONTINUED)**

The following presents the balances in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2015 and 2014 (dollars in thousands):

	<b>Real Estate</b>					<b>Credit card</b>	
	<b>Commercial</b>	<b>Residential</b>	<b>Non-residential</b>	<b>Construction</b>	<b>Consumer</b>		<b>Total</b>
<b>2015</b>							
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	\$ -	\$ 180	\$ 2	\$ -	\$ -	\$ -	\$ 182
Collectively evaluated for impairment	<u>593</u>	<u>1,317</u>	<u>1,795</u>	<u>141</u>	<u>349</u>	<u>80</u>	<u>4,275</u>
<b>Total</b>	<u>\$ 593</u>	<u>\$ 1,497</u>	<u>\$ 1,797</u>	<u>\$ 141</u>	<u>\$ 349</u>	<u>\$ 80</u>	<u>\$ 4,457</u>
Loans:							
Loans individually evaluated for impairment	\$ 182	\$ 3,255	\$ 3,475	\$ -	\$ -	\$ -	\$ 6,912
Loans acquired with deteriorated credit quality	57	487	260	-	-	-	804
Loans collectively evaluated for impairment	<u>58,691</u>	<u>146,030</u>	<u>258,388</u>	<u>16,170</u>	<u>38,563</u>	<u>3,426</u>	<u>521,268</u>
<b>Total</b>	<u>\$58,930</u>	<u>\$149,772</u>	<u>\$262,123</u>	<u>\$16,170</u>	<u>\$38,563</u>	<u>\$3,426</u>	<u>\$528,984</u>
<b>2014</b>							
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	\$ -	\$ 175	\$ 15	\$ -	\$ -	\$ -	\$ 190
Collectively evaluated for impairment	<u>479</u>	<u>1,542</u>	<u>1,620</u>	<u>147</u>	<u>211</u>	<u>75</u>	<u>4,074</u>
<b>Total</b>	<u>\$ 479</u>	<u>\$ 1,717</u>	<u>\$ 1,635</u>	<u>\$ 147</u>	<u>\$ 211</u>	<u>\$ 75</u>	<u>\$ 4,264</u>
Loans:							
Loans individually evaluated for impairment	\$ 1,422	\$ 3,558	\$ 3,256	\$ -	\$ -	\$ -	\$ 8,236
Loans acquired with deteriorated credit quality	82	797	1,669	-	-	-	2,548
Loans collectively evaluated for impairment	<u>50,521</u>	<u>161,579</u>	<u>223,193</u>	<u>4,705</u>	<u>29,637</u>	<u>3,633</u>	<u>473,268</u>
<b>Total</b>	<u>\$52,025</u>	<u>\$165,934</u>	<u>\$228,118</u>	<u>\$ 4,705</u>	<u>\$29,637</u>	<u>\$3,633</u>	<u>\$484,052</u>



## NOTE 5 - LOANS (CONTINUED)

The contractual loan receivable for loans acquired with deteriorated credit quality was \$979,000 and \$2,861,000 at December 31, 2015 and 2014. The change in the contractual loan receivable included \$1,766,000 of loan payments and \$116,000 of net charge offs. The recorded investment in loans acquired with deteriorated credit quality is presented net of a credit quality and market adjustment that amounted to \$175,000 and \$313,000 at December 31, 2015 and 2014.

The following represents loans individually evaluated for impairment by class of loans as of December 31, 2015 and 2014 (dollars in thousands):

	2015			2014		
	Unpaid principal balance	Recorded investment	Allowance for loan losses allocated	Unpaid principal balance	Recorded investment	Allowance for loan losses allocated
With no related allowance recorded:						
Commercial loans	\$ 221	\$ 182	\$ -	\$ 1,450	\$ 1,422	\$ -
Open-end home equity	347	322	-	316	244	-
1 – 4 family real estate (1st mortgages)	2,382	2,217	-	2,299	2,050	-
1 – 4 family real estate (Jr. mortgages)	-	-	-	3	3	-
Multifamily real estate	76	39	-	255	230	-
Non-farm/non-residential real estate	3,514	3,434	-	3,177	3,085	-
With an allowance recorded:						
Open-end home equity	54	54	40	193	193	35
1 – 4 family real estate (1st mortgages)	801	662	140	955	838	140
Non-farm/non-residential real estate	<u>2</u>	<u>2</u>	<u>2</u>	<u>176</u>	<u>171</u>	<u>15</u>
<b>Total</b>	<b><u>\$ 7,397</u></b>	<b><u>\$ 6,912</u></b>	<b><u>\$ 182</u></b>	<b><u>\$ 8,824</u></b>	<b><u>\$ 8,236</u></b>	<b><u>\$ 190</u></b>

The following is additional information with respect to impaired loans for the years ended December 31, 2015 and 2014 (dollars in thousands):

	2015	2014
Average investment in impaired loans	<u>\$ 8,126</u>	<u>\$ 6,822</u>
Interest income recognized on impaired loans	<u>\$ 547</u>	<u>\$ 401</u>
Interest income recognized on a cash basis on impaired loans	<u>\$ 15</u>	<u>\$ 33</u>

No additional funds are committed to be advanced in connection with impaired loans.

**NOTE 5 - LOANS (CONTINUED)**

The following represents a summary of the number and recorded investments of trouble debt restructurings ("TDR") occurring during the years ended December 31, 2015 and 2014 (dollars in thousands):

	2015		2014	
	Number	Amount	Number	Amount
Commercial loans	3	\$ 61	3	\$ 271
Open-end home equity	-	-	3	60
1 – 4 family real estate (1st mortgage)	3	502	6	505
Multifamily real estate	-	-	-	-
Non-farm/non-residential real estate	1	607	2	395
Construction real estate	-	-	-	-
<b>Total recorded investments</b>	<u>7</u>	<u>\$ 1,170</u>	<u>14</u>	<u>\$ 1,231</u>

There was no provision for loan losses relating to loans that were modified in TDR in 2015 and there was a \$6,000 provision in 2014.

TDR occurring in 2015 consisted of 7 loans and 6 overall borrowing relationships. These modifications included four modifications which included debt consolidation and extension of loan payments, one line of credit that which was termed out, and one line of credit which had the interest rate reduced.

TDR occurring in 2014 consisted of 14 loans and 12 overall borrowing relationships. These modifications included six modifications and extension of loan payments, three lines of credit that were termed out, two where monthly payments were reduced, two where matured balloon notes were re-amortized, and one where the maturity of a single pay note was extended.

The post-modification balances approximate the pre-modification balances. The aggregate amount of charge-offs resulting from restructuring are not significant.

There were no TDR that subsequently defaulted within twelve months of the date of modification during the years ended December 31, 2015 and 2014.

The Bank does not have material commitments to lend additional funds to borrowers with loans whose terms have been modified in TDR or whose loans are on nonaccrual.

**NOTE 5 - LOANS (CONTINUED)**

The following presents the recorded investment in past due and non-accrual loans as of December 31, 2015 and 2014 by class of loans (dollars in thousands).

Assets (dollars in thousands):

	Loans past due accruing interest			Loans on non- accrual	Loans not past due or non- accrual	Total
	30 – 89 days	90+ days	Total			
<b>2015</b>						
Agricultural loans	\$ -	\$ -	\$ -	\$ -	\$ 3,711	\$ 3,711
Commercial loans	26	-	26	110	53,561	53,697
Commercial overdraft LOC	-	-	-	-	899	899
Commercial non-profit/political subdivisions	-	-	-	-	623	623
Open-end home equity	73	18	91	85	33,257	33,433
1 – 4 family real estate (1 <sup>st</sup> mortgages)	2,776	47	2,823	778	109,903	113,504
1 – 4 family real estate (Jr. mortgages)	11	-	11	-	2,824	2,835
Multifamily real estate	583	-	583	39	35,367	35,989
Farm real estate	-	-	-	-	8,358	8,358
Non-farm/non-residential real estate	357	-	357	107	217,312	217,776
Construction real estate	-	-	-	-	16,170	16,170
Consumer loans – vehicle	134	10	144	-	18,067	18,211
Consumer overdraft LOC	5	6	11	-	254	265
Consumer loans:						
Mobile home	21	22	43	-	2,380	2,423
Home Improvement	-	-	-	-	333	333
Other	57	21	78	-	17,253	17,331
MasterCard/VISA	19	10	29	-	3,397	3,426
<b>Total</b>	<b>\$ 4,062</b>	<b>\$ 134</b>	<b>\$ 4,196</b>	<b>\$ 1,119</b>	<b>\$ 523,669</b>	<b>\$ 528,984</b>
<b>2014</b>						
Agricultural loans	\$ -	\$ -	\$ -	\$ 5	\$ 3,340	\$ 3,345
Commercial loans	159	-	159	136	47,328	47,623
Commercial overdraft LOC	-	-	-	-	201	201
Commercial non-profit/political subdivisions	-	-	-	-	856	856
Open-end home equity	388	19	407	112	34,965	35,484
1 – 4 family real estate (1 <sup>st</sup> mortgages)	2,038	469	2,507	1,417	122,539	126,463
1 – 4 family real estate (Jr. mortgages)	6	5	11	-	3,976	3,987
Multifamily real estate	-	-	-	230	38,178	38,408
Farm real estate	30	39	69	-	8,550	8,619
Non-farm/non-residential real estate	1,140	13	1,153	1,192	178,746	181,091
Construction real estate	-	-	-	-	4,705	4,705
Consumer loans – vehicle	146	6	152	-	13,702	13,854
Consumer overdraft LOC	7	4	11	-	260	271
Consumer loans:						
Mobile home	37	-	37	-	1,852	1,889
Home Improvement	-	-	-	-	269	269
Other	99	28	127	-	13,227	13,354
MasterCard/VISA	23	9	32	-	3,601	3,633
<b>Total</b>	<b>\$ 4,073</b>	<b>\$ 592</b>	<b>\$ 4,665</b>	<b>\$ 3,092</b>	<b>\$ 476,295</b>	<b>\$ 484,052</b>

## NOTE 5 - LOANS (CONTINUED)

The Bank categorizes loans into risk categories based on relevant information about the ability of the borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Bank uses the following definitions for risk ratings:

- **Special Mention** – Loans classified special mention possess some credit deficiency or potential weakness that deserves close attention, but do not yet warrant substandard classification. Such loans pose unwarranted financial risk that, if not corrected, could weaken the loan and increase risk of losses in the future.
- **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 classified as substandard have well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are categorized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.
- **Doubtful** – Loans classified as doubtful have all of the weaknesses of those classified as substandard. Additionally, however, these weaknesses make collection or liquidation in full based on existing conditions 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. The following presents loans as of December 31, 2015 and 2014 that are collectively evaluated for impairment and are not considered to be impaired (dollars in thousands):

	<b>Pass</b>	<b>Special mention</b>	<b>Sub- standard</b>	<b>Doubtful</b>	<b>Not rated</b>	<b>Total</b>
<b>2015</b>						
Agricultural loans	\$ 3,711	\$ -	\$ -	\$ -	\$ -	\$ 3,711
Commercial loans	52,986	280	431	-	-	53,697
Commercial overdraft LOC	-	-	-	-	899	899
Commercial non-profit/political subdivisions	623	-	-	-	-	623
Open-end home equity	32,705	339	389	-	-	33,433
1 – 4 family real estate (1st mortgages)	108,446	2,605	2,453	-	-	113,504
1 – 4 family real estate (Jr. mortgages)	2,753	42	40	-	-	2,835
Multifamily real estate	33,891	-	2,098	-	-	35,989
Farm real estate	8,258	-	100	-	-	8,358
Non-farm/non-residential real estate	204,190	1,240	12,346	-	-	217,776
Construction real estate	16,170	-	-	-	-	16,170
Consumer loans – vehicle	18,160	47	4	-	-	18,211
Consumer overdraft LOC	-	-	-	-	265	265
Consumer loans:						
Mobile home	2,380	21	22	-	-	2,423
Home improvement	333	-	-	-	-	333
Other	17,266	35	30	-	-	17,331
MasterCard/VISA	-	-	-	-	3,426	3,426
<b>Total</b>	<b>\$ 501,872</b>	<b>\$ 4,609</b>	<b>\$17,913</b>	<b>\$ -</b>	<b>\$ 4,590</b>	<b>\$ 528,984</b>
<b>2014</b>						
Agricultural loans	\$ 3,345	\$ -	\$ -	\$ -	\$ -	\$ 3,345
Commercial loans	45,426	5	2,192	-	-	47,623
Commercial overdraft LOC	-	-	-	-	201	201
Commercial non-profit/political subdivisions	856	-	-	-	-	856
Open-end home equity	34,503	330	651	-	-	35,484
1 – 4 family real estate (1st mortgages)	119,575	2,599	4,289	-	-	126,463
1 – 4 family real estate (Jr. mortgages)	3,844	121	22	-	-	3,987
Multifamily real estate	35,982	-	2,426	-	-	38,408
Farm real estate	8,509	-	110	-	-	8,619
Non-farm/non-residential real estate	162,349	1,008	17,734	-	-	181,091
Construction real estate	4,705	-	-	-	-	4,705
Consumer loans – vehicle	13,731	109	14	-	-	13,854
Consumer overdraft LOC	-	-	-	-	271	271
Consumer loans:						
Mobile home	1,861	28	-	-	-	1,889
Home improvement	269	-	-	-	-	269
Other	13,053	220	81	-	-	13,354
MasterCard/VISA	-	-	-	-	3,633	3,633
<b>Total</b>	<b>\$ 448,008</b>	<b>\$ 4,420</b>	<b>\$27,519</b>	<b>\$ -</b>	<b>\$ 4,105</b>	<b>\$ 484,052</b>

**NOTE 5 - LOANS (CONTINUED)**

Certain directors and executive officers, including their immediate families and companies in which they are principal owners, are loan clients of the Bank. Such loans are made in the ordinary course of business in accordance with the Bank's normal lending policies, including the interest rate charged and collateralization, and do not represent more than a normal collection risk. Such loans amounted to \$1,012,000 and \$1,554,000 at December 31, 2015 and 2014, respectively.

The following is a summary of activity during 2015 and 2014 with loan renewals included in additions and repayments (dollars in thousands):

	Balance at beginning	Additions	Repayments	Balance at end
2015	<u>\$ 1,554</u>	<u>\$ 125</u>	<u>\$ 667</u>	<u>\$ 1,012</u>
2014	<u>\$ 1,398</u>	<u>\$1,059</u>	<u>\$ 903</u>	<u>\$ 1,554</u>

Deposits to officers, directors, and employees of the Bank approximated \$3,975,000 as of December 31, 2015, and \$4,484,000 at December 31, 2014.

**NOTE 6 - ALLOWANCE FOR LOAN LOSSES**

The following presents the balances and activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2015 and 2014 (dollars in thousands):

	Commercial	Residential real estate	Non- residential real estate	Construction real estate	Consumer	Credit card	Total
Balance at December 31, 2014	\$ 479	\$ 1,717	\$ 1,635	\$ 147	\$ 211	\$ 75	\$ 4,264
Provision (credit) for loan losses	40	(81)	147	(6)	207	43	350
Losses charged off	(27)	(157)	(190)	-	(94)	(49)	(517)
Recoveries	<u>101</u>	<u>18</u>	<u>205</u>	<u>-</u>	<u>25</u>	<u>11</u>	<u>360</u>
Balance at December 31, 2015	<u>\$ 593</u>	<u>\$ 1,497</u>	<u>\$ 1,797</u>	<u>\$ 141</u>	<u>\$ 349</u>	<u>\$ 80</u>	<u>\$ 4,457</u>
Balance at December 31, 2013	\$ 456	\$ 1,885	\$ 1,000	\$ 464	\$ 164	\$ 73	\$ 4,042
Provision (credit) for loan losses	100	169	647	(317)	107	34	740
Losses charged off	(90)	(346)	(60)	-	(68)	(48)	(612)
Recoveries	<u>13</u>	<u>9</u>	<u>48</u>	<u>-</u>	<u>8</u>	<u>16</u>	<u>94</u>
Balance at December 31, 2014	<u>\$ 479</u>	<u>\$ 1,717</u>	<u>\$ 1,635</u>	<u>\$ 147</u>	<u>\$ 211</u>	<u>\$ 75</u>	<u>\$ 4,264</u>

## NOTE 7 - PREMISES AND EQUIPMENT

The following is a summary of premises and equipment at December 31, 2015 and 2014 (dollars in thousands):

	2015	2014
Land and improvements	\$ 2,867	\$ 2,867
Buildings	13,601	13,072
Equipment	<u>8,875</u>	<u>8,359</u>
	25,343	24,298
Less accumulated depreciation	<u>15,393</u>	<u>14,598</u>
Premises and equipment, net	<u>\$ 9,950</u>	<u>\$ 9,700</u>

Depreciation of premises and equipment amounted to \$820,000 in 2015 and \$785,000 in 2014.

## NOTE 8 - SECONDARY MARKET LENDING

As part of its normal business activity, the Bank services loans for others, including substantially all qualifying fixed rate residential mortgage loans which it originates and sells in the secondary market with servicing retained. Serviced loans are not reported as assets of the Bank and amounted to \$173,648,000 and \$170,173,000 as of December 31, 2015 and 2014, respectively.

Loans sold in the secondary market amounted to \$25,021,000 and \$26,309,000 during the years ended December 31, 2015 and 2014, respectively, resulting in gain on sale of loans of \$676,000 in 2015 and \$699,000 in 2014.

The following is a summary of activity for capitalized mortgage servicing rights for the years ended December 31, 2015 and 2014 (dollars in thousands):

	2015	2014
Balance at beginning of year	\$1,277	\$1,315
Capitalized servicing rights	200	224
Amortized to expense	<u>(290)</u>	<u>(262)</u>
Balance at end of year	<u>\$1,187</u>	<u>\$1,277</u>

Mortgage servicing rights are included in other assets in the accompanying consolidated balance sheets.

## NOTE 9 - DEPOSITS

Time deposits at December 31, 2015 that included individual deposits of \$250,000 and over amounted to \$13,296,000 and \$17,461,000 at December 31, 2014.

At December 31, 2015, the scheduled maturities of time deposits were as follows (dollars in thousands):

2016	\$ 60,523
2017	23,159
2018	16,520
2019	26,086
2020	15,404
Thereafter	<u>8,424</u>
Total	<u>\$ 150,116</u>

## NOTE 10 - BORROWED FUNDS

Borrowed funds consisted of the following at December 31, 2015 and 2014 (dollars in thousands):

	2015	2014
Federal Home Loan Bank (FHLB):		
Secured note, with interest at 4.45%, due February 2017	\$ 5,000	\$ 5,000
Secured note, with interest at .35%, due January 2016	7,000	
Secured note, with interest at .34%, due January 2016	5,000	
Secured note, with interest at 1.87%, due February 2021	<u>708</u>	<u>931</u>
	\$17,708	\$ 5,931
Great Lakes Bankers Bank (GLBB):		
Term note payable in quarterly installments of \$337,000 including interest at the greater of prime rate (3.50% at December 31, 2015) or 4.5% with any remaining principal due January 1, 2017. Loan is secured by certain assets of the Corporation as stated in the pledge agreement dated October 20, 2011.	<u>1,654</u>	<u>2,890</u>
Total	<u>\$19,362</u>	<u>\$ 8,821</u>

Future maturities of borrowed funds at December 31, 2015 were as follows (dollars in thousands):

2016	\$ 13,482
2017	5,521
2018	136
2019	114
2020	95
2021	<u>14</u>
Total	<u>\$ 19,362</u>

The FHLB notes require monthly interest payments and are secured by stock in the FHLB of Cincinnati and eligible mortgage loans totaling \$266,804,000 at December 31, 2015.

The GLBB term note contains certain financial covenants which require the Corporation and Bank to, among other things, maintain minimum capital ratios, return on assets, and debt service coverage ratios (as defined), as well as asset quality and liquidity levels. As of December 31, 2015, the Corporation and Bank is in compliance with all covenants.

At December 31, 2015, the Bank has available borrowings of \$52,253,000 under its line of credit with the Federal Home Loan Bank. In addition, the Bank had \$10,000,000 of short-term borrowing availability at December 31, 2015, under lines of credit with one correspondent bank.

## NOTE 11 - SECURITIES SOLD UNDER REPURCHASE AGREEMENTS

Securities sold under repurchase agreements, which are classified as secured borrowings, generally mature within one to four days from the transaction date. The weighted average interest rate was .09% and .11% for securities sold under repurchase agreements outstanding as of December 31, 2015 and 2014, respectively. Securities sold under repurchase agreements are reflected at the amount of cash received in connection with the transactions. The Bank may be required to provide additional collateral based on the fair value of the underlying securities.

## NOTE 12 - NON-INTEREST EXPENSES

The following is a summary of non-interest expenses for the years ended December 31, 2015 and 2014 (dollars in thousands):

	2015	2014
Salaries, wages, and employee benefits	\$ 13,011	\$ 12,366
Occupancy of premises	1,173	1,140
Amortization of core deposit intangible assets	879	1,011
FDIC premium assessments	435	523
Equipment and vehicle	1,582	1,552
Professional and examination	713	815
State franchise and other taxes	707	643
Postage, stationery, and supplies	670	634
Advertising and marketing	675	435
Third-party computer processing	164	194
MasterCard franchise and processing	274	294
Loan collection and repossession fees	279	323
ATM network and processing fees	539	484
Other	<u>1,780</u>	<u>1,515</u>
Total non-interest expenses	<u>\$ 22,881</u>	<u>\$ 21,929</u>

## NOTE 13 - FEDERAL INCOME TAXES

The provision for federal income taxes consisted of the following for 2015 and 2014 (dollars in thousands):

	2015	2014
Current	\$ 2,298	\$ 2,326
Deferred	<u>385</u>	<u>439</u>
Total	<u>\$ 2,683</u>	<u>\$ 2,765</u>

The income tax provision attributable to income from operations differs from the amounts computed by applying the U.S. federal income tax rate of 34% to income before federal income taxes as a result of the following (dollars in thousands):

	2015	2014
Expected tax using statutory tax rate of 34%	\$ 3,768	\$ 3,870
Increase (decrease) in tax resulting from:		
Tax-exempt income on state and municipal securities and political subdivision loans	(1,004)	(1,029)
Interest expense associated with carrying certain state and municipal securities and political subdivision loans	16	19
Increase in cash value of life insurance policies	(100)	(103)
Other, net	<u>3</u>	<u>8</u>
Total	<u>\$ 2,683</u>	<u>\$ 2,765</u>

The deferred federal income tax provision of \$385,000 in 2015 and \$439,000 in 2014 resulted from the tax effects of temporary differences. There was no impact for changes in tax laws and rates or changes in the valuation allowance for deferred tax assets.



**NOTE 13 - FEDERAL INCOME TAXES (CONTINUED)**

The tax effects of temporary differences that give rise to significant portions of deferred tax liabilities and deferred tax assets at December 31, 2015 and 2014 are presented below (dollars in thousands):

	2015	2014
Deferred tax assets:		
Purchase accounting basis difference	\$ 1,539	\$ 2,029
Allowance for loan losses	1,450	1,336
Accrued expenses and other	<u>592</u>	<u>762</u>
Total deferred tax assets	<u>3,581</u>	<u>4,127</u>
Deferred tax liabilities:		
Unrealized gain on securities available-for-sale	1,784	1,874
Purchase accounting basis difference	1,693	1,877
Depreciation of premises and equipment	289	275
Federal Home Loan Bank stock dividends	573	573
Mortgage servicing rights	404	435
Deferred loan costs and other	<u>331</u>	<u>290</u>
Total deferred tax liabilities	<u>5,074</u>	<u>5,324</u>
Net deferred tax assets (liabilities)	<u><u>\$ (1,493)</u></u>	<u><u>\$ (1,197)</u></u>

Net deferred tax liabilities at December 31, 2015 and December 31, 2014 are included in other liabilities in the accompanying consolidated balance sheets.

Management believes it is more likely than not that the benefit of deferred tax assets will be realized. Consequently, no valuation allowance for deferred tax assets is deemed necessary as of December 31, 2015 and 2014.

In management's determination, the Corporation has no tax positions for which it deems reasonably possible that the total amounts of the unrecognized tax benefit will significantly increase or decrease within the 12 months subsequent to December 31, 2015. The tax years that remain open and subject to examination as of December 31, 2015 are years 2012 – 2015 for Federal and the State of Ohio.

**NOTE 14 - EMPLOYEE BENEFITS**

The Bank sponsors The Croghan Colonial Bank 401(k) Profit Sharing Plan (The Plan), a defined contribution plan which provides for both profit sharing and employer matching contributions. The Plan permits the investing in the Corporation's stock subject to various limitations. The Bank's profit sharing and matching contributions to the 401(k) profit sharing plan for the years ended December 31, 2015 and 2014 amounted to \$609,000 and \$538,000, respectively. As of December 31, 2015, the Plan held 20,467 shares of the Corporation's common stock.

The Bank has entered into various split-dollar life insurance arrangements, including agreements with certain officers and employees of the Bank to provide for supplemental retirement benefits. All split-dollar policies required the payment of single premiums. The cash value of all split-dollar policies amounted to \$17,380,000 and \$17,085,000 at December 31, 2015 and 2014, respectively.

In connection with the agreements, the Bank provided an estimated liability for accumulated supplemental retirement benefits of \$403,000 at December 31, 2015 and \$392,000 at December 31, 2014, which is included in other liabilities in the accompanying consolidated balance sheets. The Bank recognized a provision for deferred compensation of \$11,000 in 2015 and \$13,000 in 2014.

No other postretirement or postemployment benefits are offered to retirees or employees.

## NOTE 15 - STOCK-BASED COMPENSATION

The Corporation established in 2002 a Stock Option and Incentive Plan (the "2002 Plan") which permitted the awarding of stock options and/or stock appreciation rights to directors, managerial and other key employees of the Bank. The 2002 Plan, which provided for the issuance of up to 190,951 shares, expired in March 2012.

At the 2012 Annual Meeting of Shareholders, the shareholders of the Corporation adopted the Croghan Bancshares, Inc. 2012 Equity Incentive Plan (the "2012 Plan"), which permits the Corporation to award stock options, stock appreciation rights, restricted stock, and other stock-based and performance-based awards to directors, employees, and other eligible participants. A total of 162,082 shares are available for issuance pursuant to the 2012 Plan.

Following is a summary of activity for stock options for the years ended December 31, 2015 and 2014:

	2015	2014
Outstanding, beginning of year	17,683	27,494
Granted	-	-
Exercised	-	(7,061)
Forfeited	-	(2,750)
Outstanding, end of year	<u>17,683</u>	<u>17,683</u>

The options vest over a three-year period on the anniversary date of issuance with a \$24.99 per share exercisable price. At December 31, 2015, 17,683 options were exercisable with a weighted average remaining contractual term of 5 years.

Compensation expense related to issued stock options amounted to a credit, due to the forfeited shares in the amount of \$3,000 in 2014. As of December 31, 2015, all expenses related to the stock options has been accounted for fully.

Restricted stock awards may also be issued under the 2012 Plan. The Corporation granted 2,735 shares of restricted stock in 2015. A summary of restricted stock activity for 2015 and 2014 activity is as follows:

	2015		2014	
	Shares	Weighted average grant date fair value	Shares	Weighted average grant date fair value
Nonvested at beginning of year	7,023	\$33.19	4,200	\$31.21
Granted	2,735	34.71	4,970	34.75
Vested	(1,844)	-	(1,447)	-
Forfeited	-	-	(700)	31.21
Nonvested at end of year	<u>7,914</u>	<u>\$33.97</u>	<u>7,023</u>	<u>\$33.19</u>

Restricted stock awards vest over a five year period. Compensation expense relating to restricted stock is recognized over the vesting period based on the market value of the shares on the issue date and amounted to \$77,000 in 2015 and \$97,000 in 2014. As of December 31, 2015, there was \$212,000 of total unrecognized compensation cost related to unvested restricted stock awards. The cost is expected to be recognized over a weighted average period of 2.01 years.

## NOTE 16 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its clients. These financial instruments are primarily loan commitments to extend credit and letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amounts recognized in the consolidated balance sheets. The contract amount of these instruments reflects the extent of involvement the Bank has in these financial instruments.

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

The following financial instruments whose contract amount represents credit risk were outstanding at December 31, 2015 and 2014 (dollars in thousands):

	<u>Contract amount</u>	
	2015	2014
Commitments to extend credit, including commitments to grant loans and unfunded commitments under lines of credit	<u>\$ 112,572</u>	<u>\$ 109,813</u>
Standby letters of credit	<u>\$ 572</u>	<u>\$ 1,394</u>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the client. Collateral held varies but may include accounts receivable; inventory; property, plant, and equipment; and income-producing commercial properties.

Standby letters of credit are written conditional commitments issued by the Bank to guarantee the performance of a customer to a third party and are reviewed for renewal at expiration. All outstanding standby letters of credit at December 31, 2015 expire in 2016 and 2017. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loans to clients. The Bank requires collateral supporting these commitments when deemed necessary.

## NOTE 17 - REGULATORY MATTERS

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

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined in the regulations), and of Tier I capital to average assets (as defined in the regulations). Management believes, as of December 31, 2015 and 2014, that the Corporation and the Bank met all capital adequacy requirements to which they were subject.

As of December 31, 2015, the most recent notification from federal and state banking agencies 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 I risk-based and Tier I leverage ratios as set forth in the following. There are no conditions or events since that notification that management believes have changed the Bank's category.

## NOTE 17 - REGULATORY MATTERS (CONTINUED)

Banking regulations have established minimum capital requirements for banks, including risk-based capital ratios and leverage ratios. Regulations require all banks to have a minimum total risk-based capital ratio of 8.0%, with half of the capital composed of core capital. On January 1, 2015, the final rules of the Federal Reserve Board went into effect implementing in the United States the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Under the final rule, minimum requirements increased for both the quality and quantity of capital held by banking institutions. The rule requires a new minimum ratio of common equity tier 1 capital to risk-weighted assets of 4.5 percent and a common equity tier 1 capital conservation buffer of 2.5 percent of risk-weighted assets that will apply to all supervised financial institutions. The capital conservation buffer does not come into effect until January 1, 2016. The rule also raises the minimum ratio of tier 1 capital to risk-weighted assets from 4 percent to 6 percent and includes a minimum leverage ratio of 4 percent for all banking institutions.

The actual capital amounts and ratios of the Bank as of December 31, 2015 and 2014 are presented as follows (dollars in thousands):

	Actual		Minimum capital requirement		Minimum to be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2015</b>						
Total Capital (to Risk-Weighted Assets)						
Bank	\$78,110	13.7%	\$45,627	≥ 8.0%	\$ 57,034	≥ 10.0%
Common Equity Tier 1 Capital (to Risk-Weighted Assets)						
Bank	73,653	12.9%	25,665	≥ 4.5%	37,072	≥ 6.5%
Tier I Capital (to Risk-Weighted Assets)						
Bank	73,653	12.9%	34,220	≥ 6.0%	45,627	≥ 8.0%
Tier I Capital (to Average Assets)						
Bank	73,653	9.7%	30,438	≥ 4.0%	38,048	≥ 5.0%
<b>As of December 31, 2014</b>						
Total Capital (to Risk-Weighted Assets)						
Bank	\$70,053	13.7%	\$40,928	≥ 8.0%	\$ 51,160	≥ 10.0%
Tier I Capital (to Risk-Weighted Assets)						
Bank	65,789	12.9%	20,464	≥ 4.0%	30,696	≥ 6.0%
Tier I Capital (to Average Assets)						
Bank	65,789	8.7%	30,200	≥ 4.0%	37,751	≥ 5.0%

On a parent company only basis, the Corporation's primary source of funds are dividends paid by the Bank. The ability of the Bank to pay dividends is subject to limitations under various laws and regulations, and to prudent and sound banking principles. Generally, subject to certain minimum capital requirements, the Bank may declare a dividend without the approval of the State of Ohio Division of Financial Institutions, unless the total dividends in a calendar year exceed the total of its net profits for the year combined with its retained profits of the two preceding years.

The Board of Governors of the Federal Reserve System generally considers it to be an unsafe and unsound banking practice for a bank holding company to pay dividends except out of current operating income, although other factors such as overall capital adequacy and projected income may also be relevant in determining whether dividends should be paid.

**NOTE 18 - CONDENSED PARENT COMPANY FINANCIAL INFORMATION**

A summary of condensed financial information of the parent company as of December 31, 2015 and 2014 and for each of the two years in the period ended December 31, 2015 was as follows (dollars in thousands):

<b>CONDENSED BALANCE SHEETS</b>	<b>2015</b>	<b>2014</b>
Assets:		
Cash	\$ -	\$ 164
Dividends receivable from subsidiary	800	731
Investment in subsidiary	99,968	96,012
Available-for-sale security	350	350
Other asset	<u>146</u>	<u>68</u>
Total assets	<u>\$101,264</u>	<u>\$ 97,325</u>
Liabilities:		
Borrowed funds	\$ 1,654	\$ 2,890
Dividends and other payables	<u>818</u>	<u>816</u>
Total liabilities	<u>2,472</u>	<u>3,706</u>
Stockholders' equity:		
Common stock	31,328	31,328
Surplus	13,219	13,241
Retained earnings	58,362	53,092
Accumulated other comprehensive income	3,463	3,637
Treasury stock	<u>(7,580)</u>	<u>(7,679)</u>
Total stockholders' equity	<u>98,792</u>	<u>93,619</u>
Total liabilities and stockholders' equity	<u>\$101,264</u>	<u>\$ 97,325</u>
 <b>CONDENSED STATEMENTS OF OPERATIONS</b>	 <b>2015</b>	 <b>2014</b>
Income – dividends from subsidiary	\$ 4,405	\$ 4,263
Professional fees, interest, and other expenses	<u>(204)</u>	<u>(200)</u>
Income before income taxes and equity in undistributed net income of subsidiary	4,201	4,063
Federal income tax credit	<u>(69)</u>	<u>(68)</u>
Income before equity in undistributed net income of subsidiary	4,270	4,131
Equity in net income of subsidiary, less dividends	<u>4,130</u>	<u>4,486</u>
Net income	<u>\$ 8,400</u>	<u>\$ 8,617</u>

**NOTE 18 - CONDENSED PARENT COMPANY FINANCIAL INFORMATION (CONTINUED)**

<b>CONDENSED STATEMENTS OF CASH FLOWS</b>	<b>2015</b>	<b>2014</b>
Cash flows from operating activities:		
Net income	\$ 8,400	\$ 8,617
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in net income of subsidiary, less dividends	(4,130)	(4,486)
Decrease (increase) in dividends receivable	(69)	(5)
Stock-based compensation expense	77	108
Decrease (increase) in other assets	(78)	61
Increase (decrease) in other liabilities	<u>(22)</u>	<u>(72)</u>
Net cash provided by operating activities	<u>4,178</u>	<u>4,223</u>
Cash flows from financing activities:		
Principal payments on borrowed funds	(1,236)	(1,180)
Cash dividends paid	<u>(3,106)</u>	<u>(2,936)</u>
Net cash used in financing activities	<u>(4,342)</u>	<u>(4,116)</u>
Net increase (decrease) in cash	(164)	107
Cash at beginning of year	<u>164</u>	<u>57</u>
Cash at end of year	<u>\$ -</u>	<u>\$ 164</u>

The Board of Directors authorized a stock buyback plan commencing February 1, 2016 and ending August 1, 2016, which allows up to 68,567 outstanding common shares to be repurchased.

The decision whether to purchase shares, the number of shares to be purchased, and the price to be paid depends upon the availability of shares, prevailing market prices, and other possible considerations which might affect the advisability of purchasing shares.

**NOTE 19 - FAIR VALUE MEASUREMENTS**

ASC 820-10 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are independent, knowledgeable, and both able and willing to transact.

Nonfinancial assets and liabilities measured at fair value on a recurring basis include reporting units measured at fair value in the first step of a goodwill impairment test. Nonfinancial assets measured at fair value on a nonrecurring basis include nonfinancial assets and liabilities measured at fair value in the second step of a goodwill impairment test, as well as intangible assets and other nonfinancial long-lived assets measured at fair value for impairment assessment, such as other real estate owned.

**NOTE 19 - FAIR VALUE MEASUREMENTS (CONTINUED)**

ASC 820-10 requires the use of valuation techniques that are consistent with the market approach, the income approach, and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable or unobservable. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources. Unobservable inputs reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, ASC 820-10 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

*Level 1* – Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date.

*Level 2* – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

*Level 3* – Unobservable inputs for the asset or liability for which there is little, if any, market activity at the measurement date. Unobservable inputs reflect the Corporation's own assumptions about what market participants would use to price the asset or liability. The inputs are developed based on the best information available in the circumstances, which might include the Corporation's own financial data such as internally developed pricing models, discounted cash flow methodologies, as well as instruments for which the fair value determination requires significant management judgment.

There were no financial instruments measured at fair value that moved to a lower level in the fair value hierarchy due to the lack of observable quotes in inactive markets for those instruments at December 31, 2015 and 2014.

The following summarizes financial assets (there were no financial liabilities) measured at fair value as of December 31, 2015 and 2014, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (dollars in thousands):

	Level 1 inputs	Level 2 inputs	Level 3 inputs	Total fair value
<b>2015</b>				
Recurring:				
Securities available-for-sale:				
Obligations of U.S. Government agencies and corporations	\$ -	\$ 88,942	\$ -	\$ 88,942
Obligations of states and political subdivisions	-	100,797	-	100,797
Other	-	350	-	350
Total	<u>\$ -</u>	<u>\$ 190,089</u>	<u>\$ -</u>	<u>\$ 190,089</u>
Nonrecurring:				
Other real estate owned	\$ -	\$ -	\$ 287	\$ 287
Impaired loans	-	-	7,716	7,716
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,003</u>	<u>\$ 8,003</u>



## NOTE 19 - FAIR VALUE MEASUREMENTS (CONTINUED)

	Level 1 inputs	Level 2 inputs	Level 3 inputs	Total fair value
<b>2014</b>				
Recurring:				
Securities available-for-sale:				
Obligations of U.S. Government agencies and corporations	\$ -	\$ 123,643	\$ -	\$ 123,643
Obligations of states and political subdivisions	-	95,551	-	95,551
Other	-	350	-	350
Total	<u>\$ -</u>	<u>\$ 219,544</u>	<u>\$ -</u>	<u>\$ 219,544</u>
Nonrecurring:				
Other real estate owned	\$ -	\$ -	\$ 865	\$ 865
Impaired loans	-	-	7,854	7,854
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,719</u>	<u>\$ 8,719</u>

Other real estate owned, which is measured at the lower of carrying or fair value less costs to sell, had a net carrying amount as of December 31, 2015 of \$287,000. Other real estate owned had a net carrying amount of \$865,000 made up of the balance of \$957,000, net of a valuation allowance of \$92,000, at December 31, 2014. Write-downs for the year of other real estate owned amounted to \$152,000 and \$57,000 for the years ended December 31, 2015 and 2014, respectively, and are included in other non-interest expenses.

There were no transfers of financial instruments between Levels 1 and 2 during 2015 and 2014.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, follows.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality, the Corporation's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Corporation's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Corporation's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

### ***Securities Available-for-Sale***

Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would typically include government bonds and exchange traded equities. If quoted market prices are not available, then fair values are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Examples of such instruments, which would generally be classified within Level 2 of the valuation hierarchy, include corporate and municipal bonds, mortgage-backed securities, and asset-backed securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. The Corporation did not have any securities classified as Level 1 or Level 3 at December 31, 2015 and 2014.



## NOTE 19 - FAIR VALUE MEASUREMENTS (CONTINUED)

### *Impaired Loans*

The Corporation does not record impaired loans at fair value on a recurring basis. However, periodically, a loan is considered impaired and is reported at the fair value of the underlying collateral, less estimated costs to sell, if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs, including recent appraisals and Level 3 inputs based on customized discounting criteria including discounting of appraisals based on age or changes in property or market conditions. These discounts generally range from 10% to 55%. Collateral values are also discounted for estimated selling costs of 10%. Estimated cash flows are discounted considering the loan rate and current market rates and generally range from 5% to 11%. Due to the significance of the Level 3 inputs, impaired loans fair values have been classified as Level 3.

### *Other Real Estate Owned*

The Corporation values other real estate owned at the estimated fair value of the underlying collateral less expected selling costs, generally approximating 10%. Such values are estimated primarily using appraisals and reflect a market value approach. Due to the significance of the Level 3 inputs, other real estate owned has been classified as Level 3.

## NOTE 20 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair values of recognized financial instruments at December 31, 2015 and 2014, as well as indication of where the instrument falls within the fair value hierarchy described in Note 19, are as follows (dollars in thousands):

	<u>2015</u>		<u>2014</u>	
	<u>Carrying amount</u>	<u>Fair value</u>	<u>Carrying amount</u>	<u>Fair value</u>
FINANCIAL ASSETS				
Cash and cash equivalents	\$ 18,101	\$ 18,101	\$ 13,647	\$ 13,647
Securities	195,961	195,961	225,407	225,407
Loans, net	<u>524,527</u>	<u>531,494</u>	<u>479,788</u>	<u>492,020</u>
Total	<u>\$ 738,589</u>	<u>\$ 745,556</u>	<u>\$ 718,842</u>	<u>\$ 731,074</u>
FINANCIAL LIABILITIES				
Deposits	\$ 650,445	\$ 652,936	\$ 649,270	\$ 650,806
Federal funds purchased and securities sold under repurchase agreements	22,869	22,869	22,450	22,450
Borrowed funds	<u>19,362</u>	<u>19,571</u>	<u>8,821</u>	<u>9,341</u>
Total	<u>\$ 692,676</u>	<u>\$ 695,376</u>	<u>\$ 680,541</u>	<u>\$ 682,597</u>

The preceding summary does not include accrued interest receivable, cash surrender value of life insurance, dividends payable, and other liabilities which are also considered financial instruments. The estimated fair value of such items is considered to be their carrying amount.

The Bank also has unrecognized financial instruments which relate to commitments to extend credit and standby letters of credit. The contract amount of such financial instruments was \$113,144,000 at December 31, 2015 and \$111,206,000 at December 31, 2014. The fair value of such instruments is not considered significant since they represent commitments at current interest rates.

The following methods and assumptions were used to estimate fair value of each class of financial instruments:

### **Cash and Cash Equivalents**

Fair value is determined to be the carrying amount for these items because they represent cash or mature in 90 days or less and do not represent unanticipated credit concerns.

## **NOTE 20 - FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)**

### **Securities**

The fair value of available-for-sale securities is determined based on quoted market prices of the individual securities or, if not available, estimated fair value was obtained by comparison to other known securities with similar risk and maturity characteristics. Such value does not consider possible tax ramifications or estimated transaction costs. The fair value of restricted stock is considered to be its carrying amount.

### **Loans**

Fair value for loans is estimated for portfolios of loans with similar financial characteristics. For adjustable rate loans, which re-price at least annually and generally possess low risk characteristics, the carrying amount is believed to be a reasonable estimate of fair value. For fixed-rate loans, the fair value is estimated based on a discounted cash flow analysis, considering weighted average rates and terms of the portfolio, adjusted for credit and interest rate risk inherent in the loans. Fair value for nonperforming loans is based on recent appraisals or estimated discounted cash flows. The estimated value of credit card loans is based on existing loans and does not include the value that relates to estimated cash flows from new loans generated from existing cardholders over the remaining life of the portfolio.

### **Deposit**

The fair value of core deposits, including demand deposits, savings accounts, and certain money market deposits, is the amount payable on demand. The fair value of fixed-maturity certificates of deposit is estimated using the rates offered at year end for deposits of similar remaining maturities. The estimated fair value does not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the marketplace.

### **Other Financial Instruments and Borrowed Funds**

Federal funds purchased and securities sold under repurchase agreements are considered to be short-term borrowings and are valued at carrying value. Borrowed funds are typically long-term in nature with fair value determined based on discounted cash flow analysis using current interest rates.

The fair value estimates of financial instruments are made at a specific point in time based on relevant market information. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect these estimates.

## **NOTE 21 - COMMITMENTS AND CONTINGENCIES**

The Bank has entered into multi-year agreements to lease certain of its facilities, as well as equipment under various short-term operating leases through June 2020. Rent expense under these agreements amounted to \$24,000 in 2015 and \$15,000 in 2014. Future minimum lease payments under long-term operating leases aggregate \$148,000 at December 31, 2015 as follows: annually 2016 through December 31, 2019 \$33,000; and \$16,000 in 2020.

In the normal course of business, the Corporation and Bank may be involved in various legal actions, but in the opinion of management and its legal counsel, the ultimate disposition of such matters is not expected to have a material adverse effect on the consolidated financial statements.

# LOCATIONS

## FREMONT

MAIN  
323 Croghan Street  
Fremont, OH 43420  
419-332-7301

BALLVILLE  
1600 River Street  
Fremont, OH 43420  
419-355-2361

EAST  
1315 East State Street  
Fremont, OH 43420  
419-355-2342

NORTH  
910 Sean Drive  
Fremont, OH 43420  
419-334-7188

WEST  
2001 West State Street  
Fremont, OH 43420  
419-355-2352

## BELLEVUE

One Union Square  
Bellevue, OH 44811  
419-483-7395

## CLYDE

100 North Main Street  
Clyde, OH 43410  
419-547-9525

## CURTICE

7182 North Lucas Street  
Curtice, OH 43412  
419-836-7722

## GREEN SPRINGS

200 North Broadway Street  
Green Springs, OH 44836  
419-639-2225

## MAUMEE LPO

6465 Wheatstone Court  
Building A, Suite C  
Maumee, OH 43537  
419-794-9399

## MONROEVILLE

11 Monroe Street  
Monroeville, OH 44847  
419-465-2596

## NORWALK

60 Whittlesey Avenue  
Norwalk, OH 44857  
419-668-2507

## OAK HARBOR

147 West Water Street  
Oak Harbor, OH 43449  
419-898-5741

## OREGON

4157 Navarre Avenue  
Oregon, OH 43616  
419-691-6264

## PORT CLINTON

CATAWBA  
2820 East Harbor Road  
Port Clinton, OH 43452  
419-732-6150

DOWNTOWN  
226 East Perry Street  
Port Clinton, OH 43452  
419-734-5600

## TIFFIN

DOWNTOWN  
48 East Market Street  
Tiffin, OH 44883  
419-447-8777

WESTGATE  
796 West Market Street  
Tiffin, OH 44883  
419-447-2250

## ADDITIONAL ATM LOCATIONS

MAUMEE BAY STATE PARK  
1750 Park Road  
Oregon, OH 43616

PUT-IN-BAY  
266 Delaware Avenue  
Put-In-Bay, OH 43456

