

**STURGIS BANCORP, INC.**

**CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2024 and 2023

STURGIS BANCORP, INC.  
FINANCIAL STATEMENTS  
December 31, 2024 and 2023

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March 20, 2025

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

### ***Opinion***

We have audited the consolidated financial statements of ***Sturgis Bancorp, Inc.*** (the "Bancorp"), which comprise the consolidated balance sheets as of December 31, 2024 and 2023, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements (the "financial statements").

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of ***Sturgis Bancorp, Inc.*** as of December 31, 2024 and 2023, and the consolidated results of its operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### ***Basis for Opinion***

We conducted our audits in accordance with auditing standards generally accepted in the United States of America ("GAAS"). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are required to be independent of the Bancorp and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Responsibilities of Management 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, and for 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.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Bancorp's ability to continue as a going concern within one year after the date that the consolidated financial statements are available to be issued.



### ***Auditors' Responsibilities for the Audit of the Consolidated Financial Statements***

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Bancorp's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Bancorp's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

*Rehmann Lohman LLC*

STURGIS BANCORP, INC.  
CONSOLIDATED BALANCE SHEETS  
December 31, 2024 and 2023  
(Amounts in thousands, except share and per share data)

	<u>2024</u>	<u>2023</u>
<b>ASSETS</b>		
Cash and due from banks	\$ 10,628	\$ 10,243
Other short-term investments	<u>10,174</u>	<u>29,766</u>
Total cash and cash equivalents	20,802	40,009
Securities – available-for-sale	77,072	52,658
Securities – held-to-maturity	19,442	20,866
Federal Home Loan Bank stock	9,786	7,295
Loans held for sale	3,658	2,259
Loans, net of allowance for credit losses of \$9,289 and \$10,198 at December 31 2024 and 2023, respectively	768,430	739,461
Premises and equipment, net	18,708	19,136
Goodwill	5,834	5,834
Mortgage servicing rights	3,121	2,979
Bank-owned life insurance	15,402	15,832
Accrued interest receivable	3,405	3,099
Other assets	<u>10,729</u>	<u>10,044</u>
Total assets	<u>\$ 956,389</u>	<u>\$ 919,472</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities		
Deposits		
Noninterest-bearing	\$ 157,782	\$ 159,899
Interest-bearing	<u>656,077</u>	<u>639,039</u>
Total deposits	813,859	798,938
Federal Home Loan Bank advances and other borrowings	61,100	40,000
Subordinated debentures	14,919	14,836
Accrued interest payable	2,600	1,654
Other liabilities	<u>8,502</u>	<u>8,276</u>
Total liabilities	900,980	863,704
Stockholders' equity		
Common stock - \$1 par value: authorized – 9,000,000 shares issued and outstanding 2,159,191 shares at December 31, 2024 and 2,150,191 shares at December 31, 2023	2,159	2,150
Additional paid-in capital	8,699	8,556
Retained earnings	53,398	52,029
Accumulated other comprehensive loss	<u>(8,847)</u>	<u>(6,967)</u>
Total stockholders' equity	<u>55,409</u>	<u>55,768</u>
Total liabilities and stockholders' equity	<u>\$ 956,389</u>	<u>\$ 919,472</u>

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.  
CONSOLIDATED STATEMENTS OF INCOME  
Years ended December 31, 2024 and 2023  
(Amounts in thousands, except share and per share data)

	<u>2024</u>	<u>2023</u>
Interest and dividend income		
Loans (including fees)	\$ 42,534	\$ 37,964
Investment securities:		
Taxable	3,298	1,965
Tax-exempt	177	361
Dividends	<u>733</u>	<u>479</u>
Total interest and dividend income	46,742	40,769
Interest expense		
Deposits	15,170	10,725
Borrowed funds	<u>3,553</u>	<u>1,542</u>
Total interest expense	<u>18,723</u>	<u>12,267</u>
<b>Net interest income</b>	28,019	28,502
Credit loss expense	<u>4,585</u>	<u>1,269</u>
<b>Net interest income, after credit loss expense</b>	23,434	27,233
Noninterest income		
Service charges on deposits and other fees	1,372	1,356
Interchange income	1,369	1,349
Investment brokerage commission income	2,578	2,203
Mortgage banking activities	1,823	1,484
Trust fee income	465	365
Earnings on cash value of bank owned life insurance	867	887
Gain on sale of real estate owned, net	77	56
Gain on termination of interest rate swap	1,070	793
Proportionate net income from unconsolidated subsidiaries	365	224
Other income	<u>92</u>	<u>190</u>
Total noninterest income	10,078	8,907
Noninterest expenses		
Compensation and benefits	17,680	17,459
Occupancy and equipment	4,260	3,739
Data processing	1,319	988
Interchange expenses	708	650
Professional services	580	525
Advertising	827	723
FDIC premiums	741	675
Other expenses	<u>4,239</u>	<u>4,224</u>
Total noninterest expenses	<u>30,354</u>	<u>28,983</u>
<b>Income before income tax expense</b>	3,158	7,157
Income tax expense	<u>323</u>	<u>1,139</u>
<b>Net income</b>	<u>\$ 2,835</u>	<u>\$ 6,018</u>
Earnings per share	\$ 1.32	\$ 2.81

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
Years ended December 31, 2024 and 2023  
(Amounts in thousands, except share and per share data)

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	<u>2024</u>	<u>2023</u>
Net income	\$ 2,835	\$ 6,018
Other comprehensive income (loss)		
Unrealized holding (loss) gain on AFS securities arising during the period	(1,150)	947
Reclassification adjustment for losses recognized on securities	151	133
Tax effect	<u>210</u>	<u>(227)</u>
Net of tax	(789)	853
Change in post-retirement obligation	(35)	681
Reclassification adjustment for amortization of prior service cost and net loss (gain) included in net periodic pension cost	44	(613)
Tax effect	<u>(2)</u>	<u>(14)</u>
Net of tax	7	54
Unrealized (loss) gain on cash flow hedge	(622)	388
Reclassification adjustment for losses recognized in net income	(767)	(1,532)
Tax effect	<u>291</u>	<u>240</u>
Net of tax	<u>(1,098)</u>	<u>(904)</u>
Total other comprehensive (loss) income	<u>(1,880)</u>	<u>3</u>
Comprehensive income	<u>\$ 955</u>	<u>\$ 6,021</u>

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See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
Years ended December 31, 2024 and 2023  
(Amounts in thousands, except share and per share data)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
<b>Balance – January 1, 2023</b>	\$ 2,141	\$ 8,387	\$ 48,990	\$ (6,970)	\$ 52,548
Change in accounting principle	-	-	(1,522)	-	(1,522)
Comprehensive income	-	-	6,018	3	6,021
Common stock issued (9,000 shares)	9	169	-	-	178
Cash dividends (\$0.68 per share)	<u>-</u>	<u>-</u>	<u>(1,457)</u>	<u>-</u>	<u>(1,457)</u>
<b>Balance – December 31, 2023</b>	<u>\$ 2,150</u>	<u>\$ 8,556</u>	<u>\$ 52,029</u>	<u>\$ (6,967)</u>	<u>\$ 55,768</u>
Comprehensive income	-	-	2,835	(1,880)	955
Common stock issued (9,000 shares)	9	143	-	-	152
Cash dividends (\$0.68 per share)	<u>-</u>	<u>-</u>	<u>(1,466)</u>	<u>-</u>	<u>(1,466)</u>
<b>Balance – December 31, 2024</b>	<u>\$ 2,159</u>	<u>\$ 8,699</u>	<u>\$ 53,398</u>	<u>\$ (8,847)</u>	<u>\$ 55,409</u>

See accompanying notes to consolidated financial statements.



STURGIS BANCORP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
Years ended December 31, 2024 and 2023  
(Amounts in thousands)

	<u>2024</u>	<u>2023</u>
<b>Cash flows from operating activities</b>		
Net income	\$ 2,835	\$ 6,018
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and software amortization	1,478	1,345
Amortization of mortgage servicing rights	687	566
Amortization of subordinated debt issuance costs	83	81
Credit loss expense	4,585	1,269
Accretion and amortization of securities	(118)	303
Gain on sale of fixed assets	(16)	(109)
Gain on sale of loans	(1,812)	(1,348)
Proceeds from the sale of loans held for sale	60,125	43,616
Loans originated for sale	(60,579)	(44,441)
Mortgage servicing rights valuation allowance	38	-
Gain on sale of real estate owned	(75)	(49)
Write-down of real estate owned	-	50
Loss on sale of available for sale securities	151	133
Decrease in cash value of bank-owned life insurance	430	156
Amortization of low income housing tax partnerships	175	206
Shares issued/expensed	152	178
Changes in assets and liabilities:		
Increase in accrued interest and other assets	(2,612)	(464)
Increase in accrued interest and other liabilities	1,640	2,715
Net change in operating activities	<u>7,167</u>	<u>10,225</u>
<b>Cash flows from investing activities</b>		
Maturities of securities available-for-sale	20	15
Proceeds from sale of securities available for sale	4,296	8,008
Purchase of securities available-for-sale	(33,493)	-
Principal reduction on securities available-for-sale	3,865	3,170
Principal reduction on securities held-to-maturity	1,376	1,156
Purchase of loans	(5,000)	-
Loan principal originations, net	(28,842)	(43,202)
Proceeds from sale of real estate owned	374	542
(Purchase) sale of FHLB stock	(2,491)	1,086
Proceeds from sales of premises and equipment	36	296
Additions to premises and equipment	(1,070)	(3,237)
Net change in investing activities	<u>(60,929)</u>	<u>(32,166)</u>

(Continued)

STURGIS BANCORP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
Years ended December 31, 2024 and 2023  
(Amounts in thousands)

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	<u>2024</u>	<u>2023</u>
<b>Cash flows from financing activities</b>		
Net increase in deposits	\$ 14,921	\$ 79,422
Repayment of FHLB advances and other borrowings	(366,000)	(332,300)
Proceeds from FHLB advances and other borrowings	387,100	301,300
Cash dividends paid on common stock	<u>(1,466)</u>	<u>(1,457)</u>
Net change in financing activities	34,555	46,965
Net change in cash and cash equivalents	(19,207)	25,024
Cash and cash equivalents – beginning of year	<u>40,009</u>	<u>14,985</u>
<b>Cash and cash equivalents – end of year</b>	<u><b>\$ 20,802</b></u>	<u><b>\$ 40,009</b></u>
Supplemental information		
Cash paid for:		
Interest	\$ 17,778	\$ 11,372
Income taxes	258	1,005
Noncash investing and financing activities		
Loans transferred to real estate owned	321	293

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See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2024 and 2023  
(Amounts in thousands, except share and per share data)

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Basis of Presentation and Consolidation: The accompanying consolidated financial statements include the accounts of Sturgis Bancorp, Inc. (the Bancorp), Sturgis Bank & Trust Company (the Bank) and the Bank's wholly owned subsidiaries. The Bank's wholly owned subsidiaries include Oakleaf Financial Services, Inc., Oak Mortgage, LLC, and First Michiana Development Corporation of Sturgis, Inc. All significant intercompany transactions and balances have been eliminated in consolidation. Oakleaf Financial Services offers a complete range of investment and financial advisory services. Oak Mortgage offers residential mortgages in all markets of the Bank. First Michiana Development Corporation invests in unconsolidated subsidiaries Ayres Insurance Agency, Inc. and Oak Title, LLC. Ayres Insurance Agency, Inc., doing business as Ayres/Oak Insurance, offers various commercial and consumer insurance products. Oak Title, LLC offers commercial and consumer title insurance.

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

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

The Bank is a state-chartered bank and a member of the Federal Deposit Insurance Corporation ("FDIC") Bank Insurance Fund. The Bank is subject to the regulations and supervision of the FDIC and state regulators and undergoes periodic examinations by these regulatory authorities. The Bancorp is also subject to regulations of the Federal Reserve Board governing bank holding companies.

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

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

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

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

STURGIS BANCORP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2024 and 2023  
(Amounts in thousands, except share and per share data)

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

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

Interest income includes amortization of purchase premiums or discounts. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities, which is the earlier of call date or maturity date. Premiums on callable debt securities are amortized to their earliest call date. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

A debt security is placed on nonaccrual status at the time any principal or interest payments become 90 days delinquent. Interest accrued but not received for a security placed on nonaccrual is reversed against interest income.

*Allowance for Credit Losses - Available-for-Sale Securities*

In estimating the allowance for credit losses of available-for-sale debt securities in an unrealized loss position, management first assesses whether it intends to sell, or it is more likely than not that it will be required to sell the security before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the security's amortized cost basis is written down to fair value through income. For debt securities available-for-sale that do not meet this criteria, management evaluates whether the decline in fair value has resulted from credit losses or other factors. Management also considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency, and adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an allowance for credit losses is recorded for the credit loss, limited by the amount that the fair value is less than the amortized cost basis. Any impairment that has not been recorded through an allowance for credit losses is recognized in other comprehensive income.

Changes in the allowance for credit losses are recorded as credit loss expense (or reversal). Losses are charged against the allowance when management believes the uncollectibility of an available-for-sale security is confirmed or when either of the criteria regarding intent or requirement to sell is met.

Accrued interest receivable on available-for-sale debt securities totaled \$265 and \$192 at December 31, 2024 and 2023, respectively, and is excluded from the estimate of credit losses.

*Allowance for Credit Losses - Held-to-Maturity Securities*

Held-to-maturity debt securities are measured on a collective basis by major security type for expected credit losses, if any. Management classifies the held-to-maturity portfolio into major security types. The estimate of expected credit losses considers historical credit loss information that is adjusted for current conditions and reasonable and supportable forecasts. Accrued interest receivable on held-to-maturity debt securities totaled \$34 and \$37 at December 31, 2024 and 2023, respectively, and is excluded from the estimate of credit losses.

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(Continued)

STURGIS BANCORP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2024 and 2023  
(Amounts in thousands, except share and per share data)

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

The held-to-maturity securities consist entirely of mortgage-backed residential securities which are government agency issued and are therefore either explicitly or implicitly guaranteed by the U.S. government, highly rated by major rating agencies and have a long history of no credit losses.

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

Loans Held for Sale: Loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value. The fair value includes the servicing value of the loans as well as any accrued interest.

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

Loans: The Bancorp grants mortgage, commercial, and consumer loans to customers. Loans are reported at their outstanding unpaid principal balances, adjusted for amounts charged off, nonaccrual interest paid, the allowance for credit losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. The accrued interest related to loans was \$3,108 and \$2,866 at December 31, 2024 and 2023, respectively, and is excluded from the estimate of credit losses. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment to the related loan yield using the interest method.

The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent, unless the credit is well-secured and in the process of collection. Past due status is based on the contractual terms of the loan. In all cases, if collection of principal and interest is considered doubtful, loans are placed on nonaccrual, charged off, or charged down to the fair value.

When a loan is placed in nonaccrual status, all interest accrued in the current year but not collected is reversed against interest income, while interest accrued but not collected in prior years is reversed against the allowance for credit losses. Interest payments received on loans in nonaccrual status are accounted for as reductions to the carrying value of the principal. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. For impaired loans not classified as nonaccrual, interest income is recognized daily as it is earned according to the terms of the loan agreement.

Nonperforming loans of the loan portfolio are comprised of those loans accounted for on a nonaccrual basis (90 days or more past due on commercial loans, 120 days or more past due on secured consumer loans, and 180 days past due on residential real estate loans).

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(Continued)

STURGIS BANCORP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2024 and 2023  
(Amounts in thousands, except share and per share data)

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Allowance for Credit Losses: The allowance for credit losses ("allowance") is a valuation account that is deducted from, or added to, the loans' amortized cost basis to present the net amount expected to be collected on the loans. Loan losses are charged against the allowance, when management believes the uncollectability of a loan balance is confirmed. Expected recoveries do not exceed the aggregate of amounts previously charged-off and expected to be charged-off. Cash received on previously charged off amounts is recorded as a recovery to the allowance.

Management estimates the allowance balance using relevant available information, from internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts. The Bancorp uses a Discounted Cash Flow (DCF) model which projects cash flows over the life of the loan. Management had utilized top-down data from prior cycles of expected losses as of December 31, 2023 and changed that assumption used in the DCF model to the probability of default and loss given default to improve the overall quantification of the allowance estimate, using both the institution's own data and peer institution data from FFIEC Call Report filings. The Bancorp uses the Federal Open Market Committee (FOMC) as a source to obtain various forecast scenarios to determine the loan portfolio's expected credit loss. Historical credit loss experience provides the basis for the estimation of expected credit losses. Qualitative adjustments are made to historical loss information that may increase or reduce reserve levels and include adjustments for changes in lending policies, procedures, and strategies, changes in nature and volume of portfolio, staff experience, changes in volume and trends in classified loans, delinquencies, and nonaccruals, concentration risk, trends in underlying collateral value, external factors, such as competition, legal, and regulatory, changes in quality of the loan review system and other economic condition considerations.

The allowance for credit losses is measured on a collective (pool) basis when similar risk characteristics exist. The Bancorp has identified the following portfolio segments:

Commercial – Loans to businesses that are sole proprietorships, partnerships, limited liability companies and corporations. These loans are for commercial, industrial, or professional purposes. The risk characteristics of these loans vary based on the borrower's business and industry as repayment is typically dependent on cash flows generated from the underlying business.

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

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

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

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(Continued)

STURGIS BANCORP, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2024 and 2023  
(Amounts in thousands, except share and per share data)

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

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

Loans that do not share risk characteristics are evaluated on an individual basis. A loan is considered impaired, based on current information and events, when it is probable the Bancorp will be unable to collect the scheduled payments of principal or interest in accordance with the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls are not generally classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including length of the delay, reasons for the delay, the borrower's prior payment history, and the amount of the shortfall in relation to the amount due compared to the present value of expected future cash flows discounted at the loan's effective interest rate, the loans observable market price, or the fair value of the collateral, less costs to sell, if the loan is collateral dependent. A loan is collateral dependent if its repayment is expected to be provided solely by the underlying collateral. Impairment on a loan is generally measured on a loan-by-loan basis for commercial, commercial real estate, and residential loans where the borrower has been identified as having financial difficulty.

The majority of the Bancorp's consumer and residential loan portfolio is comprised of secured loans that are evaluated at origination on a centralized basis against standardized underwriting criteria. The ongoing measurement of credit quality of the consumer and residential loan portfolios is largely done on an exception basis. If payments are made on schedule, as agreed, then no further monitoring is performed. However, if delinquency occurs, the delinquent loans are turned over to the Bancorp's collection department for resolution, which generally occurs fairly rapidly and often through repossession and foreclosure. Credit quality for the entire consumer and residential loan portfolio is measured by the periodic delinquency rate, nonaccrual amounts and actual losses incurred.

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

For borrowers that are in financial distress, the Bancorp may provide relief to the borrower by modifying the loan through principal forgiveness, term extension, interest rate reduction or an other-than-significant payment delay. When principal forgiveness is provided, the amount of the forgiveness is charged off against the allowance for credit losses.

Although management believes the allowance to be appropriate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the appropriateness of the allowance, including consideration of the relevant risks in the portfolio, current economic conditions, and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bancorp's primary regulators review the appropriateness of the allowance. The regulatory agencies may require changes to the allowance based on their judgment about information available at the time of their examination.

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Since adoption of ASU 2016-13, the Bancorp has elected the Loss Rate, Expected Loss (i.e. simplified DCF) approach to estimate the ACL on a quarterly basis. As part of an annual update to modeling inputs and assumptions, the Bancorp elected to migrate in the year ended December 31, 2024 to “PD/LGD,” Present Value of Loss-Adjusted Cash Flows method. This migration was made to improve quantification of allowance estimates, provide additional levers through which reserves are estimated, and more explicitly satisfy requirements and best practices under ASU 2016-13.

Transfers of Financial Assets: Transfers of financial assets, including mortgage loans held for sale, are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Bancorp, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Bancorp does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. Other than servicing, as discussed in Note 5 *Mortgage Servicing Rights*, the Bancorp has no substantive continuing investment related to these loans.

Originated Mortgage Servicing Rights: Servicing rights are recognized separately when they are acquired through sales of loans. When mortgage loans are sold, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for individual groupings, to the extent that fair value is less than the carrying amount. Changes in valuation allowances are reported with mortgage banking activities on the consolidated statements of income. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income, which is reported on the consolidated statements of income as mortgage banking activities, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income. Servicing fees totaled \$875 and \$842 for the years ended December 31, 2024 and 2023, respectively, and is included in mortgage banking activities on the consolidated statements of income. Late fees and ancillary fees related to loan servicing were not material for presentation.

Premises and Equipment: Land is carried at cost. Premises and equipment are carried at cost, less accumulated depreciation computed on the straight-line method over the estimated useful lives of the assets. Buildings and related components are depreciated with useful lives ranging from 5 to 40 years. Furniture, fixtures, and equipment are depreciated with useful lives ranging from 3 to 15 years. Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Lease Arrangements: The Bancorp enters into leases in the normal course of business primarily for various operating equipment. Leases are classified as operating or finance leases at the lease commencement date. The Bancorp has elected not to recognize leases with original lease terms of 12 months or less (short-term leases) on the consolidated balance sheet. Lease expense for operating leases and short-term leases is recognized on a straight-line basis over the lease term. Right-of-use assets represent the Bancorp's right to use an underlying asset for the lease term and lease liability represent the Bancorp's obligation to make lease payments arising from the lease. Right-of-use assets and lease liability are recognized at the lease commencement date based on the estimated present value of lease payments over the lease term. As of December 31, 2024 and 2023, there was no material identified right-of-use asset or liability on the consolidated balance sheets.

Real Estate Owned: Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value at the date of foreclosure, less costs to sell when acquired, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in real estate owned expense, net, on the consolidated statements of income. Bancorp had \$153 and \$130 in real estate owned on December 31, 2024 and 2023, respectively.

Bank-Owned Life Insurance: The Bancorp has purchased life insurance policies on certain key officers. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement. The change in cash surrender value is an adjustment of premiums paid in determining the net expense or income recognized under the contracts for the year and is included in noninterest income on the consolidated statements of income.

Goodwill: Generally, intangible assets that meet certain criteria are recognized and subsequently amortized over their estimated useful lives. Goodwill with indefinite lives are not amortized, but are evaluated for impairment at least annually or on an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below the carrying value. There has been no impairment of goodwill.

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

The allowance for credit losses on off-balance-sheet credit exposures is a liability account, calculated in accordance with ASC 326, representing expected credit losses over the contractual period for which the Bancorp is exposed to credit risk resulting from a contractual obligation to extend credit. No allowance is recognized if the Bancorp has the unconditional right to cancel the obligation. Adjustments to the allowance are reported in the consolidated statement of income as a component of credit loss expense. For the period of exposure, the estimate of expected credit losses considers both the likelihood that funding will occur and the amount expected to be funded over the estimated remaining life of the commitment or other off-balance-sheet exposure. The likelihood and expected amount of funding are based on historical utilization rates. The amount of the allowance represents management's best estimate of expected credit losses on commitments expected to be funded over the contractual life of the

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

commitment. Estimating credit losses on amounts expected to be funded uses the same methodology as described for loans as if such commitments were funded.

Derivatives: The Bancorp periodically enters into hedge agreements, designated as one of two types based on the Bancorp's intentions and belief as to likely effectiveness as a hedge. These two types are (1) a hedge of the fair value of a recognized asset or liability or an unrecognized firm commitment ("fair value hedge"), or (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, are recognized in current earnings as fair values changes. For each cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same period during which the hedged transaction affects earnings. Changes in the fair value of derivatives that are not highly effective in hedging the changes in expected cash flows of the hedged item are recognized immediately in current earnings.

Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged.

The Bancorp formally documents the relationship between hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions at the inception of the hedging relationship. This documentation includes linking cash flow hedges to specific liabilities on the consolidated balance sheet or to specific firm commitments or forecasted transactions. The Bancorp also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in fair values or cash flows of the hedged items. The Bancorp discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the cash flows of the hedged item, the derivative is settled or terminates, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded as noninterest income. When a fair value hedge is discontinued, the hedged asset or liability is no longer adjusted for changes in fair value and the existing basis adjustment is amortized or accreted over the remaining life of the asset or liability. When a cash flow hedge is discontinued but the hedged cash flow or forecasted transactions are still expected to occur, gains or losses that were accumulated in other comprehensive income are amortized into earnings over the same periods which the hedged transactions will affect earnings.

The Bancorp is exposed to losses if a counterparty fails to make its payments under a contract in which the Bancorp is in the net receiving position. The Bancorp anticipates that the counterparties will be able to fully satisfy their obligations under the agreements. All of the contracts to which the Bancorp is a party settle monthly or quarterly. In addition, the Bancorp obtains collateral above certain thresholds of the fair value of its derivatives for each dealer counterparty based upon their credit standing and the Bancorp has netting agreements with the dealers with which it does business.

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

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

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

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

Earnings Per Share: Basic earnings per share represents income available to common stockholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share includes outstanding additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. As of December 31, 2024 and 2023, there were no dilutive common shares. For the years ended December 31, 2024 and 2023, weighted average shares used in computing earnings per share were 2,152,589 and 2,144,723, respectively.

Common and Preferred stock issuances: The Bancorp issues common stock to directors for their board service. Shares are issued on a quarterly basis in accordance with the amount of director fees established annually. Shares of 9,000 were issued for directors' fees in both 2024 and 2023 and vested immediately upon issuance. Expense associated with the issuance of stock for director fees is reflected in the consolidated income statement in other noninterest expense and was \$152 and \$178 for 2024 and 2023, respectively. The Bancorp also has authorized 1,000,000 shares of preferred stock. No preferred shares have been issued or are outstanding.

Comprehensive Income (Loss): Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale, changes in the fair value of cash flow hedges, and changes in the post retirement benefit obligation, which are also recognized as separate components of equity.

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

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. For more information, see Note 14 *Fair Value of Financial Instruments*.

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(Continued)

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Revenue Recognition: The majority of the Bancorp's revenues come from interest income and other sources, including loans, securities, and derivatives, that are outside of the scope of ASC 606 *Revenue from Contracts with Customers*. The Bancorp's services that fall within the scope of ASC 606 are presented within noninterest income and are recognized as revenue as the Bancorp satisfies its obligation to the customer. Services within the scope of ASC 606 include service charges on deposits, interchange income, wealth management fees, investment brokerage fees, and the sale of real estate owned.

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Deposit service charges include transaction-related fee income, such as NSF fees or ATM fees, and are recognized as income when the service is performed. Deposit service charges also include recurring charges for the account, which are recognized as income at the time the charges are assessed. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are deducted from the customer's account balance. Interchange income is recognized on a monthly basis on a one-month delay, so the Bancorp accrues an estimate of interchange income receivable.

The Bancorp earns wealth management (and investment brokerage) fees from its contracts with trust (and brokerage) customers to manage assets for investment, and/or to transact on their accounts. These fees are primarily earned over time as the Bancorp provides the contracted monthly or quarterly services and are generally assessed based on a tiered scale of the market value of assets under management (AUM) at month-end. Fees that are transaction based, including trade execution services, are recognized at the point in time that the transaction is executed, i.e., the trade date. Other related services provided include (financial planning services) and the fees the Bancorp earns, which are based on a fixed fee schedule, are recognized when the services are rendered.

The Bancorp earns fees from investment brokerage services provided to its customers by a third-party service provider. The Bancorp receives commissions from the third-party service provider on a monthly basis based upon customer activity for the month. The fees are recognized quarterly, and a receivable is recorded until commissions are generally paid by the 25th of the following quarter. Because the Bancorp (i) acts as an agent in arranging the relationship between the customer and the third-party service provider and (ii) does not control the services rendered to the customers, investment brokerage fees are presented net of related costs.

Gain on sale of real estate owned is calculated and recognized as income upon sale of the real estate.

Reclassifications: Certain amounts as reported on the 2023 consolidated financial statements have been reclassified to conform with the 2024 presentation.

Subsequent Events: In preparing these consolidated financial statements, the Bancorp has evaluated, for potential recognition or disclosure, significant events or transactions that occurred during the period subsequent to December 31, 2024, the most recent balance sheet presented herein, through the date these consolidated financial statements were available to be issued.

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STURGIS BANCORP, INC.  
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**NOTE 2 – SECURITIES**

The amortized cost and fair value of securities with gross unrealized / unrecognized gains and losses follow as of December 31:

	Amortized <u>Cost</u>	Gross Unrealized/ Unrecognized <u>Gains</u>	Gross Unrealized/ Unrecognized <u>Losses</u>	Fair <u>Value</u>
<u>2024</u>				
Available-for-sale securities:				
U. S. government sponsored entities and agencies	\$ 9,960	\$ -	\$ (2,171)	\$ 7,789
State and political subdivisions	7,014	-	(1,436)	5,578
Mortgage-backed securities-residential	16,601	-	(3,073)	13,528
Mortgage-backed securities-commercial	4,012	-	(294)	3,718
CMO-residential	18,140	43	(1,907)	16,276
CMO-commercial	<u>32,206</u>	<u>-</u>	<u>(2,023)</u>	<u>30,183</u>
Total available-for-sale	87,933	43	(10,904)	77,072
Held-to-maturity securities:				
Mortgage-backed securities-residential	<u>19,442</u>	<u>-</u>	<u>(4,314)</u>	<u>15,128</u>
Total securities	<u>\$ 107,375</u>	<u>\$ 43</u>	<u>\$ (15,218)</u>	<u>\$ 92,200</u>
<u>2023</u>				
Available-for-sale securities:				
U. S. government sponsored entities and agencies	\$ 9,994	\$ -	\$ (2,090)	\$ 7,904
State and political subdivisions	11,507	1	(1,315)	10,193
Mortgage-backed securities-residential	18,079	-	(2,827)	15,252
Mortgage-backed securities-commercial	4,191	-	(370)	3,821
CMO-residential	9,367	-	(1,726)	7,641
CMO-commercial	<u>9,382</u>	<u>-</u>	<u>(1,535)</u>	<u>7,847</u>
Total available-for-sale	62,520	1	(9,863)	52,658
Held-to-maturity securities:				
Mortgage-backed securities-residential	<u>20,866</u>	<u>-</u>	<u>(3,931)</u>	<u>16,935</u>
Total securities	<u>\$ 83,386</u>	<u>\$ 1</u>	<u>\$ (13,794)</u>	<u>\$ 69,593</u>

Securities with amortized cost of \$7,929 (fair value of \$6,651) were pledged at December 31, 2024 to secure FRB borrowings. Securities with amortized cost of \$8,432 (fair value of \$7,102) were pledged at December 31, 2023 to secure FRB borrowings.

(Continued)

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**NOTE 2 – SECURITIES** (Continued)

Securities with an amortized cost of \$3,649 (fair value of \$2,930) were pledged at December 31, 2024 to secure derivatives. No securities were pledged at December 31, 2023 to secure derivatives.

Securities with an amortized cost of \$6,960 (fair value of \$5,538) were pledged at December 31, 2024 to secure deposits. No securities were pledged at December 31, 2023 to secure deposits.

Securities with fair value of \$4,296 were sold in the year ended December 31, 2024, generating a \$151 loss on sale. Securities with fair value of \$8,008 were sold in the year ended December 31, 2023, generating a \$133 loss on sale.

The amortized cost and fair value of securities by contractual maturity at December 31, 2024 are shown below. Actual and expected maturities will differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	Held-to-Maturity		Available-for-Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ -	\$ -	\$ 20	\$ 20
Due after one through five years	-	-	944	904
Due after five through ten years	-	-	6,501	5,383
Due after ten years	-	-	9,509	7,060
Mortgage-backed securities-residential	19,442	15,128	16,601	13,528
Mortgage-backed securities-commercial	-	-	4,012	3,718
CMO-residential	-	-	18,140	16,276
CMO-commercial	-	-	32,206	30,183
	<u>\$ 19,442</u>	<u>\$ 15,128</u>	<u>\$ 87,933</u>	<u>\$ 77,072</u>

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(Continued)

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**NOTE 2 – SECURITIES** (Continued)

Available-for-sale securities with unrealized losses at year end, aggregated by investment category for which an allowance for credit losses has not been recorded and length of time that individual securities have been in a continuous unrealized loss position, are as follows as of December 31:

<u>Description</u>	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>
<u>2024</u>						
Available-for-sale securities:						
U. S. government sponsored entities and agencies	\$ -	\$ -	\$ 7,789	\$ (2,171)	\$ 7,789	\$ (2,171)
State and political subdivisions	-	-	5,478	(1,436)	5,478	(1,436)
Mortgage-backed securities – residential	-	-	13,528	(3,073)	13,528	(3,073)
Mortgage-backed securities – commercial	-	-	3,718	(294)	3,718	(294)
CMO-residential	5,291	(105)	6,629	(1,802)	11,920	(1,907)
CMO-commercial	<u>22,649</u>	<u>(525)</u>	<u>7,534</u>	<u>(1,498)</u>	<u>30,183</u>	<u>(2,023)</u>
Total available-for-sale	<u>\$ 27,940</u>	<u>\$ (630)</u>	<u>\$44,676</u>	<u>\$ (10,274)</u>	<u>\$ 72,616</u>	<u>\$ (10,904)</u>

There were 70 securities in an unrealized loss position on December 31, 2024.

<u>2023</u>						
Available-for-sale securities:						
U. S. government sponsored entities and agencies	\$ -	\$ -	\$ 7,904	\$ (2,090)	\$ 7,904	\$ (2,090)
State and political subdivisions	-	-	8,650	(1,315)	8,650	(1,315)
Mortgage-backed securities – residential	-	-	15,252	(2,827)	15,252	(2,827)
Mortgage-backed securities – commercial	-	-	3,821	(370)	3,821	(370)
CMO-residential	-	-	7,641	(1,726)	7,641	(1,726)
CMO-commercial	<u>-</u>	<u>-</u>	<u>7,847</u>	<u>(1,535)</u>	<u>7,847</u>	<u>(1,535)</u>
Total available-for-sale	<u>\$ -</u>	<u>\$ -</u>	<u>\$51,115</u>	<u>\$ (9,863)</u>	<u>\$ 51,115</u>	<u>\$ (9,863)</u>

There were 67 securities in an unrealized loss position on December 31, 2023.

(Continued)



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**NOTE 2 – SECURITIES** (Continued)

*Allowance for Credit Losses – Available-for-Sale Securities*

As of December 31, 2024, no allowance for credit losses has been recognized on available-for-sale securities in an unrealized loss position as Management does not believe any of the securities are impaired due to reasons of credit quality. This is based upon Management's analysis of the underlying risk characteristics, including credit ratings, and other qualitative factors related to our available for sale securities and in consideration of our historical credit loss experience and internal forecasts. The issuers of these securities continue to make timely principal and interest payments under the contractual terms of the securities. Furthermore, Management does not have the intent to sell any of the securities classified as available for sale in the table above and believes that it is more likely than not that we will not have to sell any such securities before a recovery of cost. The unrealized losses are due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline.

*Allowance for Credit Losses – Held-to-Maturity Securities*

The allowance for credit losses on held-to-maturity securities is a contra-asset valuation account that is deducted from the amortized cost basis of held-to-maturity securities to present the net amount expected to be collected. Management measures expected credit losses on held-to-maturity securities on a collective basis by major security type with each type sharing similar risk characteristics, and considers historical credit loss information that is adjusted for current conditions and reasonable and supportable forecasts. With regard to securities issued by local municipal entities, Management considers (i) whether issuers continue to make timely principal and interest payments under the contractual terms of the securities, (ii) internal forecasts and (iii) whether or not such securities are guaranteed or pre-refunded by the issuers.

The Bancorp monitors the credit quality of debt securities held-to-maturity, if any, through review of the annual financial statements, ongoing interest payments, their historical experience with applicable municipal entities.

At December 31, 2024, the Bancorp had no securities held-to-maturity that were past due 30 days or more as to principal or interest payments. The Bancorp had no securities held-to-maturity classified as nonaccrual for the year ended December 31, 2024.

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**NOTE 3 – LOANS**

A summary of the balances of loans follows:

	<u>2024</u>	<u>2023</u>
Residential loans:		
Residential	\$ 394,869	\$ 361,286
Home equity	78,272	69,859
Residential construction	<u>21,150</u>	<u>21,117</u>
Total residential loans	494,291	452,262
 Commercial real estate loans:		
Commercial real estate	219,132	225,692
Commercial construction	<u>6,362</u>	<u>6,237</u>
Total commercial real estate loans	225,494	231,929
 Commercial loans	41,853	53,123
 Consumer loans	<u>15,145</u>	<u>10,961</u>
	776,783	748,275
Less:		
Allowance for credit losses	(9,289)	(10,198)
Add:		
Deferred loan origination and other costs, net of fees	<u>936</u>	<u>1,384</u>
 Loans, net	<u>\$ 768,430</u>	<u>\$ 739,461</u>

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(Continued)

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**NOTE 3 – LOANS** (Continued)

The following table presents the activity in the allowance for credit losses by portfolio segment for the years ended December 31, 2024 and 2023:

	<u>Residential</u>	<u>Home Equity</u>	<u>Residential Construction</u>	<u>Commercial Real Estate</u>	<u>Commercial Construction</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
<u>December 31, 2024</u>								
Allowance for credit losses:								
Beginning balance	\$ 5,409	\$ 469	\$ 334	\$ 2,533	\$ -	\$ 1,345	\$ 108	\$ 10,198
Credit loss expense	149	23	(110)	(52)	67	4,442	15	4,534
Loans charged-off	-	-	-	-	-	(5,498)	(27)	(5,525)
Recoveries collected	<u>50</u>	<u>6</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>16</u>	<u>10</u>	<u>82</u>
Total ending allowance balance	<u>\$ 5,608</u>	<u>\$ 498</u>	<u>\$ 224</u>	<u>\$ 2,481</u>	<u>\$ 67</u>	<u>\$ 305</u>	<u>\$ 106</u>	<u>\$ 9,289</u>
<u>December 31, 2023</u>								
Allowance for credit losses:								
Beginning balance, prior to adoption of ASC 326	\$ 2,615	\$ 635	\$ 275	\$ 2,638	\$ 175	\$ 709	\$ 94	\$ 7,141
Impact of adopting ASC 326	1,604	(169)	136	216	87	(278)	19	1,615
Credit loss expense	856	18	(78)	(316)	(262)	928	129	1,275
Loans charged-off	-	(15)	-	(5)	-	(30)	(138)	(188)
Recoveries collected	<u>334</u>	<u>-</u>	<u>1</u>	<u>-</u>	<u>-</u>	<u>16</u>	<u>4</u>	<u>355</u>
Total ending allowance balance	<u>\$ 5,409</u>	<u>\$ 469</u>	<u>\$ 334</u>	<u>\$ 2,533</u>	<u>\$ -</u>	<u>\$ 1,345</u>	<u>\$ 108</u>	<u>\$ 10,198</u>

Nonaccrual loans and loans past due 90 days or more still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. Impaired loans include commercial loans that are individually evaluated for impairment and deemed impaired (i.e. individually classified impaired loans). The sum of nonaccrual loans and loans past due over 90 days will differ from the total impaired loan amount.

(Continued)

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**NOTE 3 – LOANS** (Continued)

The following table presents the amortized cost basis of loans on nonaccrual status and loans past due over 89 days and still accruing as of December 31, 2024 and 2023:

	Nonaccrual With No Allowance For Credit Loss	Total Nonaccrual	Loans Past Due Over 89 Days Still Accruing
<u>December 31, 2024</u>			
Residential	\$ 993	\$ 1,234	\$ -
Home equity	6	6	-
Commercial real estate	1,644	1,644	-
Commercial	<u>3,461</u>	<u>3,461</u>	<u>-</u>
Total	<u>\$ 6,104</u>	<u>\$ 6,345</u>	<u>\$ -</u>
	Nonaccrual With No Allowance For Credit Loss	Total Nonaccrual	Loans Past Due Over 89 Days Still Accruing
<u>December 31, 2023</u>			
Residential	\$ 31	\$ 777	\$ 320
Home equity	-	7	82
Commercial real estate	1,001	1,501	-
Commercial	<u>-</u>	<u>8,467</u>	<u>-</u>
Total	<u>\$ 1,032</u>	<u>\$ 10,752</u>	<u>\$ 402</u>

The Bancorp recognized \$60 and \$459 of interest income on nonaccrual loans during the years ended December 31, 2024 and 2023, respectively.

The following table presents the amortized cost basis of individually evaluated or nonaccrual loans or loans otherwise designated as having a higher credit risk that are collateral-dependent loans by class of loans as of December 31, 2024 and 2023:

	<u>Real Estate</u>	<u>SBA Guarantee</u>
<u>December 31, 2024</u>		
Commercial real estate	\$ 1,503	\$ -
Commercial	<u>-</u>	<u>3,289</u>
Total	<u>\$ 1,503</u>	<u>\$ 3,289</u>
	<u>Real Estate</u>	
<u>December 31, 2023</u>		
Commercial real estate	\$ 80	

(Continued)

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**NOTE 3 – LOANS** (Continued)

The following table presents the aging of the amortized cost basis in past-due loans as of December 31 by class of loans:

	30-59 Days <u>Past Due</u>	60-89 Days <u>Past Due</u>	Greater than 89 Days <u>Past Due</u>	Total <u>Past Due</u>	Loans not <u>Past Due</u>	<u>Total</u>
<u>December 31, 2024</u>						
Residential	\$ 1,502	\$ 1,592	\$ 503	\$ 3,597	\$ 392,148	\$ 395,745
Home equity	803	80	-	883	77,389	78,272
Residential construction	-	-	-	-	21,157	21,157
Commercial real estate	1,442	98	595	2,135	216,957	219,092
Commercial construction	-	395	-	395	5,929	6,324
Commercial	668	-	3,425	4,093	37,913	42,006
Consumer	92	-	-	92	15,031	15,123
Total amortized cost	<u>\$ 4,507</u>	<u>\$ 2,165</u>	<u>\$ 4,523</u>	<u>\$ 11,195</u>	<u>\$ 766,524</u>	<u>\$ 777,719</u>
	30-59 Days <u>Past Due</u>	60-89 Days <u>Past Due</u>	Greater than 89 Days <u>Past Due</u>	Total <u>Past Due</u>	Loans not <u>Past Due</u>	<u>Total</u>
<u>December 31, 2023</u>						
Residential	\$ 1,154	\$ 786	\$ 568	\$ 2,508	\$ 359,385	\$ 361,893
Home equity	311	272	82	665	69,862	70,527
Residential construction	-	-	-	-	21,133	21,133
Commercial real estate	1,453	-	-	1,453	224,241	225,694
Commercial construction	-	-	-	-	6,222	6,222
Commercial	787	-	-	787	52,465	53,252
Consumer	68	-	-	68	10,870	10,938
Total amortized cost	<u>\$ 3,773</u>	<u>\$ 1,058</u>	<u>\$ 650</u>	<u>\$ 5,481</u>	<u>\$ 744,178</u>	<u>\$ 749,659</u>

Occasionally, the Bancorp modifies loans to borrowers in financial distress by providing modifications, such as principal forgiveness, term extension, or other-than-insignificant payment delay or interest rate reduction. When principal forgiveness is provided, the amount of forgiveness is charged-off against the allowance for credit losses.

The Bancorp may provide multiple types of concessions on one loan. Typically, one type of concession, such as a term extension, is granted initially. If the borrower continues to experience financial difficulty, another concession, such as principal forgiveness, may be granted.

During the year ended December 31, 2024, one loan for \$48 was modified for a borrower in financial distress with a 30-year term extension. There were no amounts committed to lend additional funds to this borrower. During the year ended December 31, 2023, no such loan modifications were offered for borrowers in financial distress.

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

There were no loans modified for borrowers experiencing financial difficulty for which there was a payment default within the twelve months following the modification during the years ended December 31, 2024 and 2023.

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STURGIS BANCORP, INC.  
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**NOTE 3 – LOANS** (Continued)

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

**Credit Quality Indicators:**

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

**Pass.** A pass loan is a credit with no existing or known potential weakness deserving of management's close attention.

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

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

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

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STURGIS BANCORP, INC.  
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**NOTE 3 – LOANS** (Continued)

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. Loans listed as not rated are either less than \$250 or are included in groups of homogeneous loans. Management monitors loans reported to be not rated by segregating between performing and nonperforming loans, which generally uses delinquency statistics.

Based on the most recent analysis performed, the risk category of loans by class of loans by origination year is as follows:

As of December 31, 2024	2024	2023	2022	2021	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
Commercial								
Risk rating								
Pass	\$ 4,267	\$ 2,547	\$ 6,783	\$ 3,719	\$ 6,466	\$ 11,532	\$ 1,038	\$ 36,352
Special mention	-	-	-	-	36	2,363	-	2,399
Substandard	-	-	-	-	-	-	-	-
Doubtful	-	-	3,255	-	-	-	-	3,255
Total commercial	<u>\$ 4,267</u>	<u>\$ 2,547</u>	<u>\$ 10,038</u>	<u>\$ 3,719</u>	<u>\$ 6,502</u>	<u>\$ 13,895</u>	<u>\$ 1,038</u>	<u>\$ 42,006</u>
Commercial								
Current period gross write offs	\$ -	\$ 45	\$ 1,453	\$ -	\$ -	\$ 4,000	\$ -	\$ 5,498
Commercial real estate								
Risk rating								
Pass	\$ 25,929	\$ 14,924	\$ 41,761	\$ 37,628	\$ 62,988	\$ 32,935	\$ -	\$ 216,165
Special mention	-	-	215	-	456	595	-	1,266
Substandard	16	-	372	365	908	-	-	1,661
Doubtful	-	-	-	-	-	-	-	-
Total commercial real estate	<u>\$ 25,945</u>	<u>\$ 14,924</u>	<u>\$ 42,348</u>	<u>\$ 37,993</u>	<u>\$ 64,352</u>	<u>\$ 33,530</u>	<u>\$ -</u>	<u>\$ 219,092</u>
Commercial real estate								
Current period gross write offs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial construction								
Risk rating								
Pass	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 6,324	\$ -	\$ 6,324
Special mention	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-
Total commercial construction	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 6,324</u>	<u>\$ -</u>	<u>\$ 6,324</u>
Commercial construction								
Current period gross write offs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

(Continued)

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As of December 31, 2024 (cont)	2024	2023	2022	2021	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term	Total
Residential								
Payment performance								
Performing	\$ 39,904	\$ 61,225	\$115,744	\$ 84,537	\$ 90,444	\$ -	\$ -	\$ 391,854
Nonperforming	-	512	1,176	873	1,330	-	-	3,891
Total residential	<u>\$ 39,904</u>	<u>\$ 61,737</u>	<u>\$116,920</u>	<u>\$ 85,410</u>	<u>\$ 91,774</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 395,745</u>
Residential								
Current period gross write offs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Home equity								
Payment performance								
Performing	\$ 6,171	\$ 5,135	\$ 2,352	\$ 991	\$ 1,960	\$ 59,933	\$ 847	\$ 77,389
Nonperforming	-	-	11	39	50	36	747	883
Total home equity	<u>\$ 6,171</u>	<u>\$ 5,135</u>	<u>\$ 2,363</u>	<u>\$ 1,030</u>	<u>\$ 2,010</u>	<u>\$ 59,969</u>	<u>\$ 1,594</u>	<u>\$ 78,272</u>
Home equity								
Current period gross write offs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Residential construction								
Payment performance								
Performing	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 21,157	\$ -	\$ 21,157
Nonperforming	-	-	-	-	-	-	-	-
Total residential construction	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 21,157</u>	<u>\$ -</u>	<u>\$ 21,157</u>
Residential construction								
Current period gross write offs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Consumer								
Payment performance								
Performing	\$ 8,156	\$ 2,896	\$ 2,029	\$ 992	\$ 585	\$ 375	\$ -	\$ 15,033
Nonperforming	33	-	49	9	-	-	-	91
Total consumer	<u>\$ 8,189</u>	<u>\$ 2,896</u>	<u>\$ 2,078</u>	<u>\$ 1,001</u>	<u>\$ 585</u>	<u>\$ 375</u>	<u>\$ -</u>	<u>\$ 15,124</u>
Consumer								
Current period gross write offs	\$ -	\$ 6	\$ 20	\$ -	\$ 1	\$ -	\$ -	\$ 27

(Continued)



STURGIS BANCORP, INC.  
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<u>As of December 31, 2023</u>	<u>2023</u>	<u>2022</u>	<u>2021</u>	<u>Prior</u>	<u>Revolving Loans Amortized Cost Basis</u>	<u>Revolving Loans Converted to Term</u>	<u>Total</u>
Commercial							
Risk rating							
Pass	\$ 4,304	\$ 7,575	\$ 3,986	\$ 8,675	\$ 18,310	\$ 1,258	\$ 44,108
Special mention	-	-	-	5	594	-	599
Substandard	-	4,467	69	9	4,000	-	8,545
Doubtful	-	-	-	-	-	-	-
Total commercial	<u>\$ 4,304</u>	<u>\$ 12,042</u>	<u>\$ 4,055</u>	<u>\$ 8,689</u>	<u>\$ 22,904</u>	<u>\$ 1,258</u>	<u>\$ 53,252</u>
Commercial							
Current period gross write offs	\$ -	\$ 30	\$ -	\$ -	\$ -	\$ -	\$ 30
Commercial real estate							
Risk rating							
Pass	\$ 25,350	\$ 49,279	\$ 50,039	\$ 93,851	\$ -	\$ -	\$ 218,519
Special mention	-	-	-	4,506	-	-	4,506
Substandard	-	907	463	1,299	-	-	2,669
Doubtful	-	-	-	-	-	-	-
Total commercial real estate	<u>\$ 25,350</u>	<u>\$ 50,186</u>	<u>\$ 50,502</u>	<u>\$ 99,656</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 225,694</u>
Commercial real estate							
Current period gross write offs	\$ 5	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 5
Commercial construction							
Risk rating							
Pass	\$ -	\$ -	\$ -	\$ -	\$ 6,222	\$ -	\$ 6,222
Special mention	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-
Total commercial construction	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 6,222</u>	<u>\$ -</u>	<u>\$ 6,222</u>
Commercial construction							
Current period gross write offs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

(Continued)

STURGIS BANCORP, INC.  
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<u>As of December 31, 2023 (cont)</u>	<u>2023</u>	<u>2022</u>	<u>2021</u>	<u>Prior</u>	<u>Revolving Loans Amortized Cost Basis</u>	<u>Revolving Loans Converted to Term</u>	<u>Total</u>
Residential							
Payment performance							
Performing	\$ 50,133	\$119,118	\$ 90,499	\$101,095	\$ -	\$ -	\$ 360,845
Nonperforming	-	520	315	213	-	-	1,048
Total residential	<u>\$ 50,133</u>	<u>\$119,638</u>	<u>\$ 90,814</u>	<u>\$101,308</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 361,893</u>
Residential							
Current period gross write offs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Home equity							
Payment performance							
Performing	\$ 6,345	\$ 2,825	\$ 1,229	\$ 2,501	\$ 56,582	\$ 1,037	\$ 70,519
Nonperforming	-	-	8	-	-	-	8
Total home equity	<u>\$ 6,345</u>	<u>\$ 2,825</u>	<u>\$ 1,237</u>	<u>\$ 2,501</u>	<u>\$ 56,582</u>	<u>\$ 1,037</u>	<u>\$ 70,527</u>
Home equity							
Current period gross write offs	\$ -	\$ -	\$ -	\$ 15	\$ -	\$ -	\$ 15
Residential construction							
Payment performance							
Performing	\$ -	\$ -	\$ -	\$ -	\$ 21,133	\$ -	\$ 21,133
Nonperforming	-	-	-	-	-	-	-
Total residential construction	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 21,133</u>	<u>\$ -</u>	<u>\$ 21,133</u>
Residential construction							
Current period gross write offs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Consumer							
Payment performance							
Performing	\$ 4,594	\$ 3,412	\$ 1,405	\$ 1,067	\$ 460	\$ -	\$ 10,938
Nonperforming	-	-	-	-	-	-	-
Total consumer	<u>\$ 4,594</u>	<u>\$ 3,412</u>	<u>\$ 1,405</u>	<u>\$ 1,067</u>	<u>\$ 460</u>	<u>\$ -</u>	<u>\$ 10,938</u>
Consumer							
Current period gross write offs	\$ -	\$ 50	\$ 40	\$ 48	\$ -	\$ -	\$ 138

The Bancorp purchased \$5,000 in consumer loans during 2024. No loans were purchased during 2023. There was no credit deterioration of purchased loans during the year ended December 31, 2024.

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**NOTE 4 – PREMISES AND EQUIPMENT**

A summary of the cost and accumulated depreciation and amortization of premises and equipment follows as of December 31:

	<u>2024</u>	<u>2023</u>
Land	\$ 2,983	\$ 2,983
Land improvements	1,190	1,176
Office buildings	16,557	16,548
Furniture, fixtures, and equipment	10,207	9,856
Leasehold improvements	1,091	1,031
Construction in progress	494	10
Total premises and equipment	32,522	31,604
Less accumulated depreciation and amortization	<u>(13,814)</u>	<u>(12,468)</u>
Net carrying amount	<u>\$ 18,708</u>	<u>\$ 19,136</u>

Depreciation expense and software amortization for the years ended December 31, 2024 and 2023 amounted to \$1,478 and \$1,345, respectively.

**NOTE 5 – MORTGAGE SERVICING RIGHTS**

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balance of mortgages and other loans serviced for others were \$364,672 and \$341,154 at December 31, 2024 and 2023, respectively.

The fair values of the rights to service these loans were \$4,662 and \$4,607 at December 31, 2024 and 2023, respectively. The fair value of servicing rights at December 31, 2024 was determined using a discount rate of 10.5% and prepayment speeds ranging from 6.00 to 24.23 Conditional Prepayment Rate ("CPR"), depending on the stratification of the servicing right. The fair value of servicing rights at December 31, 2023 was determined using a discount rate of 11% and prepayment speeds ranging from 6.00 to 15.29 Conditional Prepayment Rate ("CPR"), depending on the stratification of the servicing right.

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(Continued)

STURGIS BANCORP, INC.  
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**NOTE 5 – MORTGAGE SERVICING RIGHTS (Continued)**

The following summarizes the activity in mortgage servicing rights and the related valuation allowance as of December 31:

	<u>2024</u>	<u>2023</u>
Mortgage servicing rights:		
Balance at beginning of year	\$ 2,979	\$ 2,967
Mortgage servicing rights capitalized	867	578
Mortgage servicing rights amortized	(687)	(566)
Change in valuation allowance	<u>(38)</u>	<u>-</u>
Balance at end of year	<u>\$ 3,121</u>	<u>\$ 2,979</u>
Valuation allowances:		
Balance at beginning of year	\$ -	\$ -
Additions	<u>38</u>	<u>-</u>
Balance at end of year	<u>\$ 38</u>	<u>\$ -</u>

**NOTE 6 – EQUITY AND LIMITED PARTNERSHIP INVESTMENTS**

Limited Partnerships

The following table summarizes the Bancorp's limited partnership investments recorded as of December 31:

<u>Investment</u>	<u>Year Invested</u>	<u>Ownership %</u>	<u>2024</u>			<u>2023</u>		
			<u>Asset (a)</u>	<u>Unfunded Commitment (b)</u>	<u>Amortization/ Impairment (c)</u>	<u>Asset (a)</u>	<u>Unfunded Commitment (b)</u>	<u>Amortization/ Impairment (c)</u>
TGap 2	2008	0.950	\$ 119	\$ -	\$ (24)	\$ 95	\$ -	\$ 1
Great Lakes XX	2010	4.878	22	10	1	23	14	9
Great Lakes XX-2	2012	4.546	15	6	7	22	9	13
Great Lakes XX-3	2014	7.692	157	22	86	243	23	86
Cinnaire Michigan Fund for Housing LP 20-6	2020	6.250	<u>691</u>	<u>51</u>	<u>81</u>	<u>772</u>	<u>74</u>	<u>98</u>
Totals			<u>\$ 1,004</u>	<u>\$ 89</u>	<u>\$ 151</u>	<u>\$ 1,155</u>	<u>\$ 120</u>	<u>\$ 207</u>

(Continued)

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**NOTE 6 – EQUITY AND LIMITED PARTNERSHIP INVESTMENTS** (Continued)

- (a) Investments are included in other assets on the consolidated balance sheets at December 31, 2024 and 2023.
- (b) Unfunded commitments are included in other liabilities on the consolidated balance sheets at December 31, 2024 and 2023.
- (c) Amortization / impairment expense of (\$24) and \$1 is included in other noninterest expense on the consolidated statements of income for the years ended December 31, 2024 and 2023. Amortization / impairment expense of \$175 and \$206 for the years ended December 31, 2024 and 2023, respectively, is included in income tax expense on the consolidated statements of income.

The TGap 2 investment represents investments in venture capital limited partnerships that mostly invest in medical research companies. The Bancorp anticipates receiving income in the future from the sale of these medical research companies to a third party. There were no distributions from the venture capital limited partnerships in 2024 and 2023.

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

The Bancorp's share of tax credits generated by the above partnerships totaled \$191 in 2024 and \$212 in 2023.

Equity Investments

The Bancorp has a 49% partnership interest in Ayres Insurance Agency, Inc., an insurance company, with 51% owned by a director. The Bancorp's investment in Ayres Insurance Agency, Inc. of \$2,623 and \$2,665 as of December 31, 2024 and 2023, respectively, is recorded in other assets on the consolidated balance sheets. The Bancorp recorded income of \$301 in 2024 and \$165 in 2023 on Ayres Insurance Agency, Inc., respectively, in the consolidated statements of income. For more information, see Note 13 *Related Party Transactions*.

The Bancorp has a 35% partnership interest in Oak Title, LLC, a title insurance company, with unrelated parties owning 65% as of December 31, 2024 and 2023. The Bancorp's investment of \$87 and \$90 as of December 31, 2024 and 2023, respectively, is recorded in other assets on the consolidated balance sheets. The Bancorp recorded income of \$64 and \$59 in the consolidated statements of income in 2024 and 2023, respectively.

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**NOTE 7 – DEPOSITS**

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

	<u>2024</u>	<u>2023</u>
Savings accounts	\$ 154,983	\$ 150,973
NOW accounts	209,621	195,030
Time:		
\$250 and over	152,326	149,068
Under \$250	<u>139,147</u>	<u>143,968</u>
	<u>\$ 656,077</u>	<u>\$ 639,039</u>

At December 31, 2024, the scheduled maturities of time deposits are as follows:

<u>Maturing in the Year Ending December 31.</u>	<u>Under \$250</u>	<u>\$250 and Over</u>
2025	\$ 117,569	\$ 147,951
2026	8,820	4,059
2027	5,978	316
2028	4,935	-
2029	1,831	-
Thereafter	<u>14</u>	<u>-</u>
	<u>\$ 139,147</u>	<u>\$ 152,326</u>

**NOTE 8 – FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS**

The Bancorp had advances from the Federal Home Loan Bank of Indianapolis (FHLB) at December 31, 2024 and 2023. These advances are subject to prepayment penalties as defined in the credit policy of the FHLB.

The Bancorp has an available one-year line of credit with the FHLB which provides for advances up to \$25,000 and matures in October 2025. There were no balances outstanding on this line of credit at December 31, 2024 or 2023.

Contractual maturities of FHLB advances are as follows for the years following December 31:

	<u>2024</u>	<u>2023</u>
2024	\$ -	\$ 40,000
2025	<u>61,100</u>	<u>-</u>
	<u>\$ 61,100</u>	<u>\$ 40,000</u>

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**NOTE 8 – FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS** (Continued)

The advances and line of credit are collateralized by certain performing non-employee residential and commercial mortgage loans. The unpaid principal balance of pledged loans was \$262,606 and \$382,065 at December 31, 2024 and 2023, respectively.

On December 30, 2020, the Bancorp issued subordinated debt for \$15,000, maturing in 2030. The interest rate is fixed at 5% until 2025, payable on June 30 and December 30 each year. For the subsequent five years, the interest rate is floating at 4.73% over SOFR with quarterly resets. Beginning in 2025, the Bancorp may redeem the debt at par, in whole or in part. Costs recorded in 2020 to issue the debt were \$400 with \$82 amortized in 2024 and \$81 amortized in 2023. The Bancorp invested \$3,000 from the proceeds of the subordinated debt in the Bank in 2021 and \$10,000 in 2020, which qualifies for Tier 1 capital for the Bank. The Bancorp itself has no minimum capital requirements.

**NOTE 9 – INCOME TAXES**

The following is a summary of the provision for income taxes for the years ended December 31:

	<u>2024</u>	<u>2023</u>
Current expense	\$ 20	\$ 1,707
Deferred	<u>303</u>	<u>(568)</u>
Income taxes	<u>\$ 323</u>	<u>\$ 1,139</u>

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**NOTE 9 – INCOME TAXES** (Continued)

A reconciliation of the difference between total income tax expense and the amount computed by applying the statutory tax rate of 21% to income before income taxes is as follows for the years ended December 31:

	<u>2024</u>	<u>2023</u>
Amount computed at statutory rate	\$ 663	\$ 1,503
Tax-exempt income from Bank-owned life insurance	(182)	(186)
Tax-exempt interest income	(106)	(151)
Amortization of low-income housing investments	174	206
Low-income housing tax credits	(191)	(212)
Other, net	<u>(35)</u>	<u>(21)</u>
Income taxes	<u>\$ 323</u>	<u>\$ 1,139</u>

The components of the net deferred tax asset were as follows as of December 31:

	<u>2024</u>	<u>2023</u>
Deferred tax assets:		
Allowance for loan losses	\$ 1,972	\$ 2,169
Unfunded pension liability	109	111
Deferred compensation	672	832
Unrealized loss on available-for-sale securities	2,281	2,071
Net operating loss	12	-
Other	<u>306</u>	<u>290</u>
	<u>5,352</u>	<u>5,473</u>
Deferred tax liabilities:		
Deferred loan fees	\$ (355)	\$ (295)
Mortgage servicing rights	(663)	(633)
Amortization of goodwill	(1,162)	(1,149)
Depreciation	(948)	(1,060)
FHLB stock dividends	(19)	(19)
Cash flow hedge	(38)	(330)
Other	<u>(236)</u>	<u>(253)</u>
	<u>(3,421)</u>	<u>(3,739)</u>
Net deferred tax asset	<u>\$ 1,931</u>	<u>\$ 1,734</u>

The Bancorp and its subsidiaries are subject to U.S. federal income tax as well as income tax to the State of Indiana. The Bancorp is no longer subject to examination by taxing authorities for years before 2021.

The Bancorp and its subsidiaries had a net operating loss carryforward of \$57 at December 31, 2024 which does not expire.

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**NOTE 9 – INCOME TAXES** (Continued)

The Bancorp is qualified under provisions of the Internal Revenue Code to deduct from taxable income a provision for bad debts in excess of such provision charged to income in the consolidated financial statements. Accordingly, retained earnings at December 31, 2024 and 2023 included approximately \$918 for which no provision for federal income taxes has been made. Unrecognized deferred taxes on this amount are approximately \$193. In the future, if this portion of retained earnings is used for any purpose other than to absorb bad debt losses, federal income taxes would be imposed at the then applicable rates.

There were no unrecognized tax benefits at December 31, 2024 and the Bancorp does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months.

For the years ended 2024 and 2023, interest and penalties related to income tax matters were not material.

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**NOTE 10 – RETIREMENT BENEFITS**

**Supplemental Retirement Plan:** The Bancorp sponsors a non-qualified defined benefit (DB) plan to provide supplemental retirement benefits for certain executives. These benefits include pre-retirement disability and death benefits, as well as post-retirement payments for 15 years. In 2023, the Bancorp recognized a settlement gain from a forfeiture in connection with an early retirement. The amount of the forfeiture is netted with service and interest cost components, resulting in a settlement gain of \$882 for the year ended December 31, 2023. The following table sets forth the DB activity and other information as of and for the years ended December 31:

	<u>2024</u>	<u>2023</u>
Changes in benefit obligation:		
Benefit obligation, January 1	\$ 2,102	\$ 2,810
Service cost	59	80
Interest cost	95	170
Loss	35	80
Benefits paid	(45)	(46)
Forfeiture	-	(992)
Benefit obligation, December 31	<u>\$ 2,246</u>	<u>\$ 2,102</u>
Funded status at end of year	<u>\$ 2,246</u>	<u>\$ 2,102</u>
Accumulated benefit obligation	\$ 1,770	\$ 1,617

The projected benefit obligation of \$2,246 in 2024 and \$2,102 in 2023 was included in other liabilities on the consolidated balance sheets as of December 31, 2024 and 2023, respectively.

	<u>2024</u>	<u>2023</u>
Components of Net Periodic Benefit Cost:		
Service cost	\$ 59	\$ 80
Interest cost	95	130
Amortization of prior service cost	23	26
Amortization of net loss	21	33
Settlement gain	-	(882)
Net periodic benefit cost	<u>198</u>	<u>(613)</u>
Net loss (gain)	35	(108)
Amortization of prior service cost and net (gain) loss	<u>(42)</u>	<u>40</u>
Total recognized in other comprehensive income	<u>(7)</u>	<u>(68)</u>
Total recognized in net periodic benefit cost and other comprehensive income	<u>\$ 190</u>	<u>\$ (545)</u>

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

	<u>2024</u>	<u>2023</u>
Net actuarial loss	\$ 250	\$ 237
Prior service cost	<u>268</u>	<u>289</u>
	<u>\$ 518</u>	<u>\$ 526</u>

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**NOTE 10 – RETIREMENT BENEFITS (Continued)**

Actuarial assumptions used in determining the benefit obligation and the net periodic pension costs are as follows at December 31,:

	<u>2024</u>	<u>2023</u>
Weighted average discount rate	4.39%	4.39%
Increase in future compensation levels	2.25%	2.25%

Bank-Owned Life Insurance: To fund the DB obligation and other employee benefits, the Bancorp has purchased insurance policies on the lives of certain officers of the Bank. The Bancorp is owner and beneficiary of these policies. At December 31, 2024 and 2023, the cash value of all bank-owned life insurance policies was \$15,402 and \$15,832, respectively. The cash value is available to fund future benefit obligations.

The DB paid \$46 of supplemental retirement benefits in 2024 and 2023. The Bancorp anticipates paying \$46 of benefits in connection with this plan annually through 2027.

401(k) Plan: A 401(k) benefit plan allows employee contributions up to 17% of their compensation, which are matched 50% on the first 10% of the compensation contributed. Expense of the 401(k) plan for the years ended December 31, 2024 and 2023 was \$468 and \$430, respectively.

**NOTE 11 – MINIMUM REGULATORY CAPITAL REQUIREMENTS**

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet minimum capital requirements can initiate regulatory action. The net unrealized gains or losses carried in other comprehensive income is not included in computing regulatory capital. Management believes, as of December 31, 2024, the Bank met all capital adequacy requirements to which the Bank is subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these items are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2024 and 2023, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category.

Basel III Capital Rules: The capital conservation buffer for 2024 and 2023 was 2.50%.

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**NOTE 11 – MINIMUM REGULATORY CAPITAL REQUIREMENTS (Continued)**

The Bank's actual capital amounts and ratios at December 31, 2024 and 2023 were as follows:

	<u>Actual</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>2024</u>				
Tier 1 (Core) Capital to average				
Total assets	\$ 74,482	7.9%	\$ 47,200	5.0%
Tier 1 (Core) Capital to				
Risk-weighted assets	\$ 74,482	11.1%	\$ 53,806	8.0%
Total capital to				
Risk-weighted assets	\$ 82,890	12.3%	\$ 67,257	10.0%
Common equity Tier 1 Capital to				
Risk-weighted assets	\$ 74,482	11.1%	\$ 43,717	6.5%
<u>2023</u>				
Tier 1 (Core) Capital to average				
Total assets	\$ 73,181	8.0%	\$ 45,463	5.0%
Tier 1 (Core) Capital to				
Risk-weighted assets	\$ 73,181	11.2%	\$ 52,508	8.0%
Total capital to				
Risk-weighted assets	\$ 81,395	12.4%	\$ 65,640	10.0%
Common equity Tier 1 Capital to				
Risk-weighted assets	\$ 73,181	11.2%	\$ 42,663	6.5%

**Dividend Restrictions** – The Bancorp's principal source of funds for dividend payments is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. As of December 31, 2024, \$11,214 of retained earnings is available to pay dividends.

**NOTE 12 – OFF-BALANCE-SHEET ACTIVITIES**

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

The Bancorp's exposure to credit loss is represented by the contractual amount of the commitments. The Bancorp follows the same credit policies in making commitments as it does for on-balance-sheet instruments; no significant losses are anticipated as a result of these commitments.

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

At December 31, 2024 and 2023, the following financial instruments with credit risk were outstanding:

	<u>2024</u>	<u>2023</u>
Commitments to grant loans	\$ 26,218	\$ 18,188
Unfunded commitments under lines of credit	127,878	121,662
Commercial and standby letters of credit	9,741	9,790

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

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. The equity and commercial lines of credit are collateralized, may not have a specified maturity date, and may not be drawn to the full extent of the Bancorp's commitment. A majority of such commitments are at fixed rates; a portion is unsecured.

Commercial and standby letters of credit are conditional commitments issued by the Bancorp to guarantee the performance of a customer to a third party. The letters of credit are primarily used to support public and private borrowing arrangements. All letters of credit issued by the Bancorp have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The collateral held as collateral is not material. Guarantees that are not derivative contracts have been recorded on the Bancorp's consolidated balance sheets at their fair value at inception. The Bancorp considers standby letters of credit to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is not significant, a liability related to such guarantees was not recorded at December 31, 2024 or 2023.

The following table presents the activity for the allowance for credit losses for unfunded loan commitments for the years ended December 31, 2024 and 2023:

Balance, December 31, 2022	\$ -
Adoption of ASU 326	312
Credit loss (reversal)	<u>(7)</u>
Balance, December 31, 2023	<u>\$ 305</u>
Credit loss	<u>51</u>
Balance, December 31, 2024	<u>\$ 356</u>

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**NOTE 13 – RELATED PARTY TRANSACTIONS**

In the ordinary course of business, the Bank has granted loans to principal officers, directors and affiliates. Related party loans were \$1,011 and \$933 at December 31, 2024 and 2023, respectively.

Deposits from related parties held by the Bank at December 31, 2024 and 2023 were \$3,857 and \$3,495, respectively.

As of December 31, 2024 and 2023, the Bancorp had 49% interest in Ayres Insurance Agency, Inc., an insurance agency, with 51% owned by a director. The Bancorp's investment of \$2,623 and \$2,665 as of December 31, 2024 and 2023, respectively, is included in other assets on the consolidated balance sheets. The Bancorp recorded income of \$301 and \$165 in 2024 and 2023, respectively, from the insurance agency investment, and is included in the proportionate net income from unconsolidated subsidiaries in the consolidated statements of income.

**NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS**

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

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Following is a description of the valuation methodologies and key inputs used to measure financial assets and liabilities recorded at fair value, which includes an indication of the level of the fair value hierarchy in which the assets or liabilities are classified.

Securities: Held-to-maturity debt securities are recorded at fair value on a nonrecurring basis and involve the application of lower of cost or market or writing down of individual assets. Debt securities classified as available-for-sale are recorded at fair value on a recurring basis. The fair values of securities are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities and include such model valuation techniques (Level 2 inputs).

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

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**NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)**

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

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

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

Derivatives (Cash Value Hedges): The fair values of derivatives are based on valuation models using observable market data as of the measurement date (Level 2). The Bancorp's derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using quantitative models that utilize multiple market inputs. The inputs will vary based on the type of derivative, but could include interest rates, prices, and indices to generate continuous yield or pricing curves, prepayment rates, and volatility factors to value the position. The majority of market inputs are actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services.

Mortgage Servicing Rights: Mortgage servicing rights are subject to impairment testing. To test for impairment, the Bancorp utilizes a discounted cash flow analysis using interest rates and prepayment speed assumptions currently quoted for comparable instruments and discount rates. If the valuation model reflects a value less than the carrying value, the asset is adjusted to fair value through a valuation allowance as determined by the model. As such, the Bancorp classifies mortgage servicing rights subject to nonrecurring fair value adjustments as Level 2.

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**NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS** (Continued)

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Bancorp believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

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

		Fair Value Measurements at December 31, 2024 Using:			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Financial Assets					
U. S. government sponsored entities and agencies	\$ 7,789	\$ -	\$ 7,789	\$ -	
State and political subdivisions	5,578	-	5,578	-	
Mortgage-backed securities – residential	13,528	-	13,528	-	
Mortgage-backed securities – commercial	3,718	-	3,718	-	
Collateralized mortgage obligations – residential	16,276	-	16,276	-	
Collateralized mortgage obligations – commercial	<u>30,183</u>	<u>-</u>	<u>30,183</u>	<u>-</u>	
Total investment securities available-for-sale					
	<u>\$ 77,072</u>	<u>\$ -</u>	<u>\$ 77,072</u>	<u>\$ -</u>	
Loans held for sale	\$ 3,658	\$ -	\$ 3,658	\$ -	
Limited partnership in TGap2	\$ 119	\$ -	\$ 119	\$ -	
Loans hedged	\$ (496)	\$ -	\$ (496)	\$ -	
Fair value hedges	\$ 496	\$ -	\$ 496	\$ -	
Cash flow hedges	\$ 180	\$ -	\$ 180	\$ -	

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	Carrying Value	Fair Value Measurements at December 31, 2023 Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
U. S. government sponsored entities and agencies	\$ 7,904	\$ -	\$ 7,904	\$ -
State and political subdivisions	10,193	-	10,193	-
Mortgage-backed securities – residential	15,252	-	15,252	-
Mortgage-backed securities – commercial	3,821	-	3,821	-
Collateralized mortgage obligations – residential	7,641	-	7,641	-
Collateralized mortgage obligations – commercial	<u>7,847</u>	<u>-</u>	<u>7,847</u>	<u>-</u>
Total investment securities available-for-sale	<u>\$ 52,658</u>	<u>\$ -</u>	<u>\$ 52,658</u>	<u>\$ -</u>
Loans held for sale	\$ 2,259	\$ -	\$ 2,259	\$ -
Limited partnership in TGap2	\$ 95	\$ -	\$ 95	\$ -
Cash flow hedges	\$ 1,569	\$ -	\$ 1,569	\$ -

Financial Instruments Recorded Using Fair Value Option

The Bancorp has elected the fair value option for loans held for sale. These loans are intended for sale and the Bancorp believes the fair value is the best indicator of the resolution of these loans. Interest income is recorded based on the contractual terms of the loan and in accordance with the Bancorp's policy on loans held for investment. None of these loans are 90 days or more past due or on nonaccrual as of December 31, 2024 and 2023.

As of December 31, 2024 and 2023, the aggregate fair value, contractual balance (including accrued interest), and gain or loss was as follows:

	<u>2024</u>	<u>2023</u>
Aggregated fair value	\$ 3,658	\$ 2,259
Contractual balance	3,618	2,191
Gain	40	68

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**NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS** (Continued)

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

	<u>2024</u>		<u>2023</u>
Interest income	\$ 97	\$	47
Change in fair value	(28)		(37)

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**NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS** (Continued)

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

	Carrying Value	Fair Value Measurements at December 31, 2024 Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Real estate owned, net:				
Residential	\$ 152	\$ -	\$ -	\$ 152
Impaired loans:				
Commercial real estate	\$ 1,503	\$ -	\$ -	\$ 1,503
Commercial nonmortgage	\$ 3,289	\$ -	\$ -	\$ 3,289

	Carrying Value	Fair Value Measurements at December 31, 2023 Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Real estate owned, net:				
Residential	\$ 105	\$ -	\$ -	\$ 105
Commercial real estate	25	-	-	25
Impaired loans:				
Commercial real estate	\$ 80	\$ -	\$ -	\$ 80

Impaired loans, which were measured for impairment using the fair value of the collateral for collateral dependent loans, had a gross carrying value of \$4,790 with \$0 of valuation allowance and a gross carrying value of \$100 with \$20 of valuation allowance at December 31, 2024 and 2023, respectively. Credit loss expense related to impaired loans measured using fair value of collateral was \$5,498 for 2024 and \$0 for 2023.

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**NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)**

The carrying amounts and estimated fair values of financial instruments not carried in their entirety at fair value, at December 31, 2024 and 2023 are as follows:

	Carrying Amount	Fair Value Measurements at December 31, 2024 Using:			
		Level 1	Level 2	Level 3	Total
<b>Financial assets</b>					
Cash and cash equivalents	\$ 20,802	\$ 20,802	\$ -	\$ -	\$ 20,802
Securities held-to-maturity	19,442	-	15,128	-	15,128
FHLB stock	9,786	-	-	9,786	9,786
Loans, net	768,430	-	-	762,786	762,786
Mortgage servicing rights	3,121	-	4,662	-	4,662
Accrued interest receivable	3,405	-	-	3,405	3,405

<b>Financial liabilities</b>					
Deposits: noninterest-bearing	\$ 157,782	\$ 157,782	\$ -	\$ -	\$ 157,782
Deposits: interest-bearing	656,077	359,359	296,187	-	655,546
FHLB advances and other borrowings	61,100	-	-	61,102	61,102
Subordinated debentures	14,919	-	-	14,494	14,494
Accrued interest payable	2,600	-	-	2,600	2,600

	Carrying Amount	Fair Value Measurements at December 31, 2023 Using:			
		Level 1	Level 2	Level 3	Total
<b>Financial assets</b>					
Cash and cash equivalents	\$ 40,009	\$ 40,009	\$ -	\$ -	\$ 40,009
Securities held-to-maturity	20,866	-	16,935	-	16,935
FHLB stock	7,295	-	-	7,295	7,295
Loans, net	739,461	-	-	731,562	731,562
Mortgage servicing rights	2,979	-	4,607	-	4,607
Accrued interest receivable	3,099	-	-	3,099	3,099
<b>Financial liabilities</b>					
Deposits: noninterest-bearing	\$ 159,899	\$ 159,899	\$ -	\$ -	\$ 159,899
Deposits: interest-bearing	639,039	346,003	292,214	-	638,217
FHLB advances and other borrowings	40,000	-	-	39,906	39,906
Subordinated debentures	14,836	-	-	13,506	13,506
Accrued interest payable	1,654	-	-	1,654	1,654

**NOTE 15 – GOODWILL AND INTANGIBLE ASSETS**

Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value, which is determined through an impairment test that is performed at least annually or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed. The Bancorp performed a qualitative assessment to determine if it was more likely than not that the fair value of the reporting unit exceeds its carrying value, including goodwill, at December 31, 2024. The results of the qualitative assessment indicated that the fair value of the reporting unit exceeded its carrying amount. Consequently, no additional impairment testing was necessary.

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**NOTE 16 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

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

	Unrealized Gains and (Losses) On Cash Flow Hedges	Unrealized Gains and (Losses) On Available- for-Sale Securities	Defined Benefit Pension Items	Total
<u>2024</u>				
Beginning balance	\$ 1,240	\$ (7,791)	\$ (416)	\$ (6,967)
Other comprehensive income (loss) before reclassification	(492)	(908)	-	(1,400)
Amounts reclassified from accumulated other comprehensive income, net of tax	<u>(606)</u>	<u>119</u>	<u>7</u>	<u>(480)</u>
Net current period other comprehensive income (loss)	<u>(1,098)</u>	<u>(789)</u>	<u>7</u>	<u>(1,880)</u>
Ending balance	<u>\$ 142</u>	<u>\$ (8,580)</u>	<u>\$ (409)</u>	<u>\$ (8,847)</u>
<u>2023</u>				
Beginning balance	\$ 2,144	\$ (8,644)	\$ (470)	\$ (6,970)
Other comprehensive income (loss) before reclassification	306	749	-	1,055
Amounts reclassified from accumulated other comprehensive income, net of tax	<u>(1,210)</u>	<u>104</u>	<u>54</u>	<u>(1,052)</u>
Net current period other comprehensive income (loss)	<u>(904)</u>	<u>853</u>	<u>54</u>	<u>3</u>
Ending balance	<u>\$ 1,240</u>	<u>\$ (7,791)</u>	<u>\$ (416)</u>	<u>\$ (6,967)</u>

Amounts reclassified from accumulated other comprehensive income for cash flow hedges, available-for-sale securities and the pension are recorded in interest expense, gain (loss) on securities, and salaries and employee benefits in the consolidated statements of income, respectively.

**NOTE 17 - DERIVATIVES**

The Bancorp utilizes interest rate swap agreements as part of its asset and liability management strategy to help manage its interest rate risk position. The notional amount of the interest rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swap agreements.

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(Continued)

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**NOTE 17 – DERIVATIVES** (Continued)

Cash Flow Hedges: Interest rate swaps with notional amounts totaling \$15,680 and \$77,500 as of December 31, 2024 and 2023 were designated as cash flow hedges of quarterly repricing (Federal Home Loan Bank advances or brokered CDs) and were determined to be effective during all periods presented. The Bancorp expects the hedges to remain effective during the remaining terms of the swaps.

Fair Value Hedges: Interest rate swaps with notional amount of \$44,320 and \$0 as of December 31, 2024 and 2023 were designated as fair value portfolio layer hedges of certain fixed rate loans. The hedges were determined to be effective during all of 2024. The Bancorp expects the hedges to remain effective during the terms of the swaps.

Summary information about the interest-rate swaps designated as a cash flow hedges as of year-end is as follows:

	<u>2024</u>	<u>2023</u>
Cash flow hedges:		
Notional amounts	\$ 15,680	\$ 77,500
Weighted average pay rates	3.660%	3.27268%
Weighted average receive rates	3-mth avg daily SOFR%	3-mth avg daily SOFR+0.0904%
Weighted average maturity	3.5 years	3.3 years
Unrealized gains (losses)	\$180	\$1,569
Fair value hedges:		
Notional amounts	\$ 44,320	
Weighted average pay rates	3.488%	
Weighted average receive rates	3-mth avg daily SOFR%	
Weighted average maturity	1.9 years	
Unrealized gains (losses)	\$496	

Interest expense recorded on the cash flow hedge transactions during 2024 totaled (\$767) as a component of interest expense on deposits and (\$79) as a component of interest expense on borrowed funds. Interest expense recorded on these hedge transactions during 2023 totaled (\$1,532) as a component of interest expense on deposits.

Interest income recorded on the fair value hedge transactions in 2024 totaled \$240 as a component of interest income on loans.

During the years ended December 31, 2024 and 2023, the Bancorp terminated interest rate swaps before the contractual maturity and recorded gains on the terminations of \$1,070 and \$793, respectively, in the consolidated statements of income.

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**NOTE 17 – DERIVATIVES** (Continued)

The following table presents the amounts recorded on the balance sheet related to cumulative basis adjustments for fair value hedges as of December 31:

Line Item in the Balance Sheet in Which the Hedged Item is Included	Carrying Amount Of the Hedged Assets (Liabilities)		Cumulative Amount of Fair Value Hedging Adjustment Included in the Carrying Amount of the Hedged Assets (Liabilities)	
	2024	2023	2024	2023
Loans	\$ 44,816	\$ -	\$ 496	\$ -

Bancorp presents derivative position gross on the balance sheet. The following table reflects the derivatives recorded on the balance sheet as of December 31:

	2024		2023	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Included in other assets:				
Derivatives designated as hedging instruments:				
Interest rate swaps related to loans	\$ 44,320	\$ 496	\$ -	\$ -
Interest rate swaps related to brokered CDs	15,680	<u>180</u>	77,500	<u>1,569</u>
Total included in other assets		<u>\$ 676</u>		<u>\$ 1,569</u>

The effect of cash flow hedge accounting on accumulated other comprehensive income for the years ended December 31 are as follows:

	2024		
	Amount of Gain (Loss) Recognized In OCI on Derivative	Location of Gain (Loss Reclassified) from OCI into income	Amount of Gain (Loss Reclassified) from OCI into income
Interest rate contracts	\$ 180	Brokered CDs	\$ 973
	2023		
	Amount of Gain (Loss) Recognized In OCI on Derivative	Location of Gain (Loss Reclassified) from OCI into income	Amount of Gain (Loss Reclassified) from OCI into income
Interest rate contracts	\$ 1,569	Brokered CDs	\$ 869

At December 31, 2024, the Bancorp expected \$71 of the unrealized gain to be reclassified as a reduction of interest expense during 2025.