Section 1: 10-K (10-K 2019 10-K)

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Section 1: 10-K (10-K)

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549
FORM 10-K

(Mark One)

☑ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the fiscal year ended December 31, 2019

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from ________ to ____________

LEVEL ONE BANCORP, INC.

(Exact name of registrant as specified in its charter)
Commission File Number: 001-38458

Michigan (State or other jurisdiction of incorporation or organization)	**71-1015624** (I.R.S. Employer Identification No.)
32991 Hamilton Court **Farmington Hills, MI** (Address of principal executive offices)	**48334** (Zip code)

(248) 737-0300

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading symbol(s)	Name of each exchange on which registered
Common Stock, no par value	**LEVL**	**Nasdaq Global Select Market**

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes☐ No ☑

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes☐ No ☑

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit such files). Yes ☑ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer ☐	Accelerated filer ☑
Non-accelerated filer ☐	Smaller reporting company ☑
Emerging growth company ☑	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.): Yes ☐ No ☑

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates on June 28, 2019 was $128,058,681 (based on the closing price on The Nasdaq Global Select Market on that date of $24.99)

As of March 6, 2020, the number of shares outstanding of the registrant's common stock, no par value, was 7,734,564 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held May 5, 2020, to be filed within 120 days after December 31, 2019, are incorporated by reference into Part III of this Form 10-K to the extent indicated in such Part.

Level One Bancorp, Inc.

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Forward-Looking Statements

This Form 10-K contains forward-looking statements within the meaning of the federal securities laws. These forward-looking statements reflect our current views with respect to, among other things, future events and our financial performance. These statements are often, but not always, made through the use of words or phrases such as "may," "might," "should," "could," "predict," "potential," "believe," "expect," "continue," "will," "anticipate," "seek," "estimate," "intend," "plan," "projection," "goal," "target," "aim," "would," "annualized" and "outlook," or the negative version of those words or other comparable words or phrases of a future or forward-looking nature. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about our industry, management's beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, we caution you that any such forward-looking statements are not guarantees of future performance and are subject to risks, assumptions, estimates and uncertainties that are difficult to predict. Although we believe that the expectations reflected in these forward-looking statements are reasonable as of the date made, actual results may prove to be materially different from the results expressed or implied by the forward-looking statements.

A number of important factors could cause our actual results to differ materially from those indicated in these forward-looking statements, including those factors identified under "Risk Factors" or "Management's Discussion and Analysis of Financial Condition and Results of Operations" or the following:

- business and economic conditions, particularly those affecting the financial services industry and our primary market areas;
- our ability to successfully manage our credit risk and the sufficiency of our allowance for loan loss;
- factors that can impact the performance of our loan portfolio, including real estate values and liquidity in our primary market areas, the financial health of our commercial borrowers and the success of construction projects that we finance, including any loans acquired in acquisition transactions;
- compliance with governmental and regulatory requirements, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and others relating to banking, consumer protection, securities and tax matters, and our ability to maintain licenses required in connection with commercial mortgage origination, sale and servicing operations;
- the impact of recent and future legislative and regulatory changes, including changes in banking, securities, tax and trade laws and regulations, and their application by our regulators;
- the occurrence of fraudulent activity, breaches or failures of our information security controls or cybersecurity-related incidents;
- interruptions involving our information technology and telecommunications systems or third-party servicers;
- risks related to our acquisition strategy, including our ability to identify suitable acquisition candidates, exposure to potential asset and credit quality risks and unknown or contingent liabilities, the time and costs of integrating systems, procedures and personnel, the need for capital to finance such transactions, our ability to obtain required regulatory approvals and possible failures in realizing the anticipated benefits from acquisitions;
- our ability to effectively execute our strategic plan and manage our growth;
- accounting treatment for loans acquired in connection with our acquisitions;
- changes in our senior management team and our ability to attract, motivate and retain qualified personnel;
- governmental monetary and fiscal policies;
- interest rate risks associated with our business;
- liquidity issues, including our ability to raise additional capital, if necessary;
- fluctuations in the values of the securities held in our securities portfolio;
- the effectiveness of our risk management framework;
- changes in benchmark interest rates used to price our loans and deposits, including the expected elimination of the London Inter-bank Offered Rate (“LIBOR”);

- changes in accounting policies and practices, as may be adopted by state and federal regulatory agencies and the Financial Accounting Standards Board (the "FASB"), including the implementation of the Current Expected Credit Loss (CECL) accounting standard;

- the effects of severe weather, natural disasters, acts of war or terrorism, widespread disease or pandemics, and other external events;

- the costs and obligations associated with being a public company;

- effects of competition within our market areas from a wide variety of local, regional, national and other providers of financial, investment and insurance services;

- our dependence on non-core funding sources and our cost of funds;

- our ability to maintain our reputation; and

- the impact of any claims or legal actions to which we may be subject, including any effect on our reputation.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this Form 10-K. Because of these risks and other uncertainties, our actual future results, performance or achievement, or industry results, may be materially different from the results indicated by the forward-looking statements in this Form 10-K. In addition, our past results of operations are not necessarily indicative of our future results. You should not rely on any forward-looking statements, which represent our beliefs, assumptions and estimates only as of the dates on which they were made, as predictions of future events. Any forward-looking statement speaks only as of the date on which it is made, and we do not undertake any obligation to update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

PART I

Item 1 - Business

Company Overview

Level One Bancorp, Inc. (the "Company," "we," "our," or "us") is the bank holding company, registered under the Bank Holding Company Act of 1956, as amended ("BHCA"), for Level One Bank (the "Bank"), headquartered in Farmington Hills located in Oakland County, Michigan. The Company is a Michigan corporation incorporated in 2006 and a financial holding company. The Bank has grown rapidly since its founding in 2007 and is one of the largest locally-headquartered commercial banks in southeastern Michigan. This growth has been driven primarily by our entrepreneurial culture, our experienced management team and by the economic strength of our core market area in Oakland County, which, as of December 31, 2019, had the fourteenth highest median income in the United States of counties with over one million residents. As of December 31, 2019, we had $1.58 billion in assets, $1.23 billion in loans, $1.14 billion in deposits and total shareholders’ equity of $170.7 million. We generated net income of $16.1 million for the year ended December 31, 2019, or $2.05 per diluted common share, and $14.4 million for the year ended December 31, 2018, or $1.91 per diluted common share.

In our twelve years of operation, we have grown to 14 offices, including 8 banking centers (our full-service branches) in Oakland County, one banking center in each of Detroit and Grand Rapids, Michigan’s two largest cities, one banking center in Sterling Heights, and one banking center in Ann Arbor as well as a mortgage loan production office. In addition to our organic growth, we acquired Michigan Heritage Bank in 2009, Paramount Bank in 2010, Lotus Bank in 2015, and Bank of Michigan in 2016, which added to our commercial banking, retail banking and mortgage lending while expanding our product suite and staffing levels. We also acquired Ann Arbor State Bank as of January 2, 2020, which expanded our client base in Ann Arbor by adding two banking centers to our already established banking center and mortgage production office, and another banking center in Jackson. Our aim is to continue our growth, primarily through organic growth but supplemented by opportunistic acquisitions that are additive to our franchise value.

Lending Activities

We offer a broad and growing set of lending products and related services, made up of commercial real estate loans, including construction and land development loans; commercial and industrial loans, including lines of credit, term loans, and loans under the Small Business Administration (SBA) lending program; residential real estate loans; and consumer loans including home equity loans, automobile loans and credit card services. We target our services to owner-managed businesses, professional firms, real estate professionals, not-for-profit businesses and consumers within our geographic markets who meet our underwriting standards.

We focus primarily on originating commercial and industrial loans, owner occupied commercial real estate loans and, to a

lesser extent, non-owner occupied commercial real estate loans in our primary market areas, which include Oakland County, the Detroit metropolitan area, the Grand Rapids metropolitan area, and the Ann Arbor metropolitan area. We have lenders dedicated to targeting mid-sized businesses with between $5.0 million and $50.0 million of annual revenue, but we also target small businesses with annual revenue of less than $5.0 million.

Commercial Loans. The commercial loans offered by the Bank include (i) commercial mortgages, (ii) commercial and industrial loans consisting of operating lines of credit, term loans, SBA-guaranteed loans and loans guaranteed by other loan programs such as the Michigan Economic Development Corporation (MEDC) collateral support program and, in the past, the U.S. Department of Agriculture (USDA) Business and Industry program; and (iii) commercial real estate construction and land development loans. Targeted customer groups include small and mid-sized business owners and operators. Another target group is professionals who are likely to build and occupy facilities at their principal employment locations.

The Bank's commercial mortgages are used to provide construction and permanent financing for owner-occupied, retail and office buildings, and multi-family buildings. Commercial real estate secured loans are generally written on a five-year term, with amortizing periods ranging up to twenty-five years. Interest rates may be fixed for three to seven years, or adjustable. The Bank generally charges an origination fee for its services. We generally require personal guarantees from the principal owners of the property supported by a review of the principal owners' personal financial statements. We attempt to limit our risk by analyzing the borrowers' cash flow and collateral value on an ongoing basis and by an annual review of rent rolls and financial statements. The loan-to-value ratio as established by an independent appraisal typically will not exceed 85%. Owner-occupied commercial real estate loans were $216.1 million, or 17.6% of the Company's loan portfolio, and non-owner occupied commercial real estate/multi-family loans were $388.5 million, or 31.6% of the Company's loan portfolio, as of December 31, 2019. Commercial and industrial loans are generally made to small to medium sized businesses for business purposes and are supported by the cash flow of the underlying business as well as collateral of accounts receivable, inventory and/or equipment as collateral and personal guaranties from the business owners.

SBA, MEDC, and USDA lending programs are utilized to enhance the credit quality of loans that already meet the requirements of the Company's rigorous credit underwriting policies and procedures. These programs have a further benefit to the Company in terms of liquidity and potential fee income, since there is an active secondary market which will purchase the guaranteed portion of these loans at a premium. Our operating lines of credit typically are limited to a percentage of the value of the assets securing the line. Lines of credit and term loans typically are reviewed annually. Commercial and industrial loans are primarily underwritten on the basis of the borrower's ability to service the loan from operating income. The terms of these loans vary by purpose and by type of underlying collateral. We typically make equipment loans for a term of five years or less at fixed or adjustable rates, with the loan fully amortized over the term. Loans to support working capital typically have terms not exceeding one year and are usually secured by accounts receivable, inventory and personal guarantees of the principals of the business. The interest rates charged on loans vary with the degree of risk and loan amount and are further subject to competitive pressures, money market rates, the availability of funds and government regulations. For loans secured by accounts receivable and inventory, principal is typically repaid as the assets securing the loan are converted into cash (monitored on a monthly, quarterly or more frequent basis as determined necessary in the underwriting process), and for loans secured with other types of collateral, principal is typically due at maturity. As of December 31, 2019, commercial and industrial loans totaled approximately $410.2 million, or 33.4% of the Company's loan portfolio.

Construction loans include commercial projects (such as multi-family housing, industrial, office and retail centers). Permanent financing is typically offered for commercial properties under construction. These loans typically have a term of less than 18 months, floating interest rates and commitment fees. Construction loans for investment real estate are made to developers who have an established record of successful project completion and loan repayment. Loan repayment for owner occupied transactions is generally from permanent financing with either the Bank or a qualified mortgage lender. The loan-to-value ratio as established by independent appraisal typically will not exceed 85% and generally is limited to 80% or less for owner occupied and 75% or less for non-owner occupied real estate. Loan proceeds are disbursed based on the percentage of completion and only after an experienced construction lender or third-party inspector has inspected the project, with construction monitoring handled by the Bank's Credit Administration department, which ensures title policies are updated for each construction draw. At December 31, 2019, we had $58.6 million in construction loans outstanding, representing 4.8% of the Company's loan portfolio, with $49.8 million in undisbursed commitments.

Residential Real Estate. We originate both fixed-rate loans and adjustable-rate loans in our residential lending program. Generally, these loans are originated to meet the requirements of the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), Federal Housing Administration ("FHA"), Veterans Affairs ("VA") and jumbo loans for sale in the secondary market to investors. We typically sell both our long term fixed rate and adjustable loan originations. We generally underwrite our one- to four-family loans based on the applicant's employment, debt to income levels, credit history and the appraised value of the subject property. Generally, we lend up to 80% of the lesser of the appraised value or purchase price for one- to four-family residential loans. In situations where we grant a residential first

mortgage loan with a loan-to-value ratio in excess of 80%, we generally require private mortgage insurance in order to reduce our exposure to 80% or less. Properties securing our one- to four-family loans are generally appraised by independent appraisers selected by our appraisal management companies conforming with appraisal independent compliance guidelines. We require our borrowers to obtain title and hazard insurance, and flood insurance, if necessary, in an amount equal to the regulatory maximum. Fixed rate loans generally are offered on a fully amortizing basis for terms ranging from 10 to 30 years at interest rates and fees that reflect current secondary market pricing. Most adjustable rate mortgage (ARM) products offered adjust annually after an initial period ranging from one to ten years, subject to a limitation on the annual change of 1.0% to 2.0% and a lifetime limitation of 5.0% to 6.0%. These ARM products most frequently adjust based upon the average yield on LIBOR or U.S. Treasury securities adjusted to a constant maturity of one year plus a margin or spread above the index. Generally, ARM loans held in our portfolio do not allow for interest-only payments nor negative amortization of principal and carry allowable prepayment restrictions. The Bank also makes a limited amount of loans secured by second mortgages on residential real estate. Second residential mortgages may have a loan to value of up 80% when combined with the first mortgage; however exceptions can be made based on credit capacity, collateral and the banking relationship. Also included in residential real estate loans are home equity lines of credit. Home equity lines of credit generally have a loan to value ratio of up to 90% at the time of origination when combined with the first mortgage. The majority of these loans are secured by a first or second mortgage on residential property. Home equity lines of credit allow for a 10-year draw period, with a 10-year repayment period, and the interest rate is generally tied to the prime rate as published by the Wall Street Journal and may include a margin. As of December 31, 2019, residential loans totaled approximately $211.8 million, or 17.3% of the Company's loan portfolio, of which $30.4 million were home equity lines of credit.

Consumer Loans. Consumer loans offered by the Bank include personal installment and auto loans and credit cards through a third-party provider. Personal lines of credit generally have maturities from one to five years and variable interest rates. Personal unsecured loans are available to creditworthy bank customers with limits determined on a loan by loan basis. Credit reports and industry standard debt-to-income ratios of 35% or less are used to qualify borrowers. As of December 31, 2019, consumer loans totaled approximately $896 thousand, or 0.1% of the Company's loan portfolio.

Loan Policy and Approval. Loan authority is delegated by the Directors Loan Committee. The Bank does not provide loan authority to any one individual, but takes a risk management approach based on aggregate credit exposure and risk grading. Aggregate exposure less than $2.0 million requires multi-signature approval. The Management Loan Committee has approval authority up to $6.0 million. The Directors Loan Committee has approval authority up to $12 million. Aggregate exposure requests that exceed $12.0 million are approved by the Directors Loan Committee on an exception basis. Each loan request requires some level of credit approval. Under applicable federal and state law, the Bank's permissible loans to one borrower are limited to $42.4 million in the aggregate, subject to two-thirds board approval. The Bank utilizes internal limits that may be less than or equal to the prevailing legal limits.

Deposit Services. The Bank offers a full range of deposit services insured by the Federal Deposit Insurance Corporation (FDIC), including (i) commercial checking and small business checking products, (ii) retirement accounts such as Individual Retirement Accounts (IRAs), and (iii) retail deposit services such as certificates of deposits, money market accounts, savings accounts, checking account products and Automated Teller Machines (ATMs). The Bank also offers debit cards and internet banking.

The Bank's business strategy concentrates heavily on the generation of "core" deposits, which are generally defined as demand deposit accounts, money market accounts, negotiable order of withdrawal (NOW) accounts, and time deposit accounts of less than $250 thousand. The Bank focuses its deposit efforts on cash rich businesses such as insurance companies, insurance agents, trade associations, title and escrow companies, real estate offices, churches and professionals such as physicians, attorneys and other services providers. The Bank has implemented deposit gathering strategies and tactics to attract and retain deposits utilizing technology to deliver treasury management services (e.g. remote deposit capture, lock box, and electronic bill payments) in addition to the traditional generation of deposit relationships in conjunction with its lending activities.

The Bank offers a broad range of deposit services that are typically available from most banks and savings and loan associations, including checking accounts, NOW accounts, savings and other time deposits of various types, ranging from daily money market accounts to longer-term certificates of deposit. The transaction accounts and time certificates are tailored to the principal market areas of the Bank at rates competitive with those offered in the area. The Bank solicits these accounts from individuals, businesses, associations, organizations and government authorities.

In addition, as of December 31, 2019, the Bank had $67.4 million of brokered deposits and deposits obtained through the use of internet listing services (approximately 5.9% of total deposits).

In addition, we generate fee income through our money services business clients (MSB), which provide cash management services for small, locally-owned cash intensive businesses. We intend to continue to grow this line of business, which we acquired in 2016 through our Bank of Michigan acquisition.

We offer commercial depository (treasury management) services, specialty deposit accounts and other solutions to serve the needs of our institutional depositors, and offer mobile banking services, checking and savings accounts, money market accounts, certificates of deposit and other customary products and services to our depositors.

Competition

The financial services industry is highly competitive as we compete for loans, deposits and customer relationships in our market. Competition involves efforts to retain current clients, make new loans and obtain new deposits, increase the scope and sophistication of services offered and offer competitive interest rates paid on deposits and charged on loans. Within our branch footprint, we primarily face competition from national, regional and other local financial institutions that have established branch networks throughout our market areas, giving them visible retail presence to customers.

In mortgage banking, we face competition from a wide range of national financial institutions, regional and local community banks, as well as credit unions and national mortgage companies. In commercial banking, we face competition to underwrite loans to sound, stable businesses and real estate projects at competitive price levels that make sense for our business and risk profile. Our major commercial bank competitors include larger national, regional and local financial institutions that may have the ability to make loans on larger projects than we can or provide a larger mix of product offerings. We also compete with smaller local financial institutions that may have aggressive pricing and unique terms on various types of loans and, increasingly, financial technology platforms that offer their products exclusively through web-based portals.

In retail banking, we primarily compete with national, regional, and local banks that have visible retail presence and personnel in our market areas. The primary factors driving competition in consumer banking are customer service, interest rates, fees charged, branch locations and hours of operation and the range of products offered. We compete for deposits by advertising, offering competitive interest rates and seeking to provide a higher level of personal service. We also face competition from non-traditional alternatives to banks such as credit unions, money centers, money market mutual funds and cash management accounts.

We believe our ability to provide a flexible, sophisticated product offering and an efficient process to our customers allows us to stay competitive in the financial services environment. We believe our local presence and hands-on approach enables us to provide a high level of service that our customers value.

Our Market Areas

We believe the demographics of our market areas provide strong growth opportunities for our loan portfolio and deposits. The following chart, which is based on data from S&P Global Market Intelligence, shows our share of the deposits in our market areas as of June 30, 2019, which is the most recent data available.

	Deposits	**Level One**	
(Dollars in millions)	**in Market**	**Deposits**	**Market Share**
Market Area by County			
Oakland County	$ 60,722.7	$ 1,114.5	1.84%
Wayne County	57,108.0	72.2	0.13
Macomb County	16,562.0	41.2	0.25
Kent County	17,242.8	15.8	0.09

Employees

As of December 31, 2019, we had 253 full-time equivalent employees. None of our employees is a party to a collective bargaining agreement. We consider our relationship with our employees to be good and have not experienced interruptions of operations due to labor disagreements.

Corporate Information

Our principal executive office is located at 32991 Hamilton Court, Farmington Hills, Michigan, and our telephone number is (248) 737-0300. Our website address is www.levelonebank.com. Through our website, under “Investor Relations,” we make available, free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as well as proxy statements, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the U.S. Securities and Exchange Commission (the “SEC”). The contents of our website are not incorporated by reference into this report.

Supervision and Regulation

General

FDIC-insured institutions, their holding companies and their affiliates are extensively regulated under federal and state law. As a result, our growth and earnings performance may be affected not only by management decisions and general economic conditions, but also by the requirements of federal and state statutes and by the regulations and policies of various bank regulatory agencies, including the Michigan Department of Insurance and Financial Services (the “DIFS”), the FDIC, the Board of Governors of the Federal Reserve System (the "Federal Reserve"), and the Consumer Financial Protection Bureau (the "CFPB"). Furthermore, taxation laws administered by the Internal Revenue Service and state taxing authorities, accounting rules developed by the FASB, securities laws administered by the SEC and state securities authorities, and anti-money laundering laws enforced by the U.S. Department of the Treasury (“Treasury”) have an impact on our business. The effect of these statutes, regulations, regulatory policies and accounting rules are significant to our operations and results.

Federal and state banking laws impose a comprehensive system of supervision, regulation and enforcement on the operations of FDIC-insured institutions, their holding companies and affiliates that is intended primarily for the protection of the FDIC-insured deposits and depositors of banks, rather than stockholders. These laws, and the regulations of the bank regulatory agencies issued under them, affect, among other things, the scope of our business, the kinds and amounts of investments the Company and the Bank may make, reserve requirements, required capital levels relative to assets, the nature and amount of collateral for loans, the establishment of branches, the ability to merge, consolidate and acquire, dealings with the Company’s and the Bank’s insiders and affiliates and our payment of dividends. In reaction to the global financial crisis and particularly following the passage of the Dodd Frank Act, we experienced heightened regulatory requirements and scrutiny. Although the reforms primarily targeted systemically important financial service providers, their influence filtered down in varying degrees to community banks over time and caused our compliance and risk management processes, and the costs thereof, to increase. However, in May 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (“Regulatory Relief Act”) was enacted by Congress in part to provide regulatory relief for community banks and their holding companies. To that end, the law eliminated questions about the applicability of certain Dodd-Frank Act reforms to community bank systems, including relieving us of any requirement to engage in mandatory stress tests, maintain a risk committee or comply with the Volcker Rule’s complicated prohibitions on proprietary trading and ownership of private funds. We believe these reforms are favorable to our operations.

The supervisory framework for U.S. banking organizations subjects banks and bank holding companies to regular examination by their respective regulatory agencies, which results in examination reports and ratings that are not publicly available and that can impact the conduct and growth of their business. These examinations consider not only compliance with applicable laws and regulations, but also capital levels, asset quality and risk, management ability and performance, earnings, liquidity, and various other factors. The regulatory agencies generally have broad discretion to impose restrictions and limitations on the operations of a regulated entity where the agencies determine, among other things, that such operations are unsafe or unsound, fail to comply with applicable law or are otherwise inconsistent with laws and regulations.

The following is a summary of the material elements of the supervisory and regulatory framework applicable to the Company and the Bank, beginning with a discussion of the continuing regulatory emphasis on our capital levels. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. The descriptions are qualified in their entirety by reference to the particular statutory and regulatory provision.

The Role of Capital

Regulatory capital represents the net assets of a banking organization available to absorb losses. Because of the risks attendant to their business, FDIC-insured institutions are generally required to hold more capital than other businesses, which directly affects their earnings capabilities. While capital has historically been one of the key measures of the financial health of both bank holding companies and banks, its role became fundamentally more important in the wake of the global financial crisis, as the banking regulators recognized that the amount and quality of capital held by banks prior to the crisis was insufficient to absorb losses during periods of severe stress. Certain provisions of the Dodd-Frank Act and Basel III, discussed below, establish capital standards that are meaningfully more stringent than those in place previously.

Minimum Required Capital Levels. Banks have been required to hold minimum levels of capital based on guidelines established by the bank regulatory agencies since 1983. The minimums have been expressed in terms of ratios of “capital” divided by “total assets.” As discussed below, bank capital measures have become more sophisticated over the years and have focused more on the quality of capital and the risk of assets. Bank holding companies have historically had to comply with less stringent capital standards than their bank subsidiaries and have been able to raise capital with hybrid instruments such as trust preferred securities. The Dodd-Frank Act mandated the Federal Reserve to establish minimum capital levels for holding companies on a consolidated basis as stringent as those required for FDIC-insured institutions.

The Basel International Capital Accords. The risk-based capital guidelines for U.S. banks since 1989 were based upon the 1988 capital accord known as “Basel I” adopted by the international Basel Committee on Banking Supervision, a committee of central banks and bank supervisors that acts as the primary global standard-setter for prudential regulation, as implemented by the U.S. bank regulatory agencies on an interagency basis. The accord recognized that bank assets for the purpose of the capital ratio calculations needed to be assigned risk weights (the theory being that riskier assets should require more capital) and that off-balance sheet exposures needed to be factored in the calculations. Basel I had a very simple formula for assigning risk weights to bank assets from 0% to 100% based on four categories. In 2008, the banking agencies collaboratively began to phase-in capital standards based on a second capital accord, referred to as “Basel II,” for large or “core” international banks (generally defined for U.S. purposes as having total assets of $250 billion or more, or consolidated foreign exposures of $10 billion or more) known as “advanced approaches” banks. The primary focus of Basel II was on the calculation of risk weights based on complex models developed by each advanced approaches bank. Because most banks were not subject to Basel II, the U.S. bank regulators worked to improve the risk sensitivity of Basel I standards without imposing the complexities of Basel II. This “standardized approach” increased the number of risk-weight categories and recognized risks well above the original 100% risk weight. It is institutionalized by the Dodd-Frank Act for all banking organizations, even for the advanced approaches banks, as a floor.

On September 12, 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, announced agreement on a strengthened set of capital requirements for banking organizations around the world, known as Basel III, to address deficiencies recognized in connection with the global financial crisis.

The Basel III Rule. In July 2013, the U.S. federal banking agencies approved the implementation of the Basel III regulatory capital reforms in pertinent part, and, at the same time, promulgated rules effecting certain changes required by the Dodd-Frank Act (the “Basel III Rule”). In contrast to capital requirements historically, which were in the form of guidelines, Basel III was released in the form of enforceable regulations by each of the regulatory agencies. The Basel III Rule is applicable to all banking organizations that are subject to minimum capital requirements, including federal and state banks and savings and loan associations, as well as to bank and savings and loan holding companies, other than “small bank holding companies” (generally certain holding companies with consolidated assets of less than $3 billion, which at this juncture does not include us) and certain qualifying banking organizations that may elect a simplified framework (which we have not done). Thus, the Company and the Bank are each currently subject to the Basel III Rule as described below.

The Basel III Rule increased the required quantity and quality of capital and, for nearly every class of assets, it requires a more complex, detailed and calibrated assessment of risk and calculation of risk-weight amounts.

Not only did the Basel III Rule increase most of the required minimum capital ratios in effect prior to January 1, 2015, but it introduced the concept of Common Equity Tier 1 Capital, which consists primarily of common stock, related surplus (net of Treasury stock), retained earnings, and Common Equity Tier 1 minority interests subject to certain regulatory adjustments. The Basel III Rule also changed the definition of capital by establishing more stringent criteria that instruments must meet to be considered Additional Tier 1 Capital (primarily non-cumulative perpetual preferred stock that meets certain requirements) and Tier 2 Capital (primarily other types of preferred stock and subordinated debt, subject to limitations). A number of instruments that qualified as Tier 1 Capital under Basel I do not qualify, or their qualifications changed. For example, noncumulative perpetual preferred stock, which qualified as simple Tier 1 Capital under Basel I, does not qualify as Common Equity Tier 1 Capital, but qualifies as Additional Tier 1 Capital. The Basel III Rule also constrained the inclusion of minority interests, mortgage-servicing assets, and deferred tax assets in capital and requires deductions from Common Equity Tier 1 Capital in the event that such assets exceed a certain percentage of a banking institution’s Common Equity Tier 1 Capital.

The Basel III Rule requires **minimum** capital ratios as follows:

- A ratio of minimum Common Equity Tier 1 Capital equal to 4.5% of risk-weighted assets;
- An increase in the minimum required amount of Tier 1 Capital from 4% to 6% of risk-weighted assets;
- A continuation of the minimum required amount of Total Capital (Tier 1 plus Tier 2) at 8% of risk-weighted assets; and
- A minimum leverage ratio of Tier 1 Capital to total quarterly average assets equal to 4% in all circumstances.

In addition, institutions that seek the freedom to make capital distributions (including for dividends and repurchases of stock) and pay discretionary bonuses to executive officers without restriction must also maintain greater than 2.5% in Common Equity Tier 1 Capital attributable to a capital conservation buffer. The purpose of the conservation buffer is to ensure that banking institutions maintain a buffer of capital that can be used to absorb losses during periods of financial and economic stress. Factoring in the conservation buffer increases the minimum ratios depicted above to 7% for Common Equity Tier 1 Capital, 8.5% for Tier 1 Capital and 10.5% for Total Capital.

Well-Capitalized Requirements. The ratios described above are minimum standards in order for banking organizations to be considered "adequately capitalized." Bank regulatory agencies uniformly encourage banks to hold more capital and be "well-capitalized" and, to that end, federal law and regulations provide various incentives for banking organizations to maintain regulatory capital at levels in excess of minimum regulatory requirements. For example, a banking organization that is well-capitalized may: (i) qualify for exemptions from prior notice or application requirements otherwise applicable to certain types of activities; (ii) qualify for expedited processing of other required notices or applications; and (iii) accept, roll-over or renew brokered deposits. Higher capital levels could also be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve's capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (*i.e.*, Tier 1 Capital less all intangible assets), well above the minimum levels.

Under the capital regulations of the FDIC and Federal Reserve, in order to be well-capitalized, a banking organization must maintain:

- A Common Equity Tier 1 Capital ratio to risk-weighted assets of 6.5% or more;
- A ratio of Tier 1 Capital to total risk-weighted assets of 8% or more (6% under Basel I);
- A ratio of Total Capital to total risk-weighted assets of 10% or more (the same as Basel I); and
- A leverage ratio of Tier 1 Capital to total adjusted average quarterly assets of 5% or greater.

It is possible under the Basel III Rule to be well-capitalized while remaining out of compliance with the capital conservation buffer discussed above. In addition, to be well-capitalized, a banking organization must not be subject to a capital requirement imposed on it as an individual institution to maintain any specified capital ratio.

As of December 31, 2019: (i) the Bank was not subject to a directive from DIFS or FDIC to increase its capital and (ii) the Bank was well-capitalized, as defined by FDIC regulations. As of December 31, 2019, the Company had regulatory capital in excess of the Federal Reserve's requirements and met the Basel III Rule requirements to be well-capitalized. We are also in compliance with the capital conservation buffer.

Prompt Corrective Action. The concept of an institution being "well-capitalized" is part of a regulatory enforcement regime that provides the federal banking regulators with broad power to take "prompt corrective action" to resolve the problems of institutions based on the capital level of each particular institution. The extent of the regulators' powers depends on whether the institution in question is "adequately capitalized," "undercapitalized," "significantly undercapitalized" or "critically undercapitalized," in each case as defined by regulation. Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: (i) requiring the institution to submit a capital restoration plan; (ii) limiting the institution's asset growth and restricting its activities; (iii) requiring the institution to issue additional capital stock (including additional voting stock) or to sell itself; (iv) restricting transactions between the institution and its affiliates; (v) restricting the interest rate that the institution may pay on deposits; (vi) ordering a new election of directors of the institution; (vii) requiring that senior executive officers or directors be dismissed; (viii) prohibiting the institution from accepting deposits from correspondent banks; (ix) requiring the institution to divest certain subsidiaries; (x) prohibiting the payment of principal or interest on subordinated debt; and (xi) ultimately, appointing a receiver for the institution.

Community Bank Capital Simplification. Community banks have long raised concerns with bank regulators about the regulatory burden, complexity, and costs associated with certain provisions of the Basil III Rule. In response, Congress provided an "off-ramp" for institutions, like us, with total consolidated assets of less than $10 billion. Section 201 of the Regulatory Relief Act instructed the federal banking regulators to establish a single "Community Bank Leverage Ratio" ("CBLR") of between 8 and 10%. Under the final rule, a community banking organization is eligible to elect the new framework if it has: less than $10 billion in total consolidated assets, limited amounts of certain assets and off-balance sheet exposures, and a CBLR greater than 9%. We may elect the CBLR framework at any time but have not currently determined to do so.

Regulation and Supervision of the Company

General. As the sole stockholder of the Bank, we are a bank holding company. As a bank holding company, we are registered with, and is subject to regulation supervision and enforcement by, the Federal Reserve under the BHCA. We are legally obligated to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances where we might not otherwise do so. Under the BHCA, we are subject to periodic examination by the Federal

Reserve. We are required to file with the Federal Reserve periodic reports of our operations and such additional information regarding us and our subsidiaries as the Federal Reserve may require.

Acquisitions, Activities and Financial Holding Company Election. The primary purpose of a bank holding company is to control and manage banks. The BHCA generally requires the prior approval of the Federal Reserve for any merger involving a bank holding company or any acquisition by a bank holding company of another bank or bank holding company. Subject to certain conditions (including deposit concentration limits established by the BHCA), the Federal Reserve may allow a bank holding company to acquire banks located in any state of the United States. In approving interstate acquisitions, the Federal Reserve is required to give effect to applicable state law limitations on the aggregate amount of deposits that may be held by the acquiring bank holding company and its FDIC-insured institution affiliates in the state in which the target bank is located (provided that those limits do not discriminate against out-of-state institutions or their holding companies) and state laws that require that the target bank have been in existence for a minimum period of time (not to exceed five years) before being acquired by an out-of-state bank holding company. Furthermore, in accordance with the Dodd-Frank Act, bank holding companies must be well-capitalized and well-managed in order to effect interstate mergers or acquisitions. For a discussion of the capital requirements, see “The Role of Capital” above.

The BHCA generally prohibits us from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company that is not a bank and from engaging in any business other than that of banking, managing and controlling banks or furnishing services to banks and their subsidiaries. This general prohibition is subject to a number of exceptions. The principal exception allows bank holding companies to engage in, and to own shares of companies engaged in, certain businesses found by the Federal Reserve prior to November 11, 1999 to be “so closely related to banking ... as to be a proper incident thereto.” This authority permits us to engage in a variety of banking-related businesses, including the ownership and operation of a savings association, or any entity engaged in consumer finance, equipment leasing, the operation of a computer service bureau (including software development) and mortgage banking and brokerage services. The BHCA does not place territorial restrictions on the domestic activities of nonbank subsidiaries of bank holding companies.

Additionally, bank holding companies that meet certain eligibility requirements prescribed by the BHCA and elect to operate as financial holding companies may engage in, or own shares in companies engaged in, a wider range of nonbanking activities, including securities and insurance underwriting and sales, merchant banking and any other activity that the Federal Reserve, in consultation with the Secretary of the Treasury, determines by regulation or order is financial in nature or incidental to any such financial activity or that the Federal Reserve determines by order to be complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of FDIC-insured institutions or the financial system generally. We have elected to operate as a financial holding company. In order to maintain our status as a financial holding company, the Company and the Bank must be well-capitalized, well-managed, and the Bank must have at least a satisfactory Community Reinvestment Act (“CRA”) rating. If the Federal Reserve determines that a financial holding company is not well-capitalized or well-managed, that company has a period of time in which to achieve compliance, but during the period of noncompliance, the Federal Reserve may place any limitations on the company it believes to be appropriate. Furthermore, if the Federal Reserve determines that a financial holding company’s subsidiary bank has not received a satisfactory CRA rating, that company will not be able to commence any new financial activities or acquire a company that engages in such activities.

Change in Control. Federal law also prohibits any person or company from acquiring “control” of an FDIC-insured depository institution or its holding company without prior notice to the appropriate federal bank regulator. “Control” is conclusively presumed to exist upon the acquisition of 25% or more of the outstanding voting securities of a bank or bank holding company but may arise under certain circumstances between 10% and 24.99% ownership.

Capital Requirements. We file consolidated capital reports with the Federal Reserve under the Basel III Rule. For a discussion of capital requirements, see “The Role of Capital” above.

Dividend Payments. Our ability to pay dividends to our stockholders may be affected by both general corporate law considerations and policies of the Federal Reserve applicable to bank holding companies. As a Michigan corporation, we are subject to the Michigan Business Corporation Act, as amended, which prohibits us from paying a dividend if, after giving effect to the dividend we would not be able to pay our debts as the debts become due in the usual course of business, or our total assets would be less than the sum of its total liabilities plus, the amount that would be needed, if we were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of stockholders whose preferential rights are superior to those receiving the distribution.

As a general matter, the Federal Reserve has indicated that the board of directors of a bank holding company should eliminate, defer or significantly reduce dividends to stockholders if: (i) the company’s net income available to stockholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (ii) the prospective rate of earnings retention is inconsistent with the company’s capital needs and overall current and prospective financial condition; or (iii) the company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy

ratios. The Federal Reserve also possesses enforcement powers over bank holding companies and their nonbank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies. In addition, under the Basel III Rule, institutions that seek the freedom to pay dividends have to maintain greater than 2.5% in Common Equity Tier 1 Capital attributable to the capital conservation buffer. See “The Role of Capital” above.

Monetary Policy. The monetary policy of the Federal Reserve has a significant effect on the operating results of financial or bank holding companies and their subsidiaries. Among the tools available to the Federal Reserve to affect the money supply are open market transactions in U.S. government securities, changes in the discount rate on bank borrowings and changes in reserve requirements against bank deposits. These means are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may affect interest rates charged on loans or paid on deposits.

Federal Securities Regulation. Our common stock is registered with the SEC under the Securities Act of 1933, as amended, and the Exchange Act. Consequently, we are subject to the information, proxy solicitation, insider trading and other restrictions and requirements of the SEC under the Exchange Act.

Corporate Governance. The Dodd-Frank Act addressed many investor protection, corporate governance and executive compensation matters that will affect most U.S. publicly traded companies. The Dodd Frank Act increased stockholder influence over boards of directors by requiring companies to give stockholders a nonbinding vote on executive compensation and so-called “golden parachute” payments, and authorizing the SEC to promulgate rules that would allow stockholders to nominate and solicit voters for their own candidates using a company’s proxy materials. The legislation also directed the Federal Reserve to promulgate rules prohibiting excessive compensation paid to executives of bank holding companies, regardless of whether such companies are publicly traded.

Supervision and Regulation of the Bank

General. The Bank is a Michigan-chartered bank. The deposit accounts of the Bank are insured by the FDIC’s Deposit Insurance Fund (“DIF”) to the maximum extent provided under federal law and FDIC regulations, currently $250,000 per insured depositor category. As a Michigan-chartered FDIC-insured bank, the Bank is subject to the examination, supervision, reporting and enforcement requirements of the DIFS, the chartering authority for Michigan banks, and the FDIC, designated by federal law as the primary federal regulator of insured state banks that, like the Bank, are not members of the Federal Reserve.

Deposit Insurance. As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system whereby FDIC-insured institutions pay insurance premiums at rates based on their risk classification. For institutions like the Bank that are not considered large and highly complex banking organizations, assessments are now based on examination ratings and financial ratios. The total base assessment rates currently range from 1.5 basis points to 30 basis points. At least semi-annually, the FDIC updates its loss and income projections for the DIF and, if needed, increases or decreases the assessment rates, following notice and comment on proposed rulemaking. The assessment base against which an FDIC-insured institution’s deposit insurance premiums paid to the DIF has been calculated since effectiveness of the Dodd-Frank Act based on its average consolidated total assets less its average tangible equity. This method shifted the burden of deposit insurance premiums toward those large depository institutions that rely on funding sources other than U.S. deposits.

The reserve ratio is the FDIC insurance fund balance divided by estimated insured deposits. The Dodd-Frank Act altered the minimum reserve ratio of the DIF, increasing the minimum from 1.15 percent to 1.35 percent of the estimated amount of total insured deposits, and eliminating the requirement that the FDIC pay dividends to FDIC-insured institutions when the reserve ratio exceeds certain thresholds. The reserve ratio reached 1.36 percent as of September 30, 2018, exceeding the statutory required minimum reserve ratio of 1.35 percent. As a result, the FDIC has provided assessment credits to insured depository institutions, like the Bank, with total consolidated assets of less than $10 billion for the portion of their regular assessments that contributed to growth in the reserve ratio between 1.15 percent and 1.35 percent. The share of the aggregate small bank credits allocated to each insured institution is proportional to its credit base, defined as the average of its regular assessment base during the credit calculation period. The FDIC has applied the credits for quarterly assessment periods beginning July 1, 2019, and, as long as the reserve ratio is at least 1.35 percent, the FDIC will remit the full nominal value of any remaining credits in a lump-sum payment.

Supervisory Assessments. All Michigan-chartered banks are required to pay supervisory assessments to the DIFS to fund the operations of that agency. The amount of the assessment is calculated on the basis of the Bank’s total assets. During the year ended December 31, 2019, the Bank paid supervisory assessments to the DIFS totaling approximately $179 thousand.

Capital Requirements. Banks are generally required to maintain capital levels in excess of other businesses. For a discussion of capital requirements, see “The Role of Capital” above.

Liquidity Requirements. Liquidity is a measure of the ability and ease with which bank assets may be converted to cash. Liquid assets are those that can be converted to cash quickly if needed to meet financial obligations. To remain viable, FDIC-insured institutions must have enough liquid assets to meet their near-term obligations, such as withdrawals by depositors. Because the global financial crisis was in part a liquidity crisis, Basel III also includes a liquidity framework that requires FDIC-insured institutions to measure their liquidity against specific liquidity tests. One test, referred to as the liquidity coverage ratio, or LCR, is designed to ensure that the banking entity has an adequate stock of unencumbered high-quality liquid assets that can be converted easily and immediately in private markets into cash to meet liquidity needs for a 30-calendar day liquidity stress scenario. The other test, known as the net stable funding ratio, or NSFR, is designed to promote more medium- and long-term funding of the assets and activities of FDIC-insured institutions over a one-year horizon. These tests provide an incentive for banks and holding companies to increase their holdings in Treasury securities and other sovereign debt as a component of assets, increase the use of long-term debt as a funding source and rely on stable funding like core deposits (in lieu of brokered deposits).

In addition to liquidity guidelines already in place, the federal bank regulatory agencies implemented the Basel III LCR in September 2014, which requires large financial firms to hold levels of liquid assets sufficient to protect against constraints on their funding during times of financial turmoil, and in 2016 proposed implementation of the NSFR. While these rules do not, and will not, apply to the Bank, it continues to review its liquidity risk management policies in light of developments.

Dividend Payments. The primary source of funds for the Company is dividends from the Bank. Under the Michigan Banking Code, the Bank cannot declare or pay a cash dividend or dividend in kind unless it will have a surplus amounting to not less than 20% of its capital after payment of the dividend. In addition, the Bank may pay dividends only out of net income then on hand, after deducting its bad debts. Further, the Bank may not declare or pay a dividend until cumulative dividends on preferred stock, if any, are paid in full.

The payment of dividends by any FDIC-insured institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a FDIC-insured institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, the Bank exceeded its capital requirements under applicable guidelines as of December 31, 2019. Notwithstanding the availability of funds for dividends, however, the FDIC and the DIFS may prohibit the payment of dividends by the Bank if either or both determine such payment would constitute an unsafe or unsound practice. In addition, under the Basel III Rule, institutions that seek the freedom to pay dividends have to maintain the capital conservation buffer. See “The Role of Capital” above.

State Bank Investments and Activities. The Bank is permitted to make investments and engage in activities directly or through subsidiaries as authorized by Michigan law. However, under federal law and FDIC regulations, FDIC-insured state banks are prohibited, subject to certain exceptions, from making or retaining equity investments of a type, or in an amount, that are not permissible for a national bank. Federal law and FDIC regulations also prohibit FDIC-insured state banks and their subsidiaries, subject to certain exceptions, from engaging as principal in any activity that is not permitted for a national bank unless the bank meets, and continues to meet, its minimum regulatory capital requirements and the FDIC determines that the activity would not pose a significant risk to the DIF. These restrictions have not had, and are not currently expected to have, a material impact on the operations of the Bank.

Insider Transactions. The Bank is subject to certain restrictions imposed by federal law on “covered transactions” between the Bank and its “affiliates.” We are an affiliate of the Bank for purposes of these restrictions, and covered transactions subject to the restrictions include extensions of credit to the Company, investments in the stock or other securities of the Company and the acceptance of the stock or other securities of the Company as collateral for loans made by the Bank. The Dodd-Frank Act enhanced the requirements for certain transactions with affiliates, including an expansion of the definition of “covered transactions” and an increase in the amount of time for which collateral requirements regarding covered transactions must be maintained.

Certain limitations and reporting requirements are also placed on extensions of credit by the Bank to its directors and officers, to directors and officers of the Company and our subsidiaries, to our principal stockholders and to “related interests” of such directors, officers and principal stockholders. In addition, federal law and regulations may affect the terms upon which any person who is a director or officer of the Company or the Bank, or a principal stockholder of the Company, may obtain credit from banks with which the Bank maintains a correspondent relationship.

Safety and Soundness Standards/Risk Management. The federal banking agencies have adopted operational and managerial standards to promote the safety and soundness of FDIC-insured institutions. The standards apply to internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings.

In general, the safety and soundness standards prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. While regulatory standards do not have the force of law, if an institution operates in an unsafe and unsound manner, the FDIC-insured institution's primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. If an FDIC-insured institution fails to submit an acceptable compliance plan, or fails in any material respect to implement a compliance plan that has been accepted by its primary federal regulator, the regulator is required to issue an order directing the institution to cure the deficiency. Until the deficiency cited in the regulator's order is cured, the regulator may restrict the FDIC-insured institution's rate of growth, require the FDIC-insured institution to increase its capital, restrict the rates the institution pays on deposits or require the institution to take any action the regulator deems appropriate under the circumstances. Noncompliance with safety and soundness may also constitute grounds for other enforcement action by the federal bank regulatory agencies, including cease and desist orders and civil money penalty assessments.

During the past decade, the bank regulatory agencies have increasingly emphasized the importance of sound risk management processes and strong internal controls when evaluating the activities of the FDIC-insured institutions they supervise. Properly managing risks has been identified as critical to the conduct of safe and sound banking activities and has become even more important as new technologies, product innovation, and the size and speed of financial transactions have changed the nature of banking markets. The agencies have identified a spectrum of risks facing a banking institution including, but not limited to, credit, market, liquidity, operational, legal and reputational risk. Key risk themes identified for 2020 are: (i) elevated operational risk as banks adapt to an evolving technology environment and persistent cybersecurity risks; (ii) the need for banks to prepare for a cyclical change in credit risk while credit performance is strong; (iii) elevated interest rate risk due to lower rates continuing to compress net interest margins; and (iv) strategic risks from non-depository financial institutions, use of innovative and evolving technology, and progressive data analysis capabilities. The Bank is expected to have active board and senior management oversight; adequate policies, procedures and limits; adequate risk measurement, monitoring and management information systems; and comprehensive internal controls.

Privacy and Cybersecurity. The Bank is subject to many U.S. federal and state laws and regulations governing requirements for maintaining policies and procedures to protect non-public confidential information of their customers. These laws require the Bank to periodically disclose its privacy policies and practices relating to sharing such information and permit consumers to opt out of their ability to share information with unaffiliated third parties under certain circumstances. They also impact the Bank's ability to share certain information with affiliates and non-affiliates for marketing and/or non-marketing purposes, or to contact customers with marketing offers. In addition, as a part of its operational risk mitigation, the Bank is required to implement a comprehensive information security program that includes administrative, technical, and physical safeguards to ensure the security and confidentiality of customer records and information and to require the same of its service providers. These security and privacy policies and procedures, for the protection of personal and confidential information, are in effect across all business lines and geographic locations.

Branching Authority. Michigan banks, such as the Bank, have the authority under Michigan law to establish branches anywhere in the State of Michigan, subject to receipt of all required regulatory approvals. The establishment of new interstate branches has historically been permitted only in those states the laws of which expressly authorize such expansion. The Dodd-Frank Act permits well-capitalized and well-managed banks to establish de novo interstate branches without impediments. Federal law permits state and national banks to merge with banks in other states subject to: (i) regulatory approval; (ii) federal and state deposit concentration limits; and (iii) state law limitations requiring the merging bank to have been in existence for a minimum period of time (not to exceed five years) prior to the merger.

Transaction Account Reserves. Federal Reserve regulations require FDIC-insured institutions to maintain reserves against their transaction accounts (primarily NOW and regular checking accounts). For 2020, the first $16.9 million of otherwise reservable balances are exempt from reserves and have a zero percent reserve requirement; for transaction accounts aggregating between $16.9 million to $127.5 million, the reserve requirement is 3% of those transaction account balances; and for net transaction accounts in excess of $127.5 million, the reserve requirement is 10% of the aggregate amount of total transaction account balances in excess of $127.5 million. These reserve requirements are subject to annual adjustment by the Federal Reserve.

Community Reinvestment Act Requirements. The CRA requires the Bank to have a continuing and affirmative obligation in a safe and sound manner to help meet the credit needs of the entire community, including low- and moderate-income neighborhoods. Federal regulators regularly assess the Bank's record of meeting the credit needs of its communities. Applications for additional acquisitions would be affected by the evaluation of the Bank's effectiveness in meeting its CRA requirements.

Anti-Money Laundering. The USA Patriot Act is designed to deny terrorists and criminals the ability to obtain access to the U.S. financial system and has significant implications for FDIC-insured institutions, brokers, dealers and other businesses involved in the transfer of money. The USA Patriot Act mandates financial services companies to have policies and procedures

with respect to measures designed to address any or all of the following matters: (i) customer identification programs; (ii) money laundering; (iii) terrorist financing; (iv) identifying and reporting suspicious activities and currency transactions; (v) currency crimes; and (vi) cooperation between FDIC-insured institutions and law enforcement authorities.

Concentrations in Commercial Real Estate. Concentration risk exists when FDIC-insured institutions deploy too many assets to any one industry or segment. A concentration in commercial real estate is one example of regulatory concern. The interagency Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices guidance ("CRE Guidance") provides supervisory criteria, including the following numerical indicators, to assist bank examiners in identifying banks with potentially significant commercial real estate loan concentrations that may warrant greater supervisory scrutiny: (i) commercial real estate loans exceeding 300% of capital and increasing 50% or more in the preceding three years; or (ii) construction and land development loans exceeding 100% of capital. The CRE Guidance does not limit banks' levels of commercial real estate lending activities, but rather guides institutions in developing risk management practices and levels of capital that are commensurate with the level and nature of their commercial real estate concentrations. On December 18, 2015, the federal banking agencies issued a statement to reinforce prudent risk-management practices related to CRE lending, having observed substantial growth in many CRE asset and lending markets, increased competitive pressures, rising CRE concentrations in banks, and an easing of CRE underwriting standards. The federal bank agencies reminded FDIC-insured institutions to maintain underwriting discipline and exercise prudent risk-management practices to identify, measure, monitor, and manage the risks arising from CRE lending. In addition, FDIC-insured institutions must maintain capital commensurate with the level and nature of their CRE concentration risk.

As of December 31, 2019, the Bank did not exceed these guidelines.

Consumer Financial Services. The historical structure of federal consumer protection regulation applicable to all providers of consumer financial products and services changed significantly on July 21, 2011, when the CFPB commenced operations to supervise and enforce consumer protection laws. The CFPB has broad rulemaking authority for a wide range of consumer protection laws that apply to all providers of consumer products and services, including the Bank, as well as the authority to prohibit "unfair, deceptive or abusive" acts and practices. The CFPB has examination and enforcement authority over providers with more than $10 billion in assets. FDIC-insured institutions with $10 billion or less in assets, like the Bank, continue to be examined by their applicable bank regulators.

Because abuses in connection with residential mortgages were a significant factor contributing to the financial crisis, many new rules issued by the CFPB and required by the Dodd-Frank Act addressed mortgage and mortgage-related products, their underwriting, origination, servicing and sales. The Dodd-Frank Act significantly expanded underwriting requirements applicable to loans secured by 1-4 family residential real property and augmented federal law combating predatory lending practices. In addition to numerous disclosure requirements, the Dodd-Frank Act imposed new standards for mortgage loan originations on all lenders, including banks and savings associations, in an effort to strongly encourage lenders to verify a borrower's ability to repay, while also establishing a presumption of compliance for certain "qualified mortgages." The Regulatory Relief Act provided relief in connection with mortgages for banks with assets of less than $10 billion, and, as a result, mortgages the Bank makes are now considered to be qualified mortgages if they are held in portfolio for the life of the loan.

The CFPB's rules have not had a significant impact on the Bank's operations, except for higher compliance costs.

Item 1A – Risk Factors

The material risks that management believes affect the Company are described below. You should carefully consider the risks, together with all of the other information included herein. The risks described below are not the only risks the Company faces. Additional risks not presently known or that the Company believes are immaterial also may have a material adverse effect on the Company's results of operations and financial condition.

Risks Related to Our Business

A decline in general business and economic conditions and any regulatory responses to such conditions could have a material adverse effect on our business, financial position, results of operations and growth prospects.

Our business and operations are sensitive to general business and economic conditions in the United States, generally, and particularly in our market areas in the state of Michigan. If the national, regional and local economies experience worsening economic conditions, including high levels of unemployment, our growth and profitability could be constrained. A decline in local economic conditions may have a greater effect on our earnings and capital than on the earnings and capital of larger financial institutions whose real estate loan portfolios are geographically diverse. Weak economic conditions are characterized by, among other indicators, deflation, elevated levels of unemployment, fluctuations in debt and equity capital markets, increased delinquencies on mortgage, commercial and consumer loans, residential and commercial real estate price declines,

and lower home sales and commercial activity. In addition, unfavorable or uncertain economic and market conditions can be caused by declines in economic growth, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; uncertainty in U.S. trade policies, legislation, treaties and tariffs; natural disasters; acts of war or terrorism; widespread disease or pandemics; or a combination of these or other factors. All of these factors are generally detrimental to our business. Our business is significantly affected by monetary, trade and other regulatory policies of the U.S. federal government, its agencies and government-sponsored entities. Changes in any of these policies are influenced by macroeconomic conditions and other factors that are beyond our control, are difficult to predict and could have a material adverse effect on our business, financial position, results of operations and growth prospects.

If we do not effectively manage our credit risk, we may experience increased levels of delinquencies, nonaccrual loans and charge-offs, which could require increases in our provision for loan losses.

There are risks inherent in making any loan, including risks inherent in dealing with individual borrowers, risks of nonpayment, risks resulting from uncertainties as to the future value of collateral and cash flows available to service debt and risks resulting from changes in economic and market conditions. We cannot guarantee that our credit underwriting and monitoring procedures will reduce these credit risks, and they cannot be expected to completely eliminate our credit risks. If the overall economic climate in the United States, generally, or our market areas, specifically, declines, our borrowers may experience difficulties in repaying their loans, and the level of nonaccrual loans, charge-offs and delinquencies could rise and require further increases in the provision for loan losses, which would cause our net income, return on equity and capital to decrease.

Our allowance for loan losses may prove to be insufficient to absorb potential losses in our loan portfolio.

While conditions in the housing and real estate markets and economic conditions in our market areas have recently improved, if slow economic conditions return or real estate values and sales deteriorate, we may experience higher delinquencies and credit losses. As a result, we could be required to increase our provision for loan losses and to charge-off additional loans in the future. If charge-offs in future periods exceed the allowance for loan losses, we may need additional provisions to replenish the allowance for loan losses.

The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other conditions within our markets, which may be beyond our control may require an increase in the allowance for loan losses.

As of December 31, 2019, our allowance for loan losses as a percentage of total loans was 1.0% and as a percentage of total nonaccrual loans, excluding the allowance allocated to loans accounted for acquired credit impaired loans accounted for pursuant to ASC 310-30, was 64.3%. Although management believes that the allowance for loan losses is adequate to absorb losses on any existing loans that may become uncollectible, we may be required to take additional provisions for loan losses in the future to further supplement the allowance for loan losses, either due to management’s decision to do so or because our banking regulators require us to do so. Bank regulatory agencies will periodically review our allowance for loan losses and the value attributed to nonaccrual loans and may require an increase in the provision for possible loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. If charge-offs in future periods exceed the allowance for loan losses, we may need additional provisions to replenish the allowance for loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and, most likely, capital, and may have a material negative effect on our financial condition and results of operations.

The acquisition method of accounting requires that acquired loans are initially recorded at fair value at the time of acquisition, and therefore no corresponding allowance for loan losses is recorded for these loans at acquisition because credit quality, among other elements, was considered in the determination of fair value. To the extent that our estimates of fair value are too high, we will incur losses associated with the acquired loans.

In addition, in June 2016, the FASB issued a new accounting standard that will replace the current approach under accounting principles generally accepted in the United States (GAAP) for establishing the allowance for loan losses, which generally considers only past events and current conditions, with a forward-looking methodology that reflects the expected credit losses over the lives of financial assets, starting when such assets are first originated or acquired. Under this standard, referred to as CECL, credit losses will be measured based on past events, current conditions and reasonable and supportable forecasts of future conditions that affect the collectability of financial assets. The new standard is expected to generally result in increases to allowance levels and will require the application of the revised methodology to existing financial assets through a one-time adjustment to retained earnings upon initial effectiveness, which may be material. As a smaller reporting company, this standard will be effective for us on January 1, 2023. In addition, this change may require us to increase our allowance for

loan losses rapidly in future periods, and greatly increases the types of data we need to collect and review to determine the appropriate level of the allowance for loan losses. It may also result in even small changes to future forecasts having a significant impact on the allowance, which could make the allowance more volatile, and regulators may impose additional capital buffers to absorb this volatility.

Because a significant portion of our loan portfolio is comprised of real estate loans, a decline in real estate values and liquidity could impair the value of collateral securing our real estate loans and result in loan and other losses.

At December 31, 2019, approximately 66.5% of our loan portfolio was comprised of loans with real estate as a primary or secondary component of collateral. As a result, adverse developments affecting real estate values in our market areas could increase the credit risk associated with our real estate loan portfolio. The market value of real estate can fluctuate significantly in a short period of time as a result of market conditions in the area in which the real estate is located. Adverse changes affecting real estate values and the liquidity of real estate in one or more of our markets could increase the credit risk associated with our loan portfolio, significantly impair the value of property pledged as collateral on loans and affect our ability to sell the collateral upon foreclosure without a loss or additional losses, which could result in losses that would adversely affect profitability. Such declines and losses would have a material adverse impact on our business, results of operations and growth prospects.

Many of our loans are to commercial borrowers, which have a higher degree of risk than other types of loans.

At December 31, 2019, we had $1.01 billion of commercial loans, consisting of $604.6 million of commercial real estate loans and $410.2 million of operating commercial loans for which real estate is not the primary source of repayment. Of the $604.6 million of commercial real estate loans, $37.6 million consisted of commercial construction and land development loans. Commercial loans represented 82.7% of our total loan portfolio at December 31, 2019. These loans typically involve higher principal amounts than other types of loans, and some of our commercial borrowers have more than one loan outstanding with us. In addition, at December 31, 2019, $388.5 million, or 31.6% of our total loan portfolio, consisted of loans secured by non-owner occupied commercial real estate properties. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan. Because payments on such loans are often dependent on the cash flow of the commercial venture and the successful operation or development of the property or business involved, repayment of such loans is often more sensitive than other types of loans to adverse conditions in the real estate market or the general business climate and economy. Repayments of loans secured by non-owner occupied properties depend primarily on the tenant’s continuing ability to pay rent to the property owner, who is our borrower, or, if the property owner is unable to find a tenant, the property owner’s ability to repay the loan without the benefit of a rental income stream. Accordingly, a downturn in the real estate market or a challenging business and economic environment may increase our risk related to commercial loans. In addition, many of our commercial real estate loans are not fully amortizing and require large balloon payments upon maturity. Such balloon payments may require the borrower to either sell or refinance the underlying property in order to make the payment, which may increase the risk of default or non-payment. Our commercial and industrial loans are primarily made based on the identified cash flow of the borrower and secondarily on the collateral underlying the loans. The borrowers’ cash flow may prove to be unpredictable, and collateral securing these loans may fluctuate in value. Most often, this collateral consists of accounts receivable, inventory and equipment. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. Inventory and equipment may depreciate over time, may be difficult to appraise, may be illiquid and may fluctuate in value based on the success of the business. If the cash flow from business operations is reduced, the borrower’s ability to repay the loan may be impaired.

The level of our commercial real estate loan portfolio may subject us to additional regulatory scrutiny.

The FDIC, the Federal Reserve, and the Office of the Comptroller of the Currency have promulgated joint guidance on sound risk management practices for financial institutions with concentrations in commercial real estate lending. Under this guidance, a financial institution that, like us, is actively involved in commercial real estate lending should perform a risk assessment to identify concentrations. A financial institution may have a concentration in commercial real estate lending if, among other factors (i) total reported loans for construction, land development and other land represent 100% or more of total capital, or (ii) total reported loans secured by multi-family and non-farm non-residential properties, loans for construction, land development and other land, and loans otherwise sensitive to the general commercial real estate market, including loans to commercial real estate related entities, represent 300% or more of total capital. The particular focus of the guidance is on exposure to commercial real estate loans that are dependent on the cash flow from the real estate held as collateral and that are likely to be at greater risk to conditions in the commercial real estate market (as opposed to real estate collateral held as a secondary source of repayment or as an abundance of caution). The purpose of the guidance is to guide banks in developing risk management practices and capital levels commensurate with the level and nature of real estate concentrations. The guidance states that management should employ heightened risk management practices including board and management

oversight and strategic planning, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing. We have concluded that we have a concentration in commercial real estate lending under the foregoing standards because our balance in commercial real estate loans at December 31, 2019 represents greater than 100% but less than 300% of total capital. While we believe we have implemented policies and procedures with respect to our commercial real estate loan portfolio consistent with this guidance, bank regulators could require us to implement additional policies and procedures consistent with their interpretation of the guidance that may result in additional costs to us.

Our high concentration of large loans to certain borrowers may increase our credit risk.

Our growth over the last several years has been partially attributable to our ability to originate and retain large loans. We have established an informal, internal limit on loans to one borrower, principal or guarantor. Our limit is based on “total exposure,” which represents the aggregate exposure of economically related borrowers for approval purposes. However, we may, under certain circumstances, consider going above this internal limit in situations where management’s understanding of the industry and the credit quality of the borrower are commensurate with the increased size of the loan. Many of these loans have been made to a small number of borrowers, resulting in a high concentration of large loans to certain borrowers. As of December 31, 2019, our 10 largest borrowing relationships accounted for approximately 10.9% of our total loan portfolio, the largest of which totaled $19.6 million. Along with other risks inherent in these loans, such as the deterioration of the underlying businesses or property securing these loans, this high concentration of borrowers presents a risk to our lending operations. If any one of these borrowers becomes unable to repay its loan obligations as a result of economic or market conditions, or personal circumstances, such as divorce or death, our nonaccruing loans and our provision for loan losses could increase significantly, which could have a material adverse effect on our business, financial condition, results of operations and prospects.

The small to midsized businesses that we lend to may have fewer resources to weather adverse business developments, which may impair a borrower’s ability to repay a loan, and such impairment could adversely affect our results of operations and financial condition.

We target our business development and marketing strategy primarily to serve the banking and financial services needs of small to midsized businesses, which we define as commercial borrowing relationships at the Bank of less than $10.0 million in aggregate loan exposure. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities, frequently have smaller market shares than their competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience substantial volatility in operating results, any of which may impair a borrower’s ability to repay a loan. In addition, the success of a small and medium-sized business often depends on the management talents and efforts of one or two people or a small group of people, and the death, disability or resignation of one or more of these people could have a material adverse impact on the business and its ability to repay its loan. If general economic conditions negatively impact the markets in which we operate and small to medium-sized businesses are adversely affected or our borrowers are otherwise affected by adverse business developments, our business, financial condition and results of operations may be adversely affected.

Our lending limit may restrict our growth and prevent us from effectively implementing our growth strategy.

We are limited in the total amount we can loan to a single borrower or related borrowers by the amount of our capital. The Bank is a Michigan chartered bank, and therefore all branches, regardless of location, fall under the legal lending limits of the laws, rules and regulations applicable to banks chartered in the state of Michigan. Michigan’s legal lending limit is a safety and soundness measure intended to prevent one person or a relatively small and economically related group of persons from borrowing an unduly large amount of a bank’s funds. It is also intended to safeguard a bank’s depositors by diversifying the risk of loan losses among a relatively large number of creditworthy borrowers engaged in various types of businesses. Under Michigan law, total loans and extensions of credit to a borrower may not generally exceed 15% of the Bank’s capital stock and surplus, subject to certain exceptions. Additionally, the Bank has an internal lending policy that limits total loans and extensions of credit to any individual borrower to no more than $10.0 million. Based upon our current capital levels, the amount we may lend to one borrower is significantly less than that of many of our larger competitors, which may discourage potential borrowers who have credit needs in excess of our lending limit from doing business with us. While we seek to accommodate larger loans by selling participations in those loans to other financial institutions, this strategy may not always be available. If we are unable to compete for loans from our target clients, we may not be able to effectively implement our business strategy, which could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

Greater seasoning of our loan portfolio could increase risk of credit defaults in the future.

As a result of our rapid growth, a significant portion of our loan portfolio at any given time is of relatively recent origin. Typically, loans do not begin to show signs of credit deterioration or default until they have been outstanding for some period of time (which varies by loan duration and loan type), a process referred to as “seasoning.” As a result, a portfolio of more

seasoned loans may more predictably follow a bank's historical default or credit deterioration patterns than a newer portfolio. The current level of delinquencies and defaults may not represent the level that may prevail as the portfolio becomes more seasoned. If delinquencies and defaults increase, we may be required to increase our provision for loan losses, which could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

Construction loans are based upon estimates of costs and values associated with the complete project. These estimates may be inaccurate, and we may be exposed to significant losses on loans for these projects.

Construction and land development loans totaled $58.6 million, or 4.8%, of our total loan portfolio as of December 31, 2019, of which $37.6 million were commercial real estate construction loans and $21.1 million were residential real estate construction loans. These loans involve additional risks because funds are advanced upon the security of the project, which is of uncertain value prior to its completion, and costs may exceed realizable values in declining real estate markets. Because of the uncertainties inherent in estimating construction costs and the realizable market value of the completed project and the effects of governmental regulation of real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. Changes in demand for new housing and higher than anticipated building costs may cause actual results to vary significantly from those estimated. For these reasons, this type of lending also typically involves higher loan principal amounts and may be concentrated with a small number of builders. A downturn in housing, or the real estate market, could increase delinquencies, defaults and foreclosures, and significantly impair the value of our collateral and our ability to sell the collateral upon foreclosure. Some of the builders we deal with have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss. In addition, during the term of some of our construction loans, no payment from the borrower is required since the accumulated interest is added to the principal of the loan through an interest reserve. As a result, construction loans often involve the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of the completed project proves to be overstated or market values or rental rates decline, we may have inadequate security for the repayment of the loan upon completion of construction of the project. Because construction loans require active monitoring of the building process, including cost comparisons and on-site inspections, these loans are more difficult and costly to monitor. Increases in market rates of interest may have a more pronounced effect on construction loans by rapidly increasing the end-purchaser's borrowing costs, thereby possibly reducing the homeowner's ability to finance the home upon completion or the overall demand for the project. Properties under construction are often difficult to sell and typically must be completed in order to be successfully sold which also complicates the process of working out problem construction loans. If we are forced to foreclose on a project prior to or at completion due to a default, we may not be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs. In addition, we may be required to fund additional amounts to complete the project and may have to hold the property for an unspecified period of time while we attempt to dispose of it. Further, in the case of speculative construction loans, there is the added risk associated with identifying an end-purchaser for the finished project. Loans on land under development or held for future construction also pose additional risk because of the lack of income being produced by the property and the potential illiquid nature of the collateral. At December 31, 2019, all construction loans were performing in accordance to their repayment terms. Any material increase in our nonperforming construction loans could have a material adverse effect on our financial condition and results of operation.

Our business may be adversely affected by credit risk associated with residential property.

At December 31, 2019, $159.8 million, or 13.0% of our total loan portfolio, was secured by first liens on one- to four-family residential loans. In addition, at December 31, 2019, our home equity lines of credit totaled $30.4 million. A portion of our one- to four-family residential real estate loan portfolio consists of jumbo loans that do not conform to secondary market mortgage requirements, and therefore are not saleable to Fannie Mae or Freddie Mac because such loans exceed the maximum balance allowable for sale (generally $510,400 - $765,600 for single-family homes in our market area), exposing us to increased risk.

In addition, one- to four-family residential loans are generally sensitive to regional and local economic conditions that significantly impact the ability of borrowers to meet their loan payment obligations, making loss levels difficult to predict. A decline in residential real estate values resulting from a downturn in the housing market in our market areas may reduce the value of the real estate collateral securing these types of loans and increase our risk of loss if borrowers default on their loans. Recessionary conditions or declines in the volume of real estate sales and/or the sales prices coupled with elevated unemployment rates may result in higher than expected loan delinquencies or problem assets, and a decline in demand for our products and services. These potential negative events may cause us to incur losses, adversely affect our capital and liquidity and damage our financial condition and business operations.

To meet our growth objectives we may originate or purchase loans outside of our market area which could affect the level of our net interest margin and nonaccrual loans.

In order to achieve our desired loan portfolio growth, we anticipate that we may, from time to time, opportunistically originate or purchase loans outside of our market area either individually, through participations, or in bulk or “pools.” In the past, we have also originated loans outside of our market areas as an accommodation to current customers and acquired loans outside of our market areas through our acquisitions of other financial institutions. We will perform certain due diligence procedures and may re-underwrite these loans to our underwriting standards prior to purchase, and anticipate acquiring loans subject to customary limited indemnities; however, we may be exposed to a greater risk of loss as we acquire loans of a type or in geographic areas where management may not have substantial prior experience and which may be more difficult for us to monitor. Further, when determining the purchase price we are willing to pay to acquire loans, management will make certain assumptions about, among other things, how borrowers will prepay their loans, the real estate market and our ability to collect loans successfully and, if necessary, to dispose of any real estate that may be acquired through foreclosure. To the extent that our underlying assumptions prove to be inaccurate or the basis for those assumptions change (such as an unanticipated decline in the real estate market), the purchase price paid may prove to have been excessive, resulting in a lower yield or a loss of some or all of the loan principal. For example, if we purchase “pools” of loans at a premium and some of the loans are prepaid before we anticipate, we will earn less interest income on the acquired loans than expected. Our success in increasing our loan portfolio through loan purchases will depend on our ability to price the loans properly and on general economic conditions in the geographic areas where the underlying properties or collateral for the loans acquired are located. Inaccurate estimates or declines in economic conditions or real estate values in the markets where we purchase loans could significantly adversely affect the level of our nonaccrual loans and our results of operations.

Our real estate lending also exposes us to the risk of environmental liabilities.

In the course of our business, we may foreclose and take title to real estate, and we could be subject to environmental liabilities with respect to these properties. We may be held liable by a governmental entity or by third persons for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, as the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we ever become subject to significant environmental liabilities, our business, financial condition and results of operations could be materially and adversely affected.

The occurrence of fraudulent activity, breaches or failures of our information security controls or cybersecurity-related incidents could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

As a bank, we are susceptible to fraudulent activity, information security breaches and cybersecurity-related incidents that may be committed against us or our clients, which may result in financial losses or increased costs to us or our clients, disclosure or misuse of our information or our client information, misappropriation of assets, privacy breaches against our clients, litigation or damage to our reputation. Such fraudulent activity may take many forms, including check fraud, electronic fraud, wire fraud, phishing, social engineering and other dishonest acts. Information security breaches and cybersecurity-related incidents may include fraudulent or unauthorized access to systems used by us or our clients, denial or degradation of service attacks and malware or other cyber-attacks.

In recent periods, there continues to be a rise in electronic fraudulent activity, security breaches and cyber-attacks within the financial services industry, especially in the commercial banking sector due to cyber criminals targeting commercial bank accounts. Moreover, in recent periods, several large corporations, including financial institutions and retail companies, have suffered major data breaches, in some cases exposing not only confidential and proprietary corporate information, but also sensitive financial and other personal information of their customers and employees and subjecting them to potential fraudulent activity. Some of our clients may have been affected by these breaches, which could increase their risks of identity theft and other fraudulent activity that could involve their accounts with us.

Information pertaining to us and our clients is maintained, and transactions are executed, on networks and systems maintained by us and certain third-party partners, such as our online banking, mobile banking or accounting systems. The secure maintenance and transmission of confidential information, as well as execution of transactions over these systems, are essential to protect us and our clients against fraud and security breaches and to maintain the confidence of our clients. Breaches of information security also may occur through intentional or unintentional acts by those having access to our systems or the confidential information of our clients, including employees. In addition, increases in criminal activity levels and sophistication, advances in computer capabilities, new discoveries, vulnerabilities in third-party technologies (including browsers and operating systems) or other developments could result in a compromise or breach of the technology, processes and controls that we use to prevent fraudulent transactions and to protect data about us, our clients and underlying transactions, as well as the technology used by our clients to access our systems. Our third-party partners’ inability to anticipate, or failure to adequately mitigate, breaches of security could result in a number of negative events, including losses to us or our clients, loss

of business or clients, damage to our reputation, the incurrence of additional expenses, disruption to our business, additional regulatory scrutiny or penalties or our exposure to civil litigation and possible financial liability, any of which could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

We depend on information technology and telecommunications systems of third parties, and any systems failures, interruptions or data breaches involving these systems could adversely affect our operations and financial condition.

Our business is highly dependent on the successful and uninterrupted functioning of our information technology and telecommunications systems, third-party servicers, accounting systems, mobile and online banking platforms and financial intermediaries. We outsource to third parties many of our major systems, such as data processing and mobile and online banking. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. A system failure or service denial could result in a deterioration of our ability to process loans or gather deposits and provide customer service, compromise our ability to operate effectively, result in potential noncompliance with applicable laws or regulations, damage our reputation, result in a loss of customer business or subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on business, financial condition, results of operations and growth prospects. In addition, failures of third parties to comply with applicable laws and regulations, or fraud or misconduct on the part of employees of any of these third parties, could disrupt our operations or adversely affect our reputation.

It may be difficult for us to replace some of our third-party vendors, particularly vendors providing our core banking and information services, in a timely manner if they are unwilling or unable to provide us with these services in the future for any reason and even if we are able to replace them, it may be at higher cost or result in the loss of customers. Any such events could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

Our operations rely heavily on the secure processing, storage and transmission of information and the monitoring of a large number of transactions on a minute-by-minute basis, and even a short interruption in service could have significant consequences. We also interact with and rely on retailers, for whom we process transactions, as well as financial counterparties and regulators. Each of these third parties may be targets of the same types of fraudulent activity, computer break-ins and other cyber security breaches described above, and the cyber security measures that they maintain to mitigate the risk of such activity may be different than our own and may be inadequate.

As a result of financial entities and technology systems becoming more interdependent and complex, a cyber incident, information breach or loss, or technology failure that compromises the systems or data of one or more financial entities could have a material impact on counterparties or other market participants, including ourselves. As a result of the foregoing, our ability to conduct business may be adversely affected by any significant disruptions to us or to third parties with whom we interact.

Our use of third-party vendors and our other ongoing third-party business relationships is subject to increasing regulatory requirements and attention.

Our use of third-party vendors for certain information systems is subject to increasingly demanding regulatory requirements and attention by our federal bank regulators. Recent regulations require us to enhance our due diligence, ongoing monitoring and control over our third-party vendors and other ongoing third-party business relationships. In certain cases we may be required to renegotiate our agreements with these vendors to meet these enhanced requirements, which could increase our costs. We expect that our regulators will hold us responsible for deficiencies in our oversight and control of our third-party relationships and in the performance of the parties with which we have these relationships. As a result, if our regulators conclude that we have not exercised adequate oversight and control over our third-party vendors or other ongoing third-party business relationships or that such third parties have not performed appropriately, we could be subject to enforcement actions, including civil money penalties or other administrative or judicial penalties or fines, as well as requirements for customer remediation, any of which could have a material adverse effect our business, financial condition, results of operations and growth prospects.

We are subject to certain operational risks, including, but not limited to, customer or employee fraud and data processing system failures and errors.

Employee errors and employee and customer misconduct could subject us to financial losses or regulatory sanctions and seriously harm our reputation. Misconduct by our employees could include hiding unauthorized activities from us, improper or unauthorized activities on behalf of our customers or improper use of confidential information. It is not always possible to prevent employee errors and misconduct, and the precautions we take to prevent and detect this activity may not be effective in all cases. Employee errors could also subject us to financial claims for negligence.

We maintain a system of internal controls and insurance coverage to mitigate against operational risks, including data processing system failures and errors and customer or employee fraud. If our internal controls fail to prevent or detect an occurrence, or if any resulting loss is not insured or exceeds applicable insurance limits, it could have a material adverse effect on our business, financial condition and results of operations.

Our strategy of pursuing growth via acquisitions exposes us to financial, execution and operational risks that could have a material adverse effect on our business, financial position, results of operations and growth prospects.

As part of our general growth strategy, we have expanded, and plan on expanding in the future, our business through acquisitions, such as our acquisition of Ann Arbor Bancorp, Inc. Although our business strategy emphasizes organic expansion, we continue, from time to time in the ordinary course of business, to engage in preliminary discussions with potential acquisition targets. There can be no assurance that, in the future, we will successfully identify suitable acquisition candidates, complete acquisitions and successfully integrate acquired operations into our existing operations or expand into new markets. The consummation of any future acquisitions may dilute shareholder value or may have an adverse effect upon our operating results while the operations of the acquired business are being integrated into our operations. In addition, once integrated, acquired operations may not achieve levels of profitability comparable to those achieved by our existing operations, or otherwise perform as expected. Further, transaction-related expenses may adversely affect our earnings. These adverse effects on our earnings and results of operations may have a negative impact on the value of our stock.

Our acquisition activities could require us to use a substantial amount of cash, other liquid assets, and/or incur debt. In addition, to the extent the purchase price of an acquisition exceeds the fair value of the net assets acquired, goodwill will be recorded in connection with the acquisition. As discussed below, we are required to assess our goodwill for impairment at least annually, and any goodwill impairment charge could materially and adversely affect our results of operations and financial conditions during the period in which the impairment was recognized.

Acquiring banks, bank branches or businesses involves risks commonly associated with acquisitions, including:

- We may incur time and expense associated with identifying and evaluating potential acquisitions and negotiating potential transactions, resulting in management’s attention being diverted from the operation of our existing business;
- We are exposed to potential asset and credit quality risks and unknown or contingent liabilities of the banks or businesses we acquire. If these issues or liabilities exceed our estimates, our earnings, capital and financial condition may be materially and adversely affected;
- Deposit attrition may be higher than expected;
- Prices at which acquisitions can be made fluctuate with market conditions. We have experienced times during which acquisitions could not be made in specific markets at prices we considered acceptable and expect that we will experience this condition in the future;
- The acquisition of other entities generally requires integration of systems, procedures and personnel of the acquired entity. This integration process is complicated and time consuming and can also be disruptive to the customers and employees of the acquired business and our business. If the integration process is not conducted successfully, we may not realize the anticipated economic benefits of acquisitions within the expected time frame, or ever, and we may lose customers or employees of the acquired business. We may also experience greater than anticipated customer losses even if the integration process is successful;
- To finance an acquisition, we may borrow funds or pursue other forms of financing, such as issuing common stock or convertible preferred stock, which may have high dividend rights or may be highly dilutive to holders of our common stock, thereby increasing our leverage and diminishing our liquidity;
- We may be unsuccessful in realizing the anticipated benefits from acquisitions. For example, we may not be successful in realizing anticipated cost savings. We also may not be successful in preventing disruptions in service to existing customer relationships of the acquired institution, which could lead to a loss in revenues; and
- We may not be able to continue to sustain our past rate of growth or to grow at all in the future.

In addition to the foregoing, we may face additional risks in acquisitions to the extent we acquire new lines of business or new products, or enter new geographic areas, in which we have little or no current experience, especially if we lose key employees of the acquired operations. We cannot assure you that we will be successful in overcoming these risks or any other problems encountered in connection with acquisitions. Our inability to overcome risks associated with acquisitions could have an adverse effect on our ability to successfully implement our acquisition growth strategy and grow our business and profitability.

If the goodwill that we recorded in connection with a business acquisition becomes impaired, it could require charges to earnings, which would have a negative impact on our financial condition and results of operations.

Goodwill represents the amount by which the cost of an acquisition exceeded the fair value of net assets we acquired in

connection with the purchase. We review goodwill for impairment at least annually, or more frequently if events or changes in circumstances indicate that the carrying value of the asset might be impaired.

We determine impairment by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Any such adjustments are reflected in our results of operations in the periods in which they become known. As of December 31, 2019, our goodwill totaled $9.4 million. There can be no assurance that our future evaluations of goodwill will not result in findings of impairment and related write-downs, which may have a material adverse effect on our financial condition and results of operations.

We may not be able to continue growing our business, particularly if we cannot make acquisitions or increase loans through organic loan growth, either because of an inability to find suitable acquisition candidates, constrained capital resources or otherwise.

We have grown our consolidated assets from $1.42 billion as of December 31, 2018, to $1.58 billion as of December 31, 2019, and our deposits from $1.13 billion as of December 31, 2018, to $1.14 billion as of December 31, 2019. While we intend to continue to grow our business through strategic acquisitions coupled with organic loan growth, because certain of our market areas are comprised of mature, rural communities with limited population growth, we anticipate that much of our future growth will be dependent on our ability to successfully implement our acquisition growth strategy. A risk exists, however, that we will not be able to identify suitable additional candidates for acquisitions. In addition, even if suitable targets are identified, we expect to compete for such businesses with other potential bidders, many of which may have greater financial resources than we have, which may adversely affect our ability to make acquisitions at attractive prices. Furthermore, many acquisitions we may wish to pursue would be subject to approvals by bank regulatory authorities, and we cannot predict whether any targeted acquisitions will receive the required regulatory approvals. In light of the foregoing, our ability to continue to grow successfully will depend to a significant extent on our capital resources. It also will depend, in part, upon our ability to attract deposits and identify favorable loan and investment opportunities and on whether we can continue to fund growth while maintaining cost controls and asset quality, as well on other factors beyond our control, such as national, regional and local economic conditions and interest rate trends.

The required accounting treatment of loans we acquire through acquisitions, including purchased credit impaired loans, could result in higher net interest margins and interest income in current periods and lower net interest margins and interest income in future periods.

Under GAAP, we are required to record loans acquired through acquisitions, including purchased credit impaired loans, at fair value. Estimating the fair value of such loans requires management to make estimates based on available information and facts and circumstances on the acquisition date. Actual performance could differ from management's initial estimates. If these loans outperform our original fair value estimates, the difference between our original estimate and the actual performance of the loan, or the discount, is accreted into net interest income. Thus, our net interest margins may initially increase due to the discount accretion. We expect the yields on our loans to decline as our acquired loan portfolio pays down or matures and the discount decreases, and we expect downward pressure on our interest income to the extent that the runoff on our acquired loan portfolio is not replaced with comparable high-yielding loans. This has resulted in higher net interest margins in historical periods and could result in lower interest income and net interest margins in current and future periods. For example, the total loan yield for the year ended December 31, 2019 was 5.42%, which included 16 basis points from excess accretion related to purchased credit impaired loans. As of December 31, 2019, we had a remaining accretable yield of $9.1 million. We are unlikely to be able to replace loans in our existing portfolio with comparable high-yielding loans, and without a larger volume of high-yielding loans, we could be adversely affected. We could also be materially and adversely affected if we choose to pursue riskier higher-yielding loans that fail to perform.

We are highly dependent on our management team, and the loss of our senior executive officers or other key employees could harm our ability to implement our strategic plan, impair our relationships with customers and adversely affect our business, results of operations and growth prospects.

Our success is dependent, to a large degree, upon the continued service and skills of our executive management team, particularly Mr. Patrick J. Fehring, our President and Chief Executive Officer, Mr. Gregory A. Wernette, our Executive Vice President and Chief Lending Officer, and Mr. David C. Walker, our Executive Vice President and Chief Financial Officer.

Our business and growth strategies are built primarily upon our ability to retain employees with experience and business relationships within their respective market areas. The loss of Mr. Fehring, Mr. Wernette, Mr. Walker or any of our other key personnel could have an adverse impact on our business and growth because of their skills, years of industry experience, knowledge of our market areas, the difficulty of finding qualified replacement personnel and any difficulties associated with transitioning of responsibilities to any new members of the executive management team. In addition, although we have non-

competition agreements with each of our executive officers and with several others of our senior personnel, we do not have any such agreements with other employees who are important to our business, and the enforceability of non-competition agreements varies across the states in which we do business. While our mortgage originators and loan officers are generally subject to non-solicitation provisions as part of their employment, our ability to enforce such agreements may not fully mitigate the injury to our business from the breach of such agreements, as such employees could leave us and immediately begin soliciting our customers. The departure of any of our personnel who are not subject to enforceable non-competition agreements could have a material adverse impact on our business, results of operations and growth prospects.

Our ability to retain bankers and recruit additional successful bankers is critical to the success of our business strategy and any failure to do so could impair our customer relationships and adversely affect our business and results of operations.

Our ability to retain and grow our loans, deposits and fee income depends upon the business generation capabilities, reputation and relationship management skills of our lenders. If we were to lose the services of any of our bankers, including successful bankers employed by banks that we may acquire, to a new or existing competitor or otherwise, we may not be able to retain valuable relationships, and some of our customers could choose to use the services of a competitor instead of our services.

Our success and growth strategy also depend on our continued ability to attract and retain experienced loan officers and support staff, as well as other management personnel. We may face difficulties in recruiting and retaining lenders and other personnel of our desired caliber, including as a result of competition from other financial institutions. Competition for loan officers and other personnel is strong, and we may not be successful in attracting or retaining the personnel we require. In particular, many of our competitors are significantly larger with greater financial resources, and may be able to offer more attractive compensation packages and broader career opportunities. Additionally, we may incur significant expenses and expend significant time and resources on training, integration and business development before we are able to determine whether a new loan officer will be profitable or effective. If we are unable to attract and retain successful loan officers and other personnel, or if our loan officers and other personnel fail to meet our expectations in terms of customer relationships and profitability, we may be unable to execute our business strategy, and our business, financial condition, results of operations and growth prospects may be negatively affected.

Fluctuations in interest rates may reduce net interest income and otherwise negatively impact our financial condition and results of operations.

Shifts in short-term interest rates may reduce net interest income, which is the principal component of our earnings. Net interest income is the difference between the amounts received by us on our interest-earning assets and the interest paid by us on our interest-bearing liabilities. The impact on earnings is more adverse when the slope of the yield curve flattens, that is, when short-term interest rates increase more than long-term interest rates or when long-term interest rates decrease more than short-term interest rates.

Interest rate increases often result in larger payment requirements for our borrowers, which increases the potential for default. At the same time, the marketability of the underlying property may be adversely affected by any reduced demand resulting from higher interest rates. In a declining interest rate environment, there may be an increase in prepayments on loans as borrowers refinance their mortgages and other indebtedness at lower rates.

A sustained increase in market interest rates could adversely affect our earnings. A significant portion of our loans have fixed interest rates and longer terms than our deposits and borrowings. As a result of the relatively low interest rate environment, an increasing percentage of our deposits have been comprised of certificates of deposit and other deposits yielding no or a relatively low rate of interest having a shorter duration than our assets. At December 31, 2019, we had $392.8 million in certificates of deposit that mature within one year and $702.4 million in non-interest bearing, NOW checking, savings and money market accounts. We would incur a higher cost of funds to retain these deposits in a rising interest rate environment. Our net interest income could be adversely affected if the rates we pay on deposits and borrowings increase more rapidly than the rates we earn on loans. In addition, a substantial amount of our residential mortgage loans and home equity lines of credit have adjustable interest rates. As a result, these loans may experience a higher rate of default in a rising interest rate environment.

Changes in interest rates also can affect the value of loans, securities and other assets. An increase in interest rates that adversely affects the ability of borrowers to pay the principal or interest on loans may lead to an increase in nonperforming assets and a reduction of income recognized, which could have a material adverse effect on our results of operations and cash flows. Further, when we place a loan on nonaccrual status, we reverse any accrued but unpaid interest receivable, which decreases interest income. Subsequently, we continue to have a cost to fund the loan, which is reflected as interest expense, without any interest income to offset the associated funding expense. Thus, an increase in the amount of nonperforming assets would have an adverse impact on net interest income.

Rising interest rates will result in a decline in value of the fixed-rate debt securities we hold in our investment securities portfolio. The unrealized losses resulting from holding these securities would be recognized in other comprehensive income (loss) and reduce total shareholders' equity. Unrealized losses do not negatively impact our regulatory capital ratios; however, tangible common equity and the associated ratios would be reduced. If debt securities in an unrealized loss position are sold, such losses become realized and will reduce our regulatory capital ratios.

If short-term interest rates return to their historically low levels for a prolonged period, and assuming longer term interest rates fall further, we could experience net interest margin compression as our interest earning assets would continue to reprice downward while our interest-bearing liability rates could fail to decline in tandem. This would have a material adverse effect on our net interest income and our results of operations.

Changes to, or elimination of, LIBOR could adversely affect our financial instruments with interest rates currently indexed to LIBOR.

In 2017, the Financial Conduct Authority of the United Kingdom (the "FCA") announced its intention to cease sustaining LIBOR after 2021. While the FCA came to an agreement with panel banks to continue receiving submissions to LIBOR until the end of 2021, it is not possible to predict whether and how credible LIBOR will be as an acceptable market benchmark. The FCA is encouraging due diligence and implementation of alternative rates prior to the phase out of LIBOR. While there is no consensus on what rate or rates may become accepted alternatives to LIBOR, the Alternative Reference Rates Committee ("ARRC"), a steering committee comprised of U.S. financial market participants, selected by the Federal Reserve Bank of New York, began to publish the Secured Overnight Financing Rate ("SOFR") as an alternative to LIBOR. SOFR is a broad measure of the cost of overnight borrowings collateralized by Treasury securities selected by the ARRC. Hence, SOFR is a risk-free rate, while LIBOR is a risk-based rate. Therefore, a spread adjustment is required and will most likely be recommended by a relevant governmental body (such as ARRC). Such language has yet to be published, and it is unknown to us whether during the transition period, banks like us will be permitted to retain LIBOR as a reference rate, be required to amend contracts to reference SOFR without economic impact (market, legal and documentation costs), or be allowed to amend the definition of LIBOR through a specific grandfathering protocol.

The market transition away from LIBOR to an alternative reference rate, such as SOFR, is complex and could have a range of adverse effects on our business, financial condition and results of operations. In particular, any such transition could:

- adversely affect the interest rates paid or received on, the revenue and expenses associated with, and the value of our floating-rate obligations, loans, deposits, subordinated debentures and other financial instruments tied to LIBOR rates, or other securities or financial arrangements given LIBOR's role in determining market interest rates globally;
- prompt inquiries or other actions from regulators in respect of our preparation and readiness for the replacement of LIBOR with an alternative reference rate;
- result in disputes, litigation or other actions with counterparties regarding the interpretation and enforceability of certain fallback language, or lack of fallback language, in LIBOR-based instruments; and
- require the transition to or development of appropriate systems and analytics to effectively transition our risk management processes from LIBOR-based products to those based on the applicable alternative pricing benchmark, such as SOFR.

We have floating rate loans and investment securities, interest rate swap agreements and subordinated debentures whose interest rates are indexed to LIBOR that mature after December 31, 2021. The transition from LIBOR could create additional costs as well as economic and reputation risk. We cannot predict any unfavorable effect the chosen alternative index may have on financial instruments currently indexed to LIBOR.

Liquidity risks could affect operations and jeopardize our business, financial condition, and results of operations.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and/or investment securities and from other sources could have a substantial negative effect on our liquidity. Our most important source of funds consists of our customer deposits, including escrow deposits held in connection with our commercial mortgage servicing business. Such deposit balances can decrease when customers perceive alternative investments, such as the stock market, as providing a better risk/return tradeoff, or, in connection with our commercial mortgage servicing business, third parties for whom we provide servicing choose to terminate that relationship with us. If customers move money out of bank deposits and into other investments, we could lose a relatively low cost source of funds, which would require us to seek wholesale funding alternatives in order to continue to grow, thereby increasing our funding costs and reducing our net interest income and net income.

Other primary sources of funds consist of cash from operations, investment security maturities and sales, and proceeds from the issuance and sale of our equity and debt securities to investors. Additional liquidity is provided by brokered deposits, repurchase agreements and the ability to borrow from the Federal Reserve Bank and the Federal Home Loan Bank of

Indianapolis (FHLB). We also may borrow from third-party lenders from time to time. Our access to funding sources in amounts adequate to finance or capitalize our activities or on terms that are acceptable to us could be impaired by factors that affect us directly or the financial services industry or economy in general, such as disruptions in the financial markets or negative views and expectations about the prospects for the financial services industry.

Any decline in available funding could adversely impact our ability to continue to implement our strategic plan, including originating loans, investing in securities, meeting our expenses, paying dividends to our shareholders or fulfilling obligations such as repaying our borrowings or meeting deposit withdrawal demands, any of which could have a material adverse impact on our liquidity, business, financial condition and results of operations.

We depend on non-core funding sources, which causes our cost of our funds to be higher when compared to other financial institutions.

We use certain non-core, wholesale funding sources, including brokered deposits and FHLB advances. As of December 31, 2019, we had approximately $67.4 million of brokered deposits, which represented approximately 5.9% of our total deposits, and $205.0 million of FHLB advances. Unlike traditional deposits from our local clients, there is a higher likelihood that the funds wholesale deposits provide will not remain with us after maturity. For example, depositors who have deposited funds with us through brokers are a less stable source of funding than typical relationship deposit clients. Although we are increasing our efforts to reduce our reliance on non-core funding sources, we may not be able to increase our market share of core-deposit funding in our highly competitive market area. If we are unable to do so, we may be forced to increase the amounts of wholesale funding sources. The cost of these funds can be volatile and may exceed the cost of core deposits in our market area, which could have a material adverse effect on our net interest income. Under FDIC regulations, in the event we are deemed to be less than well-capitalized, we would be subject to restrictions on our use of brokered deposits and the interest rate we can offer on our deposits. If this happens, our use of brokered deposits and the rates we would be allowed to pay on deposits may significantly limit our ability to use these deposits as a funding source. If we are unable to participate in the national brokered deposit market for any reason in the future, our ability to replace these deposits at maturity could be adversely impacted. In addition, our maximum borrowing capacity from the FHLB is based on the amount of mortgage and commercial loans we can pledge. If we are unable to pledge sufficient collateral to secure funding from the FHLB, we may lose access to this source of liquidity that we have historically relied upon. If we are unable to access any of these types of funding sources or if our costs related to them increases, our liquidity and ability to support demand for loans could be materially adversely affected.

Municipal deposits are one important source of funds for us, and a reduced level of such deposits may hurt our profits.

Municipal deposits are an important source of funds for our lending and investment activities. At December 31, 2019, $179.2 million, or 15.8%, of our total deposits were comprised of municipal deposits, including public funds deposits from local government entities primarily domiciled in the State of Michigan. Given our use of these high-average balance municipal deposits as a source of funds, our inability to retain such funds could have an adverse effect on our liquidity. In addition, our municipal deposits are primarily demand deposit accounts or short-term deposits and therefore are more sensitive to changes in interest rates. If we are forced to pay higher rates on our municipal deposits to retain those funds, or if we are unable to retain those funds and we are forced to turn to borrowing sources for our lending and investment activities, the interest expense associated with such borrowings may be higher than the rates we are paying on our municipal deposits, which could adversely affect our net income.

Our liquidity is dependent on dividends from the Bank.

The Company is a legal entity separate and distinct from the Bank. A substantial portion of our cash flow, including cash flow to pay principal and interest on any debt we may incur, comes from dividends the Company received from the Bank. Various federal and state laws and regulations limit the amount of dividends that the Bank may pay to the Company. For example, Michigan law only permits banks to pay dividends if the bank will have a surplus amounting to not less than 20% of its capital after the payment of the dividend, and banks may pay dividends only out of net income then on hand, after deducting its bad debts. Under federal law, the Bank’s ability to pay dividends may be restricted if the Bank does not meet the capital conservation buffer requirement. As of December 31, 2019, the Bank had the capacity to pay the Company a dividend of up to $37.2 million without the need to obtain prior regulatory approval. Also, the Company’s right to participate in a distribution of assets upon a subsidiary’s liquidation or reorganization is subject to the prior claims of the subsidiary’s creditors. In the event the Bank is unable to pay dividends to us, we may not be able to service any debt we may incur, which could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

We may need to raise additional capital in the future, and if we fail to maintain sufficient capital, whether due to losses, an inability to raise additional capital or otherwise, our financial condition, liquidity and results of operations, as well as our ability to maintain regulatory compliance, would be adversely affected.

We face significant capital and other regulatory requirements as a financial institution. We may need to raise additional capital in the future to provide us with sufficient capital resources and liquidity to meet our commitments and business needs, which could include the possibility of financing acquisitions. In addition, the Company, on a consolidated basis, and the Bank, on a stand-alone basis, must meet certain regulatory capital requirements and maintain sufficient liquidity. Importantly, regulatory capital requirements could increase from current levels, which could require us to raise additional capital or contract our operations. Our ability to raise additional capital depends on conditions in the capital markets, economic conditions and a number of other factors, including investor perceptions regarding the banking industry, market conditions and governmental activities, and on our financial condition and performance. Accordingly, we cannot assure you that we will be able to raise additional capital if needed or on terms acceptable to us. If we fail to maintain capital to meet regulatory requirements, our financial condition, liquidity and results of operations would be materially and adversely affected.

Our securities portfolio may be negatively impacted by fluctuations in market value and interest rates.

Our securities portfolio may be impacted by fluctuations in market value, potentially reducing accumulated other comprehensive income and/or earnings. Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. Changes in interest rates can have an adverse effect on our financial condition, as our available-for-sale securities are reported at their estimated fair value, and therefore are impacted by fluctuations in interest rates. For example, fixed-rate securities acquired by us are generally subject to decreases in market value when interest rates rise. Additional factors include, but are not limited to, rating agency downgrades of the securities or our own analysis of the value of the security, defaults by the issuer or individual mortgagors with respect to the underlying securities, and limited investor demand. Our securities portfolio is evaluated quarterly for other-than-temporary impairment. The process for determining whether impairment is other-than-temporary usually requires difficult, subjective judgments about the future financial performance of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security. If this evaluation shows impairment to the actual or projected cash flows associated with one or more securities, a potential loss to earnings may occur. We increase or decrease our shareholders' equity by the amount of change in the estimated fair value of the available-for-sale securities, net of taxes. There can be no assurance that the declines in market value will not result in other-than-temporary impairments of these assets, which would lead to accounting charges that could have a material adverse effect on our financial condition and results of operations.

The valuation of our investment securities also is influenced by additional external market and other factors, including implementation of SEC and FASB guidance on fair value accounting, default rates on residential mortgage securities and rating agency actions. Accordingly, there can be no assurance that future declines in the market value of our private label mortgage backed securities or other investment securities will not result in other-than-temporary impairment (OTTI) of these assets and lead to accounting charges that could have an adverse effect on our results of operations.

Downgrades in the credit rating of one or more insurers that provide credit enhancement for our state and municipal securities portfolio may have an adverse impact on the market for and valuation of these types of securities.

We invest in tax-exempt state and local municipal securities, some of which are insured by monoline insurers. As of December 31, 2019, we had $93.7 million of municipal securities, which represented 51.8% of our total securities portfolio. Several of these insurers have come under scrutiny by rating agencies. Even though management generally purchases municipal securities on the overall credit strength of the issuer, the reduction in the credit rating of an insurer may negatively impact the market for and valuation of our investment securities. Such downgrade could adversely affect our liquidity, financial condition and results of operations. Of the $93.7 million of municipal securities held as of December 31, 2019, the Bank held 56 tax-exempt state and local municipal securities totaling $40.1 million backed by the Michigan School Bond Loan Fund (MSBLF). Each of these tax-exempt state and local municipal securities positions have an underlying credit of at least BBB or better by one of the Nationally Recognized Statistical Rating Organizations as well as explicit backing by the MSBLF. The MSBLF is currently rated AA- by Standard & Poor's, and AA1 by Moody's.

Our mortgage banking profitability could significantly decline if we are not able to originate and resell a high volume of mortgage loans.

Mortgage production, especially refinancing activity, declines in rising interest rate environments. While we have been experiencing historically low interest rates over the last few years, this low interest rate environment likely will not continue indefinitely. Moreover, when interest rates increase further, there can be no assurance that our mortgage production will continue at current levels. Because we sell a substantial portion of the mortgage loans we originate, the profitability of our

mortgage banking business also depends in large part on our ability to aggregate a high volume of loans and sell them in the secondary market at a gain. Thus, in addition to our dependence on the interest rate environment, we are dependent upon (i) the existence of an active secondary market and (ii) our ability to profitably sell loans or securities into that market. If our level of mortgage production declines, the profitability will depend upon our ability to reduce our costs commensurate with the reduction of revenue from our mortgage operations.

Our ability to originate and sell mortgage loans readily is dependent upon the availability of an active secondary market for single-family mortgage loans, which in turn depends in part upon the continuation of programs currently offered by government-sponsored entities (GSEs) and other institutional and non-institutional investors. These entities account for a substantial portion of the secondary market in residential mortgage loans. Because the largest participants in the secondary market are Fannie Mae and Freddie Mac, GSEs whose activities are governed by federal law, any future changes in laws that significantly affect the activity of these GSEs could, in turn, adversely affect our operations. The federal government has for many years considered proposals to reform Fannie Mae and Freddie Mac, but the results of any such reform, and their impact on us, are difficult to predict. To date, no reform proposal has been enacted.

In addition, our ability to sell mortgage loans readily is dependent upon our ability to remain eligible for the programs offered by the GSEs and other institutional and non-institutional investors. Any significant impairment of our eligibility with any of the GSEs could materially and adversely affect our operations. Further, the criteria for loans to be accepted under such programs may be changed from time to time by the sponsoring entity, which could result in a lower volume of corresponding loan originations. The profitability of participating in specific programs may vary depending on a number of factors, including our administrative costs of originating and purchasing qualifying loans and our costs of meeting such criteria.

When we sell or securitize mortgage loans in the ordinary course of business, we are required to make certain representations and warranties to the purchaser about the mortgage loans and the manner in which they were originated. Under these agreements, we may be required to repurchase mortgage loans if we have breached any of these representations or warranties, in which case we may record a loss. In addition, if repurchase and indemnity demands increase on loans that we sell from our portfolios, our liquidity, results of operations and financial condition could be adversely affected.

Our ability to maintain our reputation is critical to the success of our business, and the failure to do so may materially adversely affect our business and the value of our stock.

We are a community bank, and our reputation is one of the most valuable components of our business. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior service to our customers and caring about our customers and associates. If our reputation is negatively affected, by the actions of our employees or otherwise, our business and, therefore, our operating results and the value of our stock may be materially adversely affected.

Our accounting estimates and risk management processes and controls rely on analytical and forecasting techniques and models and assumptions, which may not accurately predict future events.

Our accounting policies and methods are fundamental to the manner in which we record and report our financial condition and results of operations. Our management must exercise judgment in selecting and applying many of these accounting policies and methods so they comply with GAAP and reflect management’s judgment of the most appropriate manner to report our financial condition and results of operations. In some cases, management must select the accounting policy or method to apply from two or more alternatives, any of which may be reasonable under the circumstances, yet which may result in our reporting materially different results than would have been reported under a different alternative.

Certain accounting policies are critical to presenting our financial condition and results of operations. They require management to make difficult, subjective or complex judgments about matters that are uncertain. Materially different amounts could be reported under different conditions or using different assumptions or estimates. These critical accounting policies include policies related to the allowance for loan losses, securities, purchased credit impaired loans and income taxes. Because of the uncertainty of estimates involved in these matters, we may be required to do one or more of the following: significantly increase the allowance for loan losses or sustain loan losses that are significantly higher than the reserve provided, experience additional impairment in our securities portfolio or record a valuation allowance against our deferred tax assets. Any of these could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

Our risk management framework is comprised of various processes, systems and strategies, and is designed to manage the types of risk to which we are subject, including, among others, credit, market, liquidity, interest rate and compliance. Our risk management processes, internal controls, disclosure controls and corporate governance policies and procedures are based in part on certain assumptions and can provide only reasonable (not absolute) assurances that the objectives of the system are met. Any failure or circumvention of our controls, processes and procedures or failure to comply with regulations related to controls,

processes and procedures could necessitate changes in those controls, processes and procedures, which may increase our compliance costs, divert management attention from our business or subject us to regulatory actions and increased regulatory scrutiny. Any of these could have a material adverse effect on our business, financial condition, results of operations and growth prospects. If our framework is not effective, we could suffer unexpected losses, and our business, financial condition, results of operations or growth prospects could be materially and adversely affected. We may also be subject to potentially adverse regulatory consequences.

Changes in accounting standards could materially impact our financial statements.

From time to time, the FASB or the SEC may change the financial accounting and reporting standards that govern the preparation of our financial statements, such as the implementation of the CECL accounting standard. Such changes may result in us being subject to new or changing accounting and reporting standards. In addition, the bodies that interpret the accounting standards (such as banking regulators or outside auditors) may change their interpretations or positions on how these standards should be applied. These changes may be beyond our control, can be hard to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retrospectively, or apply an existing standard differently, also retrospectively, in each case resulting in our needing to revise or restate prior period financial statements.

The obligations associated with being a public company will require significant resources and management attention, which may divert from our business operations.

As a result of the Company's initial public offerings in 2018, we became subject to the reporting requirements of the Exchange Act, and the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"). The Exchange Act requires that we file annual, quarterly and current reports with respect to our business and financial condition with the SEC. The Sarbanes-Oxley Act requires, among other things, that we establish and maintain effective internal controls and procedures for financial reporting. As a result, we incur significant legal, accounting and other expenses that we did not previously incur. We anticipate that these costs will materially increase our general and administrative expenses. Furthermore, the need to establish the corporate infrastructure demanded of a public company may divert management’s attention from implementing our strategic plan, which could prevent us from successfully implementing our growth initiatives and improving our business, results of operations and financial condition.

As an “emerging growth company” as defined in the Jumpstart Our Business Startups Act (the "JOBS Act"), we intend to take advantage of certain temporary exemptions from various reporting requirements, including reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements and an exemption from the requirement to obtain an attestation from our auditors on management’s assessment of our internal control over financial reporting. When these exemptions cease to apply, we expect to incur additional expenses and devote increased management effort toward ensuring compliance with them. We cannot predict or estimate the amount of additional costs we may incur as a result of becoming a public company or the timing of such costs.

The financial reporting resources we have put in place may not be sufficient to ensure the accuracy of the additional information we are required to disclose as a publicly listed company.

As a result of becoming a publicly listed company, we are subject to the heightened financial reporting standards under GAAP and SEC rules, including more extensive levels of disclosure. Complying with these standards requires enhancements to the design and operation of our internal control over financial reporting as well as additional financial reporting and accounting staff with appropriate training and experience in GAAP and SEC rules and regulations.

If we are unable to meet the demands that will be placed upon us as a public company, including the requirements of the Sarbanes-Oxley Act, we may be unable to report our financial results accurately, or report them within the timeframes required by law or stock exchange regulations. Failure to comply with the Sarbanes-Oxley Act, when and as applicable, could also potentially subject us to sanctions or investigations by the SEC or other regulatory authorities. If material weaknesses or other deficiencies occur, our ability to report our financial results accurately and timely could be impaired, which could result in late filings of our annual and quarterly reports under the Exchange Act, restatements of our consolidated financial statements, a decline in our stock price, or suspension or delisting of our common stock from the Nasdaq Global Select Market, and could have a material adverse effect on our business, financial condition, results of operations and growth prospects. Even if we are able to report our financial statements accurately and in a timely manner, any failure in our efforts to implement the improvements or disclosure of material weaknesses in our future filings with the SEC could cause our reputation to be harmed and our stock price to decline significantly.

We have not engaged our independent registered public accounting firm to perform an audit of our internal control over financial reporting as of any balance sheet date reported in our financial statements. Had our independent registered public accounting firm performed an audit of our internal control over financial reporting, material weaknesses may have been

identified. In addition, the JOBS Act provides that, so long as we qualify as an emerging growth company, we will be exempt from the provisions of Section 404(b) of the Sarbanes-Oxley Act, which would require that our independent registered public accounting firm provide an attestation report on the effectiveness of our internal control over financial reporting. We may take advantage of this exemption so long as we qualify as an emerging growth company.

Litigation and regulatory actions, including possible enforcement actions, could subject us to significant fines, penalties, judgments or other requirements resulting in increased expenses or restrictions on our business activities.

Our business is subject to increased litigation and regulatory risks as a result of a number of factors, including the highly regulated nature of the financial services industry and the focus of state and federal prosecutors on banks and the financial services industry generally. This focus has only intensified since the financial crisis, with regulators and prosecutors focusing on a variety of financial institution practices and requirements, including foreclosure practices, compliance with applicable consumer protection laws, classification of “held for sale” assets and compliance with anti-money laundering statutes, the Bank Secrecy Act and sanctions administered by the Office of Foreign Assets Control of the Treasury.

In the normal course of business, from time to time, we have in the past and may in the future be named as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with our current or prior business activities. Legal actions could include claims for substantial compensatory or punitive damages or claims for indeterminate amounts of damages. We may also, from time to time, be the subject of subpoenas, requests for information, reviews, investigations and proceedings (both formal and informal) by governmental agencies regarding our current or prior business activities. Any such legal or regulatory actions may subject us to substantial compensatory or punitive damages, significant fines, penalties, obligations to change our business practices or other requirements resulting in increased expenses, diminished income and damage to our reputation. Our involvement in any such matters, whether tangential or otherwise and even if the matters are ultimately determined in our favor, could also cause significant harm to our reputation and divert management attention from the operation of our business. Further, any settlement, consent order or adverse judgment in connection with any formal or informal proceeding or investigation by government agencies may result in litigation, investigations or proceedings as other litigants and government agencies begin independent reviews of the same activities. As a result, the outcome of legal and regulatory actions could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

We have a continuing need for technological change, and we may not have the resources to effectively implement new technology or we may experience operational challenges when implementing new technology.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend in part upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in our operations as we continue to grow and expand our market area. We may experience operational challenges as we implement these new technology enhancements, or seek to implement them across all of our offices and business units, which could result in us not fully realizing the anticipated benefits from such new technology or require us to incur significant costs to remedy any such challenges in a timely manner.

Many of our larger competitors have substantially greater resources to invest in technological improvements. As a result, they may be able to offer additional or superior products to those that we will be able to offer, which would put us at a competitive disadvantage. Accordingly, a risk exists that we will not be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to our customers.

In addition, the implementation of technological changes and upgrades to maintain current systems and integrate new ones may also cause service interruptions, transaction processing errors and system conversion delays and may cause us to fail to comply with applicable laws. We expect that new technologies and business processes applicable to the banking industry will continue to emerge, and these new technologies and business processes may be better than those we currently use. Because the pace of technological change is high and our industry is intensely competitive, we may not be able to sustain our investment in new technology as critical systems and applications become obsolete or as better ones become available. A failure to successfully keep pace with technological change affecting the financial services industry and failure to avoid interruptions, errors and delays could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition, and could result in further losses in the future.

As of December 31, 2019, our nonaccrual loans (which consist of nonaccrual loans and nonperforming loans modified under troubled debt restructurings) totaled $18.5 million, or 1.5% of our loan portfolio, and our nonperforming assets, which include other real estate owned, totaled $19.5 million, or 1.2% of total assets. In addition, we had $7.5 million in accruing loans that were 31-89 days delinquent and $157 thousand in loans 90 or more days past due and still accruing as of December 31, 2019.

Our nonperforming assets adversely affect our net income in various ways:

- We do not record interest income on nonaccrual loans or nonperforming investment securities, except on a cash basis when the collectability of the principal is not in doubt.
- We must provide for probable loan losses through a current period charge to the provision for loan losses.
- Non-interest expense increases when we must write down the value of properties in our other real estate owned ("OREO") portfolio to reflect changing market values.
- Non-interest income decreases when we must recognize other-than-temporary impairment on nonperforming investment securities.
- There are legal fees associated with the resolution of problem assets, as well as carrying costs, such as taxes, insurance, and maintenance costs related to our OREO.
- The resolution of nonperforming assets requires the active involvement of management, which can distract them from more profitable activity.

If we experience increases in nonaccrual loans and nonperforming assets, our losses and troubled assets could increase significantly, which could have a material adverse effect on our financial condition and results of operations as our loan administration costs could increase, each of which could have an adverse effect on our net income and related ratios, such as return on assets and equity.

We depend on the accuracy and completeness of information provided by customers and counterparties.

In deciding whether to extend credit or enter into other transactions with customers and counterparties, we may rely on information furnished to us by or on behalf of customers and counterparties, including financial statements and other financial information. We also may rely on representations of customers and counterparties as to the accuracy and completeness of that information. In deciding whether to extend credit, we may rely upon our customers’ representations that their financial statements conform to GAAP and present fairly, in all material respects, the financial condition, results of operations and cash flows of the customer. We also may rely on customer representations and certifications, or other audit or accountants’ reports, with respect to the business and financial condition of our clients. Our financial condition, results of operations, financial reporting and reputation could be negatively affected if we rely on materially misleading, false, inaccurate or fraudulent information.

New lines of business, products, product enhancements or services may subject us to additional risks.

From time to time, we may implement new lines of business or offer new products and product enhancements as well as new services within our existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances in which the markets are not fully developed. In implementing, developing or marketing new lines of business, products, product enhancements or services, we may invest significant time and resources, although we may not assign the appropriate level of resources or expertise necessary to make these new lines of business, products, product enhancements or services successful or to realize their expected benefits. Further, initial timetables for the introduction and development of new lines of business, products, product enhancements or services may not be achieved, and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives and shifting market preferences, may also affect the ultimate implementation of a new line of business or offerings of new products, product enhancements or services. Furthermore, any new line of business, product, product enhancement or service or system conversion could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or offerings of new products, product enhancements or services could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

We face strong competition from financial services companies and other companies that offer banking, mortgage, and leasing services and providers of SBA loans, which could harm our business.

Our operations consist of offering banking and mortgage services, and we also offer SBA lending, trust and leasing services to generate noninterest income. Many of our competitors offer the same, or a wider variety of, banking and related financial services within our market areas. These competitors include national banks, regional banks and other community banks. We also face competition from many other types of financial institutions, including savings and loan institutions, finance companies, brokerage firms, insurance companies, credit unions, mortgage banks and other financial intermediaries. In addition, a number of out-of-state financial intermediaries have opened production offices or otherwise solicit deposits in our market areas. Additionally, we face growing competition from so-called “online businesses” with few or no physical locations, including online banks, lenders and consumer and commercial lending platforms, as well as automated retirement and investment service providers. Increased competition in our markets may result in reduced loans, deposits and commissions and brokers’ fees, as well as reduced net interest margin and profitability. Ultimately, we may not be able to compete successfully against current and future competitors. If we are unable to attract and retain banking, mortgage, and leasing customers, we may be unable to continue to grow our business, and our financial condition and results of operations may be adversely affected.

Our ability to compete successfully depends on a number of factors, including, among other things:

- the ability to develop, maintain and build long-term customer relationships based on top quality service, high ethical standards and safe, sound assets;
- the scope, relevance and pricing of products and services offered to meet customer needs and demands;
- the rate at which we introduce new products and services relative to our competitors;
- customer satisfaction with our level of service;
- the ability to expand our market position; and
- industry and general economic trends.

Failure to perform in any of these areas could significantly weaken our competitive position, which could adversely affect our growth and profitability, which, in turn, could adversely affect our business, financial condition and results of operations.

We also face competition for acquisition opportunities in connection with the implementation of our acquisition strategy. Because there are a limited number of acquisition opportunities in our target market, we face competition from other banks and financial institutions, many of which possess greater financial, human, technical and other resources than we do. Our ability to compete in acquiring target institutions will depend on our available financial resources to fund the acquisitions, including the amount of cash and cash equivalents we have and the liquidity and market price of our common stock. In addition, increased competition may also drive up the acquisition consideration that we will be required to pay in order to successfully capitalize on attractive acquisition opportunities.

The success of our SBA lending program is dependent upon the continued availability of SBA loan programs, our status as a preferred lender under the SBA loan programs and our ability to comply with applicable SBA lending requirements.

As an SBA Preferred Lender, we enable our clients to obtain SBA loans without being subject to the potentially lengthy SBA approval process necessary for lenders that are not SBA Preferred Lenders. The SBA periodically reviews the lending operations of participating lenders to assess, among other things, whether the lender exhibits prudent risk management. When weaknesses are identified, the SBA may request corrective actions or impose other restrictions, including revocation of the lender’s Preferred Lender status. If we lose our status as a Preferred Lender, we may lose our ability to compete effectively with other SBA Preferred Lenders, and as a result we would experience a material adverse effect to our financial results. Any changes to the SBA program, including changes to the level of guaranty provided by the federal government on SBA loans or changes to the level of funds appropriated by the federal government to the various SBA programs, may also have an adverse effect on our business, results of operations and financial condition.

Historically we have sold the guaranteed portion of our SBA 7(a) loans in the secondary market. These sales have resulted in our earning premium income and have created a stream of future servicing income. There can be no assurance that we will be able to continue originating these loans, that a secondary market will exist or that we will continue to realize premiums upon the sale of the guaranteed portion of these loans. When we sell the guaranteed portion of our SBA 7(a) loans, we incur credit risk on the retained, non-guaranteed portion of the loans.

In order for a borrower to be eligible to receive an SBA loan, the lender must establish that the borrower would not be able to secure a bank loan without the credit enhancements provided by a guaranty under the SBA program. Accordingly, the SBA loans in our portfolio generally have weaker credit characteristics than the rest of our portfolio, and may be at greater risk of default in the event of deterioration in economic conditions or the borrower’s financial condition. In the event of a loss resulting from default and a determination by the SBA that there is a deficiency in the manner in which the loan was originated, funded or serviced by us, the SBA may require us to repurchase the previously sold portion of the loan, deny its liability under

the guaranty, reduce the amount of the guaranty, or, if it has already paid under the guaranty, seek recovery of the principal loss related to the deficiency from us. Management has estimated losses inherent in the outstanding guaranteed portion of SBA loans and recorded a recourse reserve at a level determined to be appropriate. Significant increases to the recourse reserve may materially decrease our net income, which may adversely affect our business, results of operations and financial condition.

We provide financial services to money services businesses and other cash-intensive businesses, which include, but are not limited to, check cashers, issuers/sellers of traveler's checks, money orders and stored value cards, and money transmitters. Providing banking services to such businesses exposes us to enhanced risks from noncompliance with a variety of laws and regulations.

We provide financial services to the check cashing industry, offering currency, check clearing, monetary instrument, depository and credit services. We also provide treasury management services to money transmitters. Financial institutions that open and maintain accounts for money services businesses and other cash-intensive businesses are expected to apply the requirements of the USA Patriot Act and Bank Secrecy Act, as they do with all accountholders, on a risk-assessed basis. As with any category of accountholder, there will be money services businesses and other cash-intensive businesses that pose little risk of money laundering or lack of compliance with other laws and regulations and those that pose a significant risk. Providing treasury management services to money services businesses and other cash-intensive businesses represents a significant compliance and regulatory risk, and failure to comply with all statutory and regulatory requirements could result in fines or sanctions.

Our branch network expansion strategy may negatively affect our financial performance.

We recently opened banking centers in Grand Rapids, Detroit, Bloomfield Township and Ann Arbor, and we plan to open a new banking center in 2020. Our branch expansion strategy may not generate earnings, or may not generate earnings within a reasonable period of time. Numerous factors contribute to the performance of a new or acquired branch, such as a suitable location, each market's competitive environment, managerial resources, qualified personnel, and an effective marketing strategy. New branches require a significant investment of both financial and personnel resources. Additionally, it takes time for a new branch to generate sufficient favorably priced deposits to produce enough income, including funding loan growth generated by our organization, to offset expenses related to the branch, some of which, like salaries and occupancy expense, are considered fixed costs. Opening new branches in existing markets or new market areas could also divert resources from current core operations and thereby further adversely affect our growth and profitability. Finally, there is a risk that our new branches will not be successful even after they have been established.

Risks Related to the Business Environment and Our Industry

Legislative and regulatory actions taken now or in the future may increase our costs and impact our business, governance structure, financial condition or results of operations.

New proposals for legislation continue to be introduced in the U.S. Congress that could substantially increase regulation of the bank and non-bank financial services industries and impose restrictions on the operations and general ability of firms within the industry to conduct business consistent with historical practices. Federal and state regulatory agencies also frequently adopt changes to their regulations or change the manner in which existing regulations are applied. Certain aspects of current or proposed regulatory or legislative changes to laws applicable to the financial industry, if enacted or adopted, may impact the profitability of our business activities, require more oversight or change certain of our business practices, including the ability to offer new products, obtain financing, attract deposits, make loans and achieve satisfactory interest spreads and could expose us to additional costs, including increased compliance costs. Changes in federal policy and at regulatory agencies are expected to occur over time through policy and personnel changes, which could lead to changes involving the level of oversight and focus on the financial services industry. Regulations and legislation may be impacted by the political ideologies of the executive and legislative branches of the U.S. government as well as the heads of regulatory and administrative agencies, which may change as a result of elections. The nature, timing and economic and political effects of potential changes to the current legal and regulatory framework affecting financial institutions remain highly uncertain. These changes also may require us to invest significant management attention and resources to make any necessary changes to operations to comply and could have an adverse effect on our business, financial condition and results of operations.

Monetary policies and regulations of the Federal Reserve could adversely affect our business, financial condition and results of operations.

In addition to being affected by general economic conditions, our earnings and growth are affected by the policies of the Federal Reserve. An important function of the Federal Reserve is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve to implement these objectives are open market purchases and sales of U.S. government securities, adjustments of the discount rate and changes in banks' reserve requirements against bank deposits.

These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits.

The monetary policies and regulations of the Federal Reserve have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. The effects of such policies upon our business, financial condition and results of operations cannot be predicted.

Federal and state regulators periodically examine our business, and we may be required to remediate adverse examination findings.

The Federal Reserve, the FDIC, and the DIFS periodically examine our business, including our compliance with laws and regulations. If, as a result of an examination, a banking agency were to determine that our financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of any of our operations had become unsatisfactory, or that we were in violation of any law or regulation, they may take a number of different remedial actions as they deem appropriate. These actions include the power to enjoin “unsafe or unsound” practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to assess civil money penalties, to fine or remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate our deposit insurance and place us into receivership or conservatorship. Any regulatory action against us could have an adverse effect on our business, financial condition and results of operations.

We are subject to numerous laws designed to protect consumers, including the Community Reinvestment Act and fair lending laws, and failure to comply with these laws could lead to a wide variety of sanctions.

The Community Reinvestment Act, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations prohibit discriminatory lending practices by financial institutions. The U.S. Department of Justice and federal and state banking and other agencies are responsible for enforcing these laws and regulations. A challenge to an institution’s compliance with fair lending laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisitions activity, restrictions on expansion, and restrictions on entering new business lines. Private parties may also challenge an institution’s performance under fair lending laws in private class action litigation. Such actions could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The Bank Secrecy Act, the USA Patriot Act and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and to file reports such as suspicious activity reports and currency transaction reports. We are required to comply with these and other anti-money laundering requirements. The federal banking agencies and Financial Crimes Enforcement Network are authorized to impose significant civil money penalties for violations of those requirements and have engaged in coordinated enforcement efforts against banks and other financial services providers with the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. We are also subject to increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control. If our policies, procedures and systems are deemed deficient, we would be subject to liability, including fines and regulatory actions, which may include restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans.

Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us. Any of these results could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

Regulations relating to privacy, information security and data protection could increase our costs, affect or limit how we collect and use personal information and adversely affect our business opportunities.

We are subject to various privacy, information security and data protection laws, including requirements concerning security breach notification, and we could be negatively affected by these laws. For example, our business is subject to the Gramm-Leach-Bliley Act which, among other things (i) imposes certain limitations on our ability to share nonpublic personal information about our clients with nonaffiliated third parties, (ii) requires that we provide certain disclosures to clients about our information collection, sharing and security practices and afford clients the right to “opt out” of any information sharing by us with nonaffiliated third parties (with certain exceptions) and (iii) requires that we develop, implement and maintain a written comprehensive information security program containing appropriate safeguards based on our size and complexity, the nature and scope of our activities and the sensitivity of client information we process, as well as plans for responding to data security

breaches. Various state and federal banking regulators and states have also enacted data security breach notification requirements with varying levels of individual, consumer, regulatory or law enforcement notification in certain circumstances in the event of a security breach. Moreover, legislators and regulators in the United States are increasingly adopting or revising privacy, information security and data protection laws that potentially could have a significant impact on our current and planned privacy, data protection and information security-related practices, our collection, use, sharing, retention and safeguarding of consumer or employee information and some of our current or planned business activities. This could also increase our costs of compliance and business operations and could reduce income from certain business initiatives. This includes increased privacy-related enforcement activity at the federal level, by the Federal Trade Commission and the CFPB, as well as at the state level, such as with regard to mobile applications.

Compliance with current or future privacy, data protection and information security laws (including those regarding security breach notification) affecting client or employee data to which we are subject could result in higher compliance and technology costs and could restrict our ability to provide certain products and services, which could have a material adverse effect on our business, financial condition, results of operations and growth prospects. Our failure to comply with privacy, data protection and information security laws could result in potentially significant regulatory or governmental investigations or actions, litigation, fines, sanctions and damage to our reputation, which could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

The Federal Reserve may require us to commit capital resources to support the Bank.

As a matter of policy, the Federal Reserve expects a bank holding company to act as a source of financial and managerial strength to a subsidiary bank and to commit resources to support such subsidiary bank. The Dodd-Frank Act codified the Federal Reserve's policy on serving as a source of financial strength. Under the "source of strength" doctrine, the Federal Reserve may require a bank holding company to make capital injections into a troubled subsidiary bank and may charge the bank holding company with engaging in unsafe and unsound practices for failure to commit resources to a subsidiary bank. A capital injection may be required at times when the holding company may not have the resources to provide it and therefore may be required to borrow the funds or raise capital. Any loans by a holding company to its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a bank holding company's bankruptcy, the bankruptcy trustee will assume any commitment by the holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank. Moreover, bankruptcy law provides that claims based on any such commitment will be entitled to a priority of payment over the claims of the institution's general unsecured creditors, including the holders of its note obligations. Thus, any borrowing that must be done by the Company to make a required capital injection becomes more difficult and expensive and could have an adverse effect on our business, financial condition and results of operations.

We may be adversely affected by the soundness of other financial institutions.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing, counterparty, and other relationships. We have exposure to different industries and counterparties, and through transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services companies, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. These losses or defaults could have a material adverse effect on our business, financial condition, results of operations and growth prospects. Additionally, if our competitors were extending credit on terms we found to pose excessive risks, or at interest rates which we believed did not warrant the credit exposure, we may not be able to maintain our business volume and could experience deteriorating financial performance.

Risk Related to Our Common Stock

The stock market can be volatile, and fluctuations in our operating results and other factors could cause our stock price to decline.

The stock market has experienced, and may continue to experience, fluctuations that significantly impact the market prices of securities issued by many companies. Market fluctuations could adversely affect our stock price. These fluctuations have often been unrelated or disproportionate to the operating performance of particular companies. These broad market fluctuations, as well as general economic, systemic, political and market conditions, such as recessions, loss of investor confidence, interest rate changes, government shutdowns, international trade wars or international currency fluctuations, may negatively affect the market price of our common stock. Moreover, our operating results may fluctuate and vary from period to period due to the risk factors set forth herein. As a result, period-to-period comparisons should not be relied upon as an

indication of future performance. Our stock price could fluctuate significantly in response to the impact these risk factors have on our operating results or financial position.

Our stock is relatively thinly traded.

Although our common stock is traded on the Nasdaq Global Select Market, the average daily trading volume of our common stock is relatively small compared to many public companies. The desired market characteristics of depth, liquidity, and orderliness require the substantial presence of willing buyers and sellers in the marketplace at any given time. In our case, this presence depends on the individual decisions of a relatively small number of investors and general economic and market conditions over which we have no control. Due to the relatively small trading volume of our common stock, significant sales of our common stock, or the expectation of these sales, could cause the stock price to fall more than would be justified by the inherent worth of the Company. Conversely, attempts to purchase a significant amount of our stock could cause the market price to rise above the reasonable inherent worth of the Company.

There can be no assurances concerning continuing dividend payments.

Our common stockholders are only entitled to receive the dividends declared by our Board of Directors. Although we have paid quarterly dividends on our common stock throughout 2019, there can be no assurances that we will be able to continue to pay regular quarterly dividends or that any dividends we do declare will be in any particular amount. The primary source of money to pay our dividends comes from dividends paid to the Company by the Bank. The Bank's ability to pay dividends to the Company is subject to, among other things, its earnings, financial condition and applicable regulations, which in some instances limit the amount that may be paid as dividends.

We cannot guarantee that our stock repurchase program will be fully implemented or that it will enhance long-term shareholder value.

On January 23, 2019, the Company announced that its Board of Directors approved a repurchase program under which the Company is authorized to repurchase, from time to time as the Company deems appropriate, shares of the Company's common stock with an aggregate purchase price of up to $5 million. The repurchase program began on January 23, 2019, and expires on December 31, 2020. The repurchase program does not obligate the Company to repurchase any dollar amount of number of shares, and there is no assurance that the Company will do so or that the Company will repurchase shares at favorable prices. The repurchase program may be extended, modified, suspended or discontinued at any time, and, even if fully implemented, the program may not enhance long-term shareholder value.

Item 1B – Unresolved Staff Comments

None.

Item 2 - Properties

Our headquarters are located at 32991 Hamilton Court, Farmington Hills, Michigan. Including our headquarters building, we operate 14 offices, including 12 full-service banking centers located primarily in southeastern and west Michigan, and one mortgage loan production office in Ann Arbor, Michigan. We own our headquarters building and our branch offices located in Novi and Bloomfield Hills, and lease the remainder of our locations.

In addition, on January 2, 2020, we acquired Ann Arbor State Bank, which added three banking centers, two of which we own and we lease the other.

Item 3 – Legal Proceedings

In the normal course of business, we are named or threatened to be named as a defendant in various lawsuits, none of which we expect to have a material effect on the Company. However, given the nature, scope and complexity of the extensive legal and regulatory landscape applicable to our business (including laws and regulations governing consumer protection, fair lending, fair labor, privacy, information security, anti-money laundering and anti-terrorism), we, like all banking organizations, are subject to heightened legal and regulatory compliance and litigation risk. There are no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which we or any of our subsidiaries is a party or to which our property is the subject.

Item 4 – Mine Safety Disclosures

Not Applicable.

PART II

Item 5 – Market for Registrant's Common Equity, Related Stockholder Matters and Issuer of Purchases of Equity Securities

Market Information

Our common stock began trading on the Nasdaq Global Select Market ("Nasdaq") under the symbol "LEVL" on April 20, 2018. Prior to that, there was no public market for our common stock.

Shareholders

As of February 6, 2020, the Company had 172 common stock shareholders of record and approximately 818 beneficial holders, and the closing price of the Company's common stock was $25.16 per share.

Use of Proceeds from Registered Securities

On April 24, 2018, the Company sold 1,150,765 shares of common stock in its initial public offering, including 180,000 shares of common stock pursuant to the exercise in full by the underwriters of their option to purchase additional shares. All of the shares were sold pursuant to our Registration Statement on Form S-1, as amended (File No. 333-223866), which was declared effective by the SEC on April 19, 2018 and our Registration Statement on Form S-1 to add securities to the prior Form S-1 pursuant to Rule 462(b) of the Securities Act (File No. 333-224359).

There has been no material change in the planned use of proceeds from our initial public offering as described in our prospectus filed with the SEC on April 20, 2018 pursuant to Rule 424 (b)(4) under the Securities Act. On April 25, 2018, the Company contributed $20.0 million of the net proceeds of the initial public offering to the Bank. During 2019, the Company used a portion of the proceeds from our initial public offering to open the new Ann Arbor banking center. The remaining proceeds were used to fund the acquisition of Ann Arbor Bancorp, Inc., which closed on January 2, 2020.

Unregistered Sales of Equity Securities

None.

Issuer Purchases of Equity Securities

Share Buyback Program. On January 23, 2019, the Company announced that its Board of Directors approved a repurchase program under which the Company is authorized to repurchase, from time to time as the Company deems appropriate, shares of the Company's common stock with an aggregate purchase price of up to $5 million. The repurchase program began on January 23, 2019, and expires on December 31, 2020. The repurchase program does not obligate the Company to repurchase any dollar amount or number of shares, and the program may be extended, modified, suspended or discontinued at any time. As of December 31, 2019, $2.8 million of shares remained available to be repurchased under the repurchase program.

The following table sets forth information regarding the Company's repurchase of shares of its outstanding common stock during the three months ended December 31, 2019.

(Dollars in thousands, except per share amounts)	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Repurchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet be Purchased under the Plans or Programs
October 1-31, 2019	—	$ —	—	$ 2,892
November 1-30, 2019	2,359	24.22	2,359	2,835
December 1-31, 2019	—	—	—	2,835
Total	2,359	$ 24.22	2,359	

Under applicable state law, Michigan corporations are not permitted to retain treasury stock. As such, the price paid for the repurchased shares is recorded to common stock. As of December 31, 2019, the total shares repurchased in the amount of $2.2 million were redeemed but remain authorized, unissued shares.

Item 6 - Selected Financial Data

(Dollars in thousands, except per share data)	As of and for the year ended December 31, 2019	2018	2017	2016	2015
Earnings Summary					
Interest income	**$ 70,448**	$ 63,824	$ 55,607	$ 52,903	$ 41,335
Interest expense	**19,393**	13,400	8,078	5,832	3,792
Net interest income	**51,055**	50,424	47,529	47,071	37,543
Provision expense for loan losses	**1,383**	412	1,416	3,925	1,359
Noninterest income	**14,211**	7,055	6,502	6,407	7,214
Noninterest expense	**44,369**	39,678	36,051	32,407	24,888
Income before income taxes	**19,514**	17,389	16,564	17,146	18,510
Income tax provision	**3,403**	3,003	6,723	6,100	5,982
Net income	**16,111**	14,386	9,841	11,046	12,528
Less: Preferred stock dividends	**—**	—	—	—	112
Net income allocated to participating securities [(1)]	**159**	—	—	—	—
Net income attributable to common shareholders [(1)]	**$ 15,952**	$ 14,386	$ 9,841	$ 11,046	$ 12,416
Per Share Data					
Basic earnings per common share	**$ 2.08**	$ 1.95	$ 1.54	$ 1.74	$ 1.97
Diluted earnings per common share	**2.05**	1.91	1.49	1.69	1.92
Book value per common share	**22.13**	19.58	16.78	15.21	13.57
Tangible book value per share [(2)]	**20.86**	18.31	15.21	13.59	12.75
Shares outstanding (in thousands)	**7,715**	7,750	6,435	6,351	6,310
Average basic common shares (in thousands)	**7,632**	7,377	6,388	6,341	6,307
Average diluted common shares (in thousands)	**7,747**	7,524	6,610	6,549	6,463
Selected Period End Balances					
Total assets	**$ 1,584,899**	$ 1,416,215	$ 1,301,291	$ 1,127,531	$ 924,663
Securities available-for-sale	**180,905**	204,258	150,969	100,533	116,702
Total loans	**1,227,609**	1,126,565	1,034,923	953,393	759,718
Total deposits	**1,135,428**	1,134,635	1,120,382	924,924	784,115
Total liabilities	**1,414,196**	1,264,455	1,193,331	1,030,960	839,029
Total shareholders' equity	**170,703**	151,760	107,960	96,571	85,634
Tangible shareholders' equity [(2)]	**160,940**	141,926	97,906	86,283	80,438
Performance and Capital Ratios					
Return on average assets	**1.08%**	1.07%	0.82%	1.05%	1.43 %
Return on average equity	**9.90**	10.68	9.45	11.93	13.56
Net interest margin (fully taxable equivalent) [(3)]	**3.60**	3.92	4.18	4.73	4.60
Efficiency ratio (noninterest expense/net interest income plus noninterest income)	**67.98**	69.03	66.72	60.60	63.98
Dividend payout ratio	**7.20**	4.60	—	—	—
Total shareholders' equity to total assets	**10.77**	10.72	8.30	8.56	9.26
Tangible equity to tangible assets [(2)]	**10.22**	10.09	7.58	7.72	8.75
Common equity tier 1 to risk-weighted assets	**11.72**	11.82	9.10	8.72	10.28
Tier 1 capital to risk-weighted assets	**11.72**	11.82	9.10	8.72	10.28
Total capital to risk-weighted assets	**15.99**	14.00	11.55	11.28	13.14
Tier 1 capital to average assets (leverage ratio)	**10.41**	10.21	7.92	7.95	8.89
Asset Quality Ratios:					
Net charge-offs (recoveries) to average loans	**0.02%**	0.05%	0.08%	0.08%	(0.14)%
Nonperforming assets as a percentage of total assets	**1.23**	1.30	1.13	1.36	0.18
Nonaccrual loans as a percent of total loans	**1.51**	1.64	1.36	1.58	0.21
Allowance for loan losses as a percentage of period-end loans	**1.03**	1.03	1.13	1.16	1.04
Allowance for loan losses as a percentage of nonaccrual loans	**68.40**	62.70	83.38	73.76	484.94
Allowance for loan losses as a percentage of nonaccrual loans, excluding allowance allocated to loans accounted for under ASC 310-30	**64.29**	57.71	75.68	68.13	444.99

[(1)] Amounts presented are used in the two-class earnings per common share calculation. This method was adopted by the Company in second quarter of 2019.
[(2)] See section entitled "GAAP Reconciliation and Management Explanation of Non-GAAP Financial Measures" below.
[(3)] Presented on a tax equivalent basis using a 35% tax rate for the 2015, 2016 and 2017 periods and a 21% tax rate for the 2018 and 2019 periods.

GAAP Reconciliation and Management Explanation of Non-GAAP Financial Measures

Some of the financial measures included in this report are not measures of financial condition or performance recognized by GAAP. These non-GAAP financial measures include tangible shareholders' equity, tangible book value per share and the ratio of tangible equity to tangible assets, as well as net income and diluted earnings per common share excluding acquisition and due diligence fees. Our management uses these non-GAAP financial measures in its analysis of our performance, and we believe that providing this information to financial analysts and investors allows them to evaluate capital adequacy, as well as better understand and evaluate the Company's core financial results for the periods in question.

We calculate: (i) tangible shareholders' equity as total shareholders' equity less core deposit intangibles, mortgage servicing rights and goodwill; (ii) tangible book value per share as tangible shareholders' equity divided by shares of common stock outstanding; (iii) tangible assets as total assets, less core deposit intangibles, mortgage servicing rights and goodwill; (iv) net income, excluding acquisition and due diligence fees, as net income, as reported, less acquisition and due diligences fees, net of income tax benefit; and (v) diluted earnings per common share, excluding acquisition and due diligence fees, as diluted earnings per common share, as reported, less effect of acquisition and due diligence fees on diluted earnings per share, net of income tax benefit.

The following presents these non-GAAP financial measures along with their most directly comparable financial measures calculated in accordance with GAAP:

	As of and for the year ended December 31,				
(Dollars in thousands, except per share data)	**2019**	**2018**	**2017**	**2016**	**2015**
Total shareholders' equity	**$ 170,703**	$ 151,760	$ 107,960	$ 96,571	$ 85,634
Less:					
Goodwill	**9,387**	9,387	9,387	9,387	4,549
Other intangible assets, net	**376**	447	667	901	647
Tangible shareholders' equity	**$ 160,940**	$ 141,926	$ 97,906	$ 86,283	$ 80,438
Shares outstanding (in thousands)	**7,715**	7,750	6,435	6,351	6,310
Tangible book value per share	**$ 20.86**	$ 18.31	$ 15.21	$ 13.59	$ 12.75
Total assets	**$ 1,584,899**	$ 1,416,215	$ 1,301,291	$ 1,127,531	$ 924,663
Less:					
Goodwill	**9,387**	9,387	9,387	9,387	4,549
Other intangible assets, net	**376**	447	667	901	647
Tangible assets	**$ 1,575,136**	$ 1,406,381	$ 1,291,237	$ 1,117,243	$ 919,467
Tangible equity to tangible assets	**10.22%**	10.09%	7.58%	7.72%	8.75%
Net income, as reported	**$ 16,111**	$ 14,386	$ 9,841	$ 11,046	$ 12,528
Acquisition and due diligence fees	**539**	—	—	2,684	722
Income tax benefit [1]	**(51)**	—	—	(939)	(253)
Net income, excluding acquisition and due diligence fees	**16,599**	14,386	9,841	12,791	12,997
Diluted earnings per common share, as reported	**$ 2.05**	$ 1.91	$ 1.49	$ 1.69	$ 1.92
Effect of acquisition and due diligence fees, net of tax [1]	**0.07**	—	—	0.27	0.07
Diluted earnings per common share, excluding acquisition and due diligence fees	**$ 2.12**	$ 1.91	$ 1.49	$ 1.96	$ 1.99

(1) Assumes income tax rate of 21% on deductible acquisition expenses for 2019 and 35% on deductible acquisition expenses for 2015 and 2016.

Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion explains our financial condition as of December 31, 2019 and 2018 and results of operations for the years ended December 31, 2019, 2018 and 2017. The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes presented in Item 8 of this report.

This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Certain risks, uncertainties and other factors, including but not limited to those set forth under "Forward-Looking Statements," "Risk Factors" and elsewhere in this Form 10-K, may cause actual results to differ materially from those projected in the forward-looking statements. We assume no obligation to update any of these forward-looking statements.

Critical Accounting Policies

Our consolidated financial statements are prepared based on the application of accounting policies generally accepted in the United States. Our critical accounting policies require reliance on estimates and assumptions, which are based upon historical experience and on various other assumptions that management believes are reasonable under current circumstances, but may prove to be inaccurate or can be subject to variations. Changes in underlying factors, assumptions, or estimates could have a material impact on our future financial condition and results of operations.

The most critical of these significant accounting policies are set forth in Note 1 – Basis of Presentation and Summary of Significant Accounting Policies of the Notes to the Consolidated Statements in our consolidated financial statements included in Item 8. Financial Statements and Supplementary Data in this Form 10-K.

Overview

Level One Bancorp, Inc. is a financial holding company headquartered in Farmington Hills, Michigan, with its primary branch operations in southeastern and west Michigan. Through our wholly owned subsidiary, Level One Bank, we offer a broad range of loan products to the residential and commercial markets, as well as retail and business banking services. Hamilton Court Insurance Company, a wholly owned subsidiary of the Company, provides property and casualty insurance to the Company and the Bank and reinsurance to ten other third-party insurance captives for which insurance may not be currently available or economically feasible in the insurance marketplace.

Since 2007, we have grown substantially through organic growth and a series of four acquisitions, all of which have been fully integrated into our operations. We have made significant investments over the last several years in hiring additional staff and upgrading technology and system security. In 2016, we opened our first branch in the Grand Rapids, Michigan market. In the third quarter of 2017, we opened our second location in Bloomfield Township located in Oakland County. In the third quarter of 2018, we doubled the size of our mortgage division with the addition of new mortgage officers and support staff. As of December 31, 2019, the Company had total consolidated assets of $1.58 billion, total consolidated deposits of $1.14 billion and total consolidated shareholders' equity of $170.7 million.

Our principal business activity has been lending to and accepting deposits from individuals, businesses, municipalities and other entities. We derive income principally from interest charged on loans and leases and, to a lesser extent, from interest and dividends earned on investment securities. We have also derived income from noninterest sources, such as fees received in connection with various lending and deposit services and originations and sales of residential mortgage loans. Our principal expenses include interest expense on deposits and borrowings, operating expenses, such as salaries and employee benefits, occupancy and equipment expenses, data processing costs, professional fees and other noninterest expenses, provisions for loan losses and income tax expense.

Recent Developments

Merger with Ann Arbor Bancorp, Inc. On January 2, 2020, the Company completed its previously announced acquisition of Ann Arbor Bancorp, Inc. (“AAB”) and its wholly owned subsidiary, Ann Arbor State Bank. The transaction was completed pursuant to a merger of the Company’s wholly owned merger subsidiary (“Merger Sub”) with and into AAB, pursuant to the Agreement and Plan of Merger, dated as of August 12, 2019, among the Company, Merger Sub and AAB. Level One paid aggregate consideration of approximately $67.9 million in cash. Level One expects to have approximately $1.4 million in expenses related to the acquisition in the first quarter of 2020.

As of December 31, 2019, Ann Arbor State Bank had total assets of $319.4 million, total loans of $222.1 million and total deposits of $267.7 million.

Fourth Quarter Dividend. On December 19, 2019, the Company declared a fourth quarter 2019 cash dividend of $0.04 per share, payable on January 15, 2020 to shareholders of record on December 31, 2019.

Results of Operations

Net Income

We had net income of $16.1 million, or $2.05 per diluted common share, for the year ended December 31, 2019, compared to $14.4 million, or $1.91 per diluted common share, for the year ended December 31, 2018. The increase of $1.7 million in net income in 2019 primarily reflected an increase of $7.1 million in noninterest income and an increase of $631 thousand in net interest income. This was partially offset by increases of $4.7 million in noninterest expense, $971 thousand in provision for loan losses and $400 thousand in income tax provision.

For a discussion on the comparison of results of operations for the years ended December 31, 2018 and 2017, refer Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operation in the Company's Annual Form 10-K, filed with the SEC on March 22, 2019.

Net Interest Income

Our primary source of revenue is net interest income, which is the difference between interest income from interest-earning assets (primarily loans and securities) and interest expense of funding sources (primarily interest-bearing deposits and borrowings).

Net interest income was $51.1 million and $50.4 million for the years ended December 31, 2019 and 2018, respectively. The year ended December 31, 2019 included a $6.6 million increase in interest income as well as a $6.0 million increase in interest expense, compared to the same period in 2018. The increase in interest income was primarily driven by increases of $5.1 million in interest and fees on loans and $1.2 million in interest income from investment securities, and the increase in interest expense was primarily driven by an increase of $5.9 million in deposit interest expense. The increase in interest and fees on loans for the year ended December 31, 2019 compared to 2018, was mainly attributable to the increase in the average balance of loans of $96.7 million. The increase in interest income from investment securities was primarily due to the increase in the average balance of investment securities of $29.0 million and an increase in average interest rate paid of 0.43%. The increase in deposit interest expense during the year ended December 31, 2019 compared to 2018 was primarily due to a higher average rate paid on deposits of 1.95% compared to 1.52%, which was mainly as a result of increased competition and the federal funds rate increase of 100 basis points during the year ended December 31, 2018, compared to a 75 basis point decrease in the second half of 2019, leaving the cost of funds higher year over year. In addition, the increase in deposit expense was impacted by an increase in average balance of deposits of $98.0 million compared to the same period in 2018.

Our net interest margin (on a fully tax equivalent basis ("FTE")) for the year ended December 31, 2019 was 3.60%, compared to 3.92% for the same period in 2018. The decrease of 32 basis points in the net interest margin year over year was primarily due to the federal funds rate increase of 100 basis points during the year ended December 31, 2018, compared to a 75 basis point decrease in the second half of 2019, leaving the cost of funds higher year over year. Our net interest margin benefits from discount accretion on our purchased credit impaired loan portfolios, a component of our accretable yield. The accretable yield represents the excess of the net present value of expected future cash flows over the acquisition date fair value and includes both the expected coupon of the loan and the discount accretion. The accretable yield is recognized as interest income over the expected remaining life of the purchased credit impaired loan. The difference between the actual yield earned on total loans and the yield generated based on the contractual coupon (not including any interest income for loans in nonaccrual status) represents excess accretable yield. The contractual coupon of the loan considers the contractual coupon rates of the loan and does not include any interest income for loans in nonaccrual status. For the years ended December 31, 2019 and 2018, the average yield on total loans was 5.42% and 5.43%, respectively. The yield on total loans was impacted by 16 basis points and 28 basis points, respectively, due to the accretable yield on purchased credit impaired loans. Our net interest margin for the years ended December 31, 2019 and 2018, benefited by 15 basis points and 23 basis points, respectively, as a result of the excess accretable yield. As of December 31, 2019 and December 31, 2018, our remaining accretable yield was $9.1 million and $10.9 million, respectively, and our nonaccretable difference was $3.9 million and $5.6 million, respectively.

The following table sets forth information related to our average balance sheet, average yields on assets, and average rates on liabilities for the periods indicated. We derived these yields by dividing income or expense by the average daily balance of the corresponding assets or liabilities. In this table, adjustments were made to the yields on tax-exempt assets in order to present tax-exempt income and fully taxable income on a comparable basis.

Analysis of Net Interest Income—Fully Taxable Equivalent

	For the year ended December 31,								
	2019			2018			2017		
(Dollars in thousands)	Average Balance	Interest Revenue/Expense (1)	Average Yield/Rate (2)	Average Balance	Interest Revenue/Expense (1)	Average Yield/Rate (2)	Average Balance	Interest Revenue/Expense (1)	Average Yield/Rate (2)
Interest-earning assets:									
Gross loans(3)	**$ 1,169,486**	**$ 63,331**	**5.42%**	$ 1,072,794	$ 58,262	5.43%	$ 973,013	$ 52,043	5.35%
Investment securities(4):	**213,666**								
Taxable	**129,274**	**3,509**	**2.71**	121,505	2,939	2.42	84,899	1,746	2.06
Tax-exempt	**84,392**	**2,305**	**3.27**	63,205	1,657	3.13	38,935	955	3.57
Interest-earning cash balances	**38,268**	**855**	**2.23**	27,182	546	2.01	43,540	507	1.16
Federal Home Loan Bank stock	**8,523**	**448**	**5.26**	8,308	420	5.06	8,163	356	4.36
Total interest-earning assets	**$ 1,429,943**	**$ 70,448**	**4.96%**	$ 1,292,994	$ 63,824	4.96%	$ 1,148,550	$ 55,607	4.88%
Non-earning assets:									
Cash and due from banks	**23,910**			20,556			18,590		
Premises and equipment	**13,379**			13,207			14,576		
Goodwill	**9,387**			9,387			9,387		
Other intangible assets, net	**375**			560			789		
Bank-owned life insurance	**11,994**			11,692			11,365		
Allowance for loan losses	**(12,035)**			(11,691)			(11,466)		
Other non-earning assets	**21,005**			9,014			12,164		
Total assets	**$ 1,497,958**			$ 1,345,719			$ 1,203,955		
Interest-bearing liabilities:									
Deposits:									
Interest-bearing demand deposits	**$ 57,480**	**$ 281**	**0.49%**	$ 60,203	$ 198	0.33%	$ 59,274	$ 169	0.29%
Money market and savings deposits	**314,918**	**4,518**	**1.43**	264,656	2,609	0.99	259,449	1,605	0.62
Time deposits	**527,605**	**12,142**	**2.30**	477,164	8,248	1.73	373,762	4,493	1.20
Borrowings	**79,864**	**1,378**	**1.73**	66,926	1,330	1.99	80,283	797	0.99
Subordinated notes	**16,061**	**1,074**	**6.69**	14,866	1,015	6.83	14,813	1,014	6.85
Total interest-bearing liabilities	**$ 995,928**	**$ 19,393**	**1.95%**	$ 883,815	$ 13,400	1.52%	$ 787,581	$ 8,078	1.03%
Noninterest-bearing liabilities and shareholders' equity:									
Noninterest-bearing demand deposits	**321,487**			316,764			301,971		
Other liabilities	**17,750**			10,436			10,297		
Shareholders' equity	**162,793**			134,704			104,106		
Total liabilities and shareholders' equity	**$ 1,497,958**			$ 1,345,719			$ 1,203,955		
Net interest income		**$ 51,055**			$ 50,424			$ 47,529	
Interest spread			**3.01%**			3.44%			3.85%
Net interest margin(5)			**3.57**			3.90			4.14
Tax equivalent effect			**0.03**			0.02			0.04
Net interest margin on a fully tax equivalent basis			**3.60%**			3.92%			4.18%

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(1) Interest income is shown on actual basis and does not include taxable equivalent adjustments.
(2) Average rates and yields are presented on an annual basis and include a taxable equivalent adjustment to interest income of $453 thousand, $319 thousand, and $434 thousand on tax-exempt securities for the years ended December 31, 2019, 2018 and 2017, respectively, using the federal corporate tax rate of 21% for the periods ended December 31, 2019 and 2018 and 35% for the period ended December 31, 2017.
(3) Includes nonaccrual loans
(4) For presentation in this table, average balances and the corresponding average rates for investment securities are based upon historical cost, adjusted for amortization of premiums and accretion of discounts.
(5) Net interest margin represents net interest income divided by average total interest-earning assets.

Rate/Volume Analysis

The table below presents the effect of volume and rate changes on interest income and expense for the periods indicated. Changes in volume are changes in the average balance multiplied by the previous year's average rate. Changes in rate are changes in the average rate multiplied by the average balance from the previous year. The net changes attributable to the combined impact of both rate and volume have been allocated proportionately to the changes due to volume and the changes due to rate. The average rate for tax-exempt securities is reported on a fully taxable equivalent basis.

	For the year ended December 31, 2019 vs. 2018		
	Increase (Decrease) Due to:		
(Dollars in thousands)	**Rate**	**Volume**	**Net Increase (Decrease)**
Interest-earning assets			
Gross loans	$ (171)	$ 5,240	$ 5,069
Investment securities:			
Taxable	374	196	570
Tax-exempt	(41)	689	648
Interest-earning cash balances	67	242	309
FHLB Stock	17	11	28
Total interest income	246	6,378	6,624
Interest-bearing liabilities			
Interest-bearing demand deposits	92	(9)	83
Money market and savings deposits	1,345	564	1,909
Time deposits	2,951	943	3,894
Borrowings	(189)	237	48
Subordinated debt	(21)	80	59
Total interest expense	4,178	1,815	5,993
Change in net interest income	$ (3,932)	$ 4,563	$ 631

	For the year ended December 31, 2018 vs. 2017		
	Increase (Decrease) Due to:		
(Dollars in thousands)	**Rate**	**Volume**	**Net Increase (Decrease)**
Interest-earning assets			
Gross loans	$ 811	$ 5,408	$ 6,219
Investment securities:			
Taxable	345	848	1,193
Tax-exempt	(75)	777	702
Interest-earning cash balances	276	(237)	39
FHLB Stock	58	6	64
Total interest income	1,415	6,802	8,217
Interest-bearing liabilities			
Interest-bearing demand deposits	26	3	29
Money market and savings deposits	971	33	1,004
Time deposits	2,303	1,452	3,755
Borrowings	684	(151)	533
Subordinated debt	(3)	4	1
Total interest expense	3,981	1,341	5,322
Change in net interest income	$ (2,566)	$ 5,461	$ 2,895

Provision for Loan Losses

We established an allowance for loan losses through a provision for loan losses charged as an expense in our consolidated statements of income. Management reviews the loan portfolio, consisting of originated loans and purchased loans, on a quarterly basis to evaluate the outstanding loans and to measure both the performance of the portfolio and the adequacy of the allowance for loan losses.

Loans acquired in connection with acquisitions that have evidence of credit deterioration since origination and for which it is probable at the date of acquisition that we will not collect all contractually required principal and interest payments are accounted for under ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, or ASC 310-30. These credit-impaired loans have been recorded at their estimated fair value on the respective acquisition date, based on subjective determinations regarding risk ratings, expected future cash flows and fair value of the underlying collateral, without a carryover of the related allowance for loan losses. At the acquisition date, the Company recognizes the expected shortfall of expected future cash flows, as compared to the contractual amount due, as a nonaccretable discount. Any excess of the net present value of expected future cash flows over the acquisition date fair value is recognized as the accretable discount, or accretable yield. We evaluate these loans semi-annually to assess expected cash flows. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior charges or a reclassification of the difference from nonaccretable to accretable with a positive impact on interest income. As of December 31, 2019, and December 31, 2018, our remaining accretable yield was $9.1 million and $10.9 million, respectively, and our nonaccretable difference was $3.9 million and $5.6 million, respectively.

The provision for loan losses was a provision expense of $1.4 million for the year ended December 31, 2019 compared to a $412 thousand provision expense for the same period in 2018. The increase in the provision for loan losses was primarily due to a $839 thousand increase in specific reserves on impaired loans and a $414 thousand increase in general reserves due to continued growth in our originated loan portfolio as a percentage of our total loans. This was partially offset by $284 thousand lower charge-offs during the 2019 period compared to the same period in 2018. The increase in specific reserves on impaired loans was primarily due to the release in 2018 of $729 thousand of specific reserves on a commercial loan relationship that paid off in the fourth quarter of 2018.

Noninterest Income

The following table presents noninterest income for the years ended December 31, 2019, 2018, and 2017.

	For the year ended December 31,		
(Dollars in thousands)	**2019**	**2018**	**2017**
Noninterest income			
Service charges on deposits	**$ 2,547**	$ 2,556	$ 2,543
Net gain (loss) on sales of securities	**1,174**	(71)	208
Mortgage banking activities	**7,880**	2,330	1,698
Net gain (loss) on sale of commercial loans	**(45)**	11	146
Other charges and fees	**2,655**	2,229	1,907
Total noninterest income	**$ 14,211**	$ 7,055	$ 6,502

Noninterest income increased $7.1 million to $14.2 million for the year ended December 31, 2019 compared to $7.1 million for the same period in 2018. The increase in noninterest income was primarily due to an increase in mortgage banking activities of $5.6 million, an increase in net gains on sales of securities of $1.2 million and an increase in interest rate swap fees of $576 thousand (included in "other charges and fees" in the table above). The increase in the mortgage banking activities income was a result of secondary market fees and application/origination fees on increased volumes of mortgage loans sold and the fair value adjustment and derivatives on higher volumes of loans held for sale. The increased volumes were predominantly a result of expanding the mortgage banking division in the third quarter of 2018 as well as lower interest rates throughout 2019. The increase in net gain on sales of securities was primarily due to the sale of securities which reflected our efforts to better position our combined investment portfolio in connection with the merger with Ann Arbor State Bank. The increase in interest rate swap fees was due to the Company offering customer-initiated derivatives for all of 2019.

Noninterest Expense

The following table presents noninterest expense for the years ended December 31, 2019, 2018, and 2017.

(Dollars in thousands)	For the year ended December 31, 2019	2018	2017
Noninterest expense			
Salary and employee benefits	**$ 28,775**	$ 25,781	$ 21,555
Occupancy and equipment expense	**4,939**	4,425	4,208
Professional service fees	**1,808**	1,672	2,314
Acquisition and due diligence fees	**539**	—	—
Marketing expense	**1,107**	1,033	930
Printing and supplies expense	**340**	441	477
Data processing expense	**2,374**	2,146	1,912
Other expense	**4,487**	4,180	4,655
Total noninterest expense	**$ 44,369**	$ 39,678	$ 36,051

Noninterest expense increased $4.7 million to $44.4 million for the year ended December 31, 2019, as compared to $39.7 million for the same period in 2018. The increase in noninterest expense was primarily due to increases in salary and employee benefits of $3.0 million, acquisition and due diligence fees of $539 thousand, occupancy and equipment expense of $514 thousand, other expense of $307 thousand, and data processing expense of $228 thousand. The increase in salary and employee benefits between the periods was primarily due to an increase of $1.8 million in mortgage commissions expense as a result of higher loan volumes as well as having the expanded mortgage team for the full 2019 calendar year. The increase in acquisition and due diligence fees was related to the merger with Ann Arbor State Bank, which closed on January 2, 2020. The increases in the data processing and occupancy and equipment expenses were primarily attributable to incremental increases in software costs and building expenses to sustain the growth of the Company. The increase in other expense was primarily due to an increase in the provision for unfunded commitments as a result of a change in the assumptions within the calculation, which resulted in a better representation of our line of credit utilization.

Income Taxes and Tax-Related Items

Refer to Note 9 - Income Taxes in the notes to the consolidated financial statements for a reconciliation between expected and actual income tax expense for the years ended December 31, 2019 and 2018.

Financial Condition

Total assets increased $168.7 million to $1.58 billion at December 31, 2019 as compared to $1.42 billion at December 31, 2018. The increase in total assets was primarily due to increases of $101.0 million in gross loans, $70.6 million in cash and cash equivalents, $8.3 million in mortgage loans held for sale, $5.1 million in receivables from a loan sub-servicer (included in "other assets" on the consolidated balance sheet), and $3.6 million in fair value of interest rate swaps (included in "other assets" on the consolidated balance sheet), partially offset by a decrease of $23.4 million in securities available-for-sale. The year over year increase in loans was primarily driven by the growth in both our commercial real estate, residential real estate, and commercial and industrial loan portfolios. Cash and cash equivalents increased primarily as a result of a $74.4 million increase in cash balances held with the Federal Reserve Bank in preparation for the closing of the merger with Ann Arbor State Bank. The Company maintains a cash balance at the Federal Reserve and manages this liquidity balance on a daily basis as required, and may have significant cash balance fluctuations in the ordinary course of business based on inflows and outflows from changing loan totals, investment activity, and deposit flows. The increase in mortgage loans held for sale was attributable to the increase in volumes of loans held for sale as a result of the doubling of our mortgage team during the third quarter of 2018 as well as the decrease in interest rates during 2019, which resulted in a higher demand for mortgage loans. The increase in the fair value of interest rate swaps was partly volume driven as a result of the Company offering interest rate swaps to customers during all of 2019, as well as due to the changes in interest rates. The decrease in securities available-for-sale reflected our efforts to better position our combined investment portfolio in connection with the merger with Ann Arbor State Bank.

Investment Securities

The following table presents the fair value of the Company's investment securities portfolio, all of which were classified as available-for-sale as of December 31, 2019, 2018 and 2017.

(Dollars in thousands)	December 31, 2019	December 31, 2018	December 31, 2017
Securities available-for-sale:			
U.S. government sponsored entities and agencies	**$ —**	$ 2,397	$ —
State and political subdivision	**93,747**	75,146	53,224
Mortgage-backed securities: residential	**10,565**	9,739	8,431
Mortgage-backed securities: commercial	**8,779**	12,382	9,819
Collateralized mortgage obligations: residential	**8,529**	18,671	19,221
Collateralized mortgage obligations: commercial	**23,181**	31,988	20,557
U.S. Treasury	**1,999**	20,481	23,573
SBA	**21,984**	15,688	12,616
Asset backed securities	**10,084**	3,842	—
Corporate bonds	**2,037**	13,924	3,528
Total securities available-for-sale	**$ 180,905**	$ 204,258	$ 150,969

The composition of our investment securities portfolio reflects our investment strategy of maintaining an appropriate level of liquidity for both normal operations and potential acquisitions, while providing an additional source of revenue. The investment portfolio also provides a balance to interest rate risk and credit risk in other categories of the balance sheet, while providing a vehicle for the investment of available funds, furnishing liquidity, and supplying securities to pledge as collateral. At December 31, 2019, total investment securities were $180.9 million, or 11.4% of total assets, compared to $204.3 million, or 14.4% of total assets, at December 31, 2018. The $23.4 million decrease in securities available-for-sale from December 31, 2018 to December 31, 2019, primarily reflected decreases in obligations of U.S. Treasury, corporate bonds, collateralized mortgage obligations: residential, collateralized mortgage obligations: commercial, mortgage backed securities: commercial, and U.S. government sponsored entities and agencies, partially offset by increases in state and political subdivisions, SBA, and asset backed securities. The decrease in securities available-for-sale year over year reflected our efforts to better position our combined investment portfolio in connection with the merger with Ann Arbor State Bank. Securities with a carrying value of $27.3 million and $22.7 million were pledged at December 31, 2019 and December 31, 2018, respectively, to secure borrowings, deposits and mortgage derivatives.

As of December 31, 2019, the Company held 56 tax-exempt state and local municipal securities totaling $40.1 million backed by the Michigan School Bond Loan Fund. Other than the aforementioned investments, at December 31, 2019 and

December 31, 2018, there were no holdings of securities of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10% of shareholders' equity.

The securities available-for-sale presented in the following tables are reported at amortized cost and by contractual maturity as of December 31, 2019 and December 31, 2018. Actual timing may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Additionally, residential mortgage-backed securities and collateralized mortgage obligations receive monthly principal payments, which are not reflected below. The yields below are calculated on a tax equivalent basis.

	December 31, 2019							
	One year or less		One to five years		Five to ten years		After ten years	
(Dollars in thousands)	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield
Securities available-for-sale:								
State and political subdivision	$ 1,375	2.25%	$ 3,747	2.24%	$ 18,566	2.95%	$ 65,616	3.38%
Mortgage-backed securities: residential	—	—	153	0.93	143	2.07	10,313	2.84
Mortgage-backed securities: commercial	431	0.99	4,874	2.27	1,435	2.65	1,827	3.64
Collateralized mortgage obligations: residential	—	—	—	—	727	2.15	7,814	2.11
Collateralized mortgage obligations: commercial	—	—	9,031	2.87	4,371	2.83	9,489	2.39
U.S. Treasury	—	—	1,976	2.06	—	—	—	—
SBA	—	—	—	—	8,706	2.59	13,345	2.49
Asset backed securities	—	—	—	—	—	—	10,390	2.59
Corporate bonds	1,006	2.44	1,024	4.43	—	—	—	—
Total securities available-for-sale	$ 2,812	2.13%	$ 20,805	2.60%	$ 33,948	2.81%	$ 118,794	3.01%

	December 31, 2018							
	One year or less		One to five years		Five to ten years		After ten years	
(Dollars in thousands)	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield
Securities available-for-sale:								
U.S. government sponsored agency obligations	$ —	—%	$ —	—%	$ 2,404	3.09%	$ —	—%
State and political subdivision	181	2.02	6,273	2.16	16,329	2.91	52,310	3.41
Mortgage-backed securities: residential	—	—	235	1.21	183	2.33	9,696	2.84
Mortgage-backed securities: commercial	—	—	6,124	2.30	5,016	2.91	1,454	3.46
Collateralized mortgage obligations: residential	—	—	—	—	837	2.09	18,079	3.22
Collateralized mortgage obligations: commercial	—	—	9,772	2.90	10,047	3.27	12,571	2.49
U.S. Treasury	—	—	21,232	1.53	—	—	—	—
SBA	—	—	—	—	1,664	3.17	14,192	3.21
Asset backed securities	—	—	—	—	—	—	3,872	3.04
Corporate bonds	1,501	2.04	10,034	3.43	2,471	3.75	—	—
Total securities available-for-sale	$ 1,682	2.04%	$ 53,670	2.29%	$ 38,951	3.06%	$ 112,174	3.19%

Loans

Our loan portfolio represents a broad range of borrowers comprised of commercial real estate, commercial and industrial, residential real estate, and consumer financing loans.

Commercial real estate loans consist of term loans secured by a mortgage lien on the real property, such as office and industrial buildings, retail shopping centers and apartment buildings, as well as commercial real estate construction loans that are offered to builders and developers. Commercial real estate loans are then segregated into two classes: non-owner occupied and owner occupied commercial real estate loans. Non-owner occupied loans, which include loans secured by non-owner occupied and nonresidential properties, generally have a greater risk profile than owner-occupied loans, which include loans secured by multifamily structures and owner-occupied commercial structures.

Commercial and industrial loans include financing for commercial purposes in various lines of businesses, including manufacturing, service industry and professional service areas. Commercial and industrial loans are generally secured with the assets of the company and/or the personal guarantee of the business owners.

Residential real estate loans represent loans to consumers for the purchase or refinance of a residence. These loans are generally financed over a 15- to 30-year term and, in most cases, are extended to borrowers to finance their primary residence with both fixed-rate and adjustable-rate terms. Real estate construction loans are also offered to consumers who wish to build their own homes and are often structured to be converted to permanent loans at the end of the construction phase, which is typically twelve months. Residential real estate loans also include home equity loans and lines of credit that are secured by a first- or second-lien on the borrower's residence. Home equity lines of credit consist mainly of revolving lines of credit secured by residential real estate.

Consumer loans include loans made to individuals not secured by real estate, including loans secured by automobiles or watercraft, and personal unsecured loans.

The following table details our loan portfolio by loan type at the dates presented:

	As of December 31,				
(Dollars in thousands)	**2019**	**2018**	**2017**	**2016**	**2015**
Commercial real estate:					
Non-owner occupied	**$ 388,515**	$ 367,671	$ 343,420	$ 322,354	$ 240,161
Owner occupied	**216,131**	194,422	168,342	169,348	146,487
Total commercial real estate	**604,646**	562,093	511,762	491,702	386,648
Commercial and industrial	**410,228**	383,455	377,686	342,069	254,808
Residential real estate	**211,839**	180,018	144,439	118,730	116,734
Consumer	**896**	999	1,036	892	1,528
Total loans	**$ 1,227,609**	$ 1,126,565	$ 1,034,923	$ 953,393	$ 759,718

Total loans were $1.23 billion at December 31, 2019, an increase of $101.0 million from December 31, 2018. The total increase in loans from December 31, 2018 was primarily due to an increase in commercial real estate loans of $42.6 million, commercial and industrial loans of $26.8 million and residential real estate of $31.8 million. In general, we target a loan portfolio mix of approximately one-half commercial real estate, approximately one-third commercial and industrial loans and one-sixth a mix of residential real estate and consumer loans. As of December 31, 2019, approximately 49.3% of our loans were commercial real estate, 33.4% were commercial and industrial, and 17.3% were residential real estate and consumer loans.

We originate both fixed and adjustable rate residential real estate loans conforming to the underwriting guidelines of Fannie Mae and Freddie Mac, as well as home equity loans and lines of credit that are secured by first or junior liens. Most of our fixed rate residential loans, along with some of our adjustable rate mortgages, are sold to other financial institutions with which we have established a correspondent lending relationship. The Company has established a direct relationship with Fannie Mae and began locking and selling loans to Fannie Mae during the third quarter of 2019.

Loan Maturity/Rate Sensitivity

The following table shows the contractual maturities of our loans as of December 31, 2019.

(Dollars in thousands)	One year or less	After one but within five years	After five years	Total
December 31, 2019				
Commercial real estate	$ 63,365	$ 374,895	$ 166,386	$ 604,646
Commercial and industrial	149,312	180,080	80,836	410,228
Residential real estate	2,770	5,316	203,753	211,839
Consumer	34	650	212	896
Total loans	$ 215,481	$ 560,941	$ 451,187	$ 1,227,609
Sensitivity of loans to changes in interest rates:				
Fixed interest rates		$ 452,057	$ 161,927	
Floating interest rates		108,884	289,260	
Total		$ 560,941	$ 451,187	

Summary of Impaired Assets and Past Due Loans

Nonperforming assets consist of nonaccrual loans and other real estate owned. We do not consider performing troubled debt restructurings (TDRs) to be nonperforming assets, but they are included as part of impaired assets. The level of nonaccrual loans is an important element in assessing asset quality. Loans are classified as nonaccrual when, in the opinion of management, collection of principal or interest is not expected according to the terms of the agreement. Generally, loans are placed on nonaccrual status due to the continued failure by the borrower to adhere to contractual payment terms coupled with other pertinent factors, such as insufficient collateral value.

A loan is categorized as a troubled debt restructuring if a concession is granted, such as to provide for the reduction of either interest or principal, due to deterioration in the financial condition of the borrower. Typical concessions include reduction of the interest rate on the loan to a rate considered lower than the current market rate, forgiveness of a portion of the loan balance, extension of the maturity date, and/or modifications from principal and interest payments to interest-only payments for a certain period. Loans are not classified as TDRs when the modification is short-term or results in only an insignificant delay or shortfall in the payments to be received.

***Credit Quality Indicators*:**

The Company 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 Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes commercial and industrial and commercial real estate loans and is performed on an annual basis. The Company uses the following definitions for risk ratings:

Pass. Loans classified as pass are higher quality loans that do not fit any of the other categories described below. This category includes loans risk rated with the following ratings: cash/stock secured, excellent credit risk, superior credit risk, good credit risk, satisfactory credit risk, and marginal credit risk.

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 Company'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 Company 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, conditions, and values, highly questionable and improbable.

For residential real estate loans and consumer loans, the Company evaluates credit quality based on the aging status of the loan and by payment activity. Residential real estate loans and consumer loans are considered nonperforming if they are 90

days or more past due. Consumer loan types are continuously monitored for changes in delinquency trends and other asset quality indicators.

Purchased credit impaired loans accounted for under ASC 310-30 are classified as performing, even though they may be contractually past due, as any nonpayment of contractual principal or interest is considered in the semi-annual re-estimation of expected cash flows and is included in the resulting recognition of current period loan loss provision or future period yield adjustments.

Total classified and criticized loans as of December 31, 2019 compared to December 31, 2018 were as follows:

(Dollars in thousands)	December 31, 2019	December 31, 2018
Classified loans:		
Substandard	**$ 20,569**	$ 18,391
Doubtful	**1,838**	44
Total classified loans	**$ 22,407**	$ 18,435
Special mention	**17,292**	13,081
Total classified and criticized loans	**$ 39,699**	$ 31,516

A summary of nonperforming assets (defined as nonaccrual loans and other real estate owned), performing troubled debt restructurings and loans 90 days or more past due and still accruing, as of the dates indicated, are presented below.

	As of December 31,				
(Dollars in thousands)	2019	2018	2017	2016	2015
Nonaccrual loans					
Commercial real estate	**$ 4,832**	$ 5,927	$ 2,257	$ 147	$ 141
Commercial and industrial	**11,112**	9,605	9,024	13,389	309
Residential real estate	**2,569**	2,915	2,767	1,498	1,177
Consumer	**16**	—	—	—	—
Total nonaccrual loans[1]	**18,529**	18,447	14,048	15,034	1,627
Other real estate owned	**921**	—	652	258	81
Total nonperforming assets	**19,450**	18,447	14,700	15,292	1,708
Performing troubled debt restructurings					
Commercial real estate	**—**	—	—	290	—
Commercial and industrial	**547**	568	961	1,018	1,069
Residential real estate	**359**	363	261	207	279
Total performing troubled debt restructurings	**906**	931	1,222	1,515	1,348
Total impaired assets, excluding ASC 310-30 loans	**$ 20,356**	$ 19,378	$ 15,922	$ 16,807	$ 3,056
Loans 90 days or more past due and still accruing	**$ 157**	$ 243	$ 440	$ 377	$ 883

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[1] Nonaccrual loans include nonperforming troubled debt restructurings of $3.0 million, $5.0 million, $6.4 million, $5.8 million, and $564 thousand at the respective dates indicated above.

During the years ended December 31, 2019 and 2018, the Company recorded $865 thousand and $394 thousand, respectively, of interest income on nonaccrual loans and performing TDRs excluding PCI loans.

In addition to nonperforming and impaired assets, the Company had purchased credit impaired loans accounted for under ASC 310-30 which amounted to $6.0 million, $7.9 million, $9.7 million, $11.6 million, and $17.6 million at the respective dates indicated in the table above.

Impaired assets increased $1.0 million as of December 31, 2019 compared to December 31, 2018. Commercial and industrial nonaccrual loans increased by $1.5 million, commercial real estate nonaccrual loans decreased by $1.1 million and

residential real estate nonaccrual loans decreased by $346 thousand. The increase in nonaccrual loans is primarily due to three commercial loan relationships totaling $12.8 million moving to nonaccrual status. This was partially offset by the payoff of three large commercial loan relationships on nonaccrual status totaling $12.4 million. There was also an increase of $921 thousand in other real estate owned due to the addition of two residential properties and one commercial property during 2019.

Allowance for Loan Losses

We maintain the allowance for loan losses at a level we believe is sufficient to absorb probable incurred losses in our loan portfolio given the conditions at the time. Management determines the adequacy of the allowance based on periodic evaluations of the loan portfolio and other factors. These evaluations are inherently subjective as they require management to make material estimates, all of which may be susceptible to significant change. The allowance is increased by provisions charged to expense and decreased by actual charge-offs, net of recoveries.

Purchased Loans

The allowance for loan losses on purchased loans is based on credit deterioration subsequent to the acquisition date. In accordance with the accounting guidance for business combinations, there was no allowance brought forward on any of the acquired loans as any credit deterioration evident in the loans was included in the determination of the fair value of the loans at the acquisition date. For purchased credit impaired loans, accounted for under ASC 310-30, management establishes an allowance for credit deterioration subsequent to the date of acquisition by re-estimating expected cash flows on a semi-annual basis with any decline in expected cash flows recorded as provision for loan losses. Impairment is measured as the excess of the recorded investment in a loan over the present value of expected future cash flows discounted at the pre-impairment accounting yield of the loan. For increases in cash flows expected to be collected, we first reverse any previously recorded allowance for loan losses, then adjust the amount of accretable yield recognized on a prospective basis over the loan's remaining life. These cash flow evaluations are inherently subjective as they require material estimates, all of which may be susceptible to significant change. For non-purchased credit impaired loans acquired in our acquisitions that are accounted for under ASC 310-20, the historical loss estimates are based on the historical losses experienced since acquisition. We record an allowance for loan losses only when the calculated amount exceeds the discount remaining from acquisition that was established for the similar period covered in the allowance for loan loss calculation. For all other purchased loans, the allowance is calculated in accordance with the methods used to calculate the allowance for loan losses for originated loans, as described below.

Originated Loans

The allowance for loan losses represents management's assessment of probable credit losses inherent in the loan portfolio. The allowance for loan losses consists of specific components, based on individual evaluation of certain loans, and general components for homogeneous pools of loans with similar risk characteristics.

Impaired loans include loans placed on nonaccrual status and troubled debt restructurings. Loans are considered impaired when based on current information and events it is probable that we will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreements. When determining if we will be unable to collect all principal and interest payments due in accordance with the original contractual terms of the loan agreement, we consider the borrower's overall financial condition, resources and payment record, support from guarantors, and the realizable value of any collateral. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

All impaired loans are identified to be individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the discounted expected future cash flows or at the fair value of collateral if repayment is collateral dependent.

The allowance for our nonimpaired loans, which includes commercial real estate, commercial and industrial, residential real estate, and consumer loans that are not individually evaluated for impairment, begins with a process of estimating the probable incurred losses in the portfolio. These estimates are established based on our historical loss data. Additional allowance estimates for commercial and industrial and commercial real estate loans are based on internal credit risk ratings. Internal credit risk ratings are assigned to each business loan at the time of approval and are subjected to subsequent periodic reviews by senior management, at least annually or more frequently upon the occurrence of a circumstance that affects the credit risk of the loan.

The Company's current methodology on historical loss analysis incorporates and fully relies on the Company's own historical loss data. The historical loss estimates are established by loan type including commercial real estate, commercial and industrial, residential real estate, and consumer. In addition, consideration is given to the borrower's rating for commercial and industrial and commercial real estate loans.

The following table presents, by loan type, the changes in the allowance for loan losses for the periods presented.

	For the year ended December 31,				
(Dollars in thousands)	**2019**	**2018**	**2017**	**2016**	**2015**
Balance at beginning of period	**$ 11,566**	$ 11,713	$ 11,089	$ 7,890	$ 5,589
Loan charge-offs:					
Commercial real estate	**(92)**	(112)	(360)	—	(26)
Commercial and industrial	**(438)**	(1,283)	(697)	(943)	(427)
Residential real estate	**—**	(47)	(85)	(211)	(50)
Consumer	**(106)**	(35)	—	—	(16)
Total loan charge-offs	**(636)**	(1,477)	(1,142)	(1,154)	(519)
Recoveries of loans previously charged-off:					
Commercial real estate	**6**	23	17	53	552
Commercial and industrial	**246**	823	190	172	665
Residential real estate	**77**	70	141	201	181
Consumer	**32**	2	2	2	63
Total loan recoveries	**361**	918	350	428	1,461
Net (charge-offs) recoveries	**(275)**	(559)	(792)	(726)	942
Provision expense for loan losses	**1,383**	412	1,416	3,925	1,359
Balance at end of period	**$ 12,674**	$ 11,566	$ 11,713	$ 11,089	$ 7,890
Allowance for loan losses as a percentage of period-end loans	**1.03%**	1.03%	1.13%	1.16%	1.04 %
Net charge-offs (recoveries) to average loans	**0.02**	0.05	0.08	0.08	(0.14)

Our allowance for loan losses was $12.7 million, or 1.03% of loans, at December 31, 2019 compared to $11.6 million, or 1.03% of loans, at December 31, 2018. The $1.1 million increase in the allowance for loan losses during the year ended December 31, 2019 was primarily due to a $1.4 million increase in general reserves related to organic loan growth, partially offset by a $158 thousand decrease in reserves related to purchase credit impaired loans and $137 thousand decrease in specific reserves related to impaired loans.

The following table presents, by loan type, the allocation of the allowance for loan losses at the dates presented.

(Dollars in thousands)	Allocated Allowance	Percentage of loans in each category to total loans
December 31, 2019		
Balance at end of period applicable to:		
Commercial real estate	**$ 5,773**	49.2%
Commercial and industrial	**5,515**	33.4
Residential real estate	**1,384**	17.3
Consumer	**2**	0.1
Total loans	**$ 12,674**	100.0%
December 31, 2018		
Balance at end of period applicable to:		
Commercial real estate	$ 5,227	49.9%
Commercial and industrial	5,174	34.0
Residential real estate	1,164	16.0
Consumer	1	0.1
Total loans	$ 11,566	100.0%
December 31, 2017		
Balance at end of period applicable to:		
Commercial real estate	$ 4,852	49.4%
Commercial and industrial	5,903	36.5
Residential real estate	950	14.0
Consumer	8	0.1
Total loans	$ 11,713	100.0%
December 31, 2016		
Balance at end of period applicable to:		
Commercial real estate	$ 4,124	51.5%
Commercial and industrial	5,932	35.9
Residential real estate	1,030	12.5
Consumer	3	0.1
Total loans	$ 11,089	100.0%
December 31, 2015		
Balance at end of period applicable to:		
Commercial real estate	$ 3,299	50.9%
Commercial and industrial	3,256	33.5
Residential real estate	1,307	15.4
Consumer	28	0.2
Total loans	$ 7,890	100.0%

Deposits

Total deposits were $1.14 billion at December 31, 2019 and $1.13 billion at December 31, 2018, representing 80.3% and 89.7% of total liabilities, respectively. The increase in deposits of $793 thousand was due to increases of $26.3 million in money market and savings deposits and $26.3 million in demand deposits, partially offset by a decrease of $51.8 million in time deposits. Our average interest-bearing deposit costs were 1.88% and 1.38% for the years ended December 31, 2019 and 2018, respectively. The increase in interest-bearing deposit costs between the two periods was impacted by the changing mix of deposit types, as well as by the increase in overnight market rates, as measured by the target federal funds rate. The target federal funds rate rose 0.25% every quarter during 2018 and decreased 0.75% during the second half of the year ended December 31, 2019.

Brokered deposits. Brokered deposits are marketed through national brokerage firms to their customers in $1,000 increments. For these brokered deposits, detailed records of owners are maintained by the Depository Trust Company under the name of CEDE & Co. This relationship provides a large source of deposits for the Company. Due to the competitive nature of the brokered deposit market, brokered deposits tend to bear higher rates of interest than non-brokered deposits. At

December 31, 2019 and December 31, 2018, the Company had approximately $67.4 million and $110.3 million in brokered deposits, respectively. The Company's ability to accept, roll-over or renew brokered deposits is contingent upon the Bank maintaining a capital level of "well-capitalized."

For periods prior to September 30, 2018, Certificate of Deposit Account Registry Service (CDARS) and reciprocal money market accounts were considered to be brokered deposits by regulatory authorities and were reported as such on quarterly Call Reports. With the passage of The Economic Growth, Regulatory Relief and Consumer Protection Act in May 2018, these items are no longer considered brokered deposits. Included in the brokered deposits total at December 31, 2019 and December 31, 2018 were $514 thousand and $1.8 million in CDARS customer deposit accounts, respectively. The $514 thousand at December 31, 2019 was due to an early withdrawal from a CDARS customer deposit account in the first quarter of 2018 that will be paid at maturity.

Management understands the importance of core deposits as a stable source of funding and may periodically implement various deposit promotion strategies to encourage core deposit growth. For periods of rising interest rates, management has modeled the aggregate yields for non-maturity deposits and time deposits to increase at a slower pace than the increase in underlying market rates, which is intended to result in net interest margin expansion and an increase in net interest income.

The following table sets forth the distribution of average deposits by account type for the periods indicated below.

	Year Ended December 31, 2019		
(Dollars in thousands)	**Average Balance**	**Percent**	**Average Rate**
Noninterest-bearing demand deposits	**$ 321,487**	**26.3%**	**—%**
Interest-bearing demand deposits	**57,480**	**4.7**	**0.49**
Money market and savings deposits	**314,918**	**25.8**	**1.43**
Time deposits	**527,605**	**43.2**	**2.30**
Total deposits	**$ 1,221,490**	**100.0%**	**1.39%**

	Year Ended December 31, 2018		
(Dollars in thousands)	**Average Balance**	**Percent**	**Average Rate**
Noninterest-bearing demand deposits	$ 316,764	28.3%	—%
Interest-bearing demand deposits	60,203	5.4	0.33
Money market and savings deposits	264,656	23.6	0.99
Time deposits	477,164	42.7	1.73
Total deposits	$ 1,118,787	100.0%	0.99%

	Year Ended December 31, 2017		
(Dollars in thousands)	**Average Balance**	**Percent**	**Average Rate**
Noninterest-bearing demand deposits	$ 301,971	30.3%	—%
Interest-bearing demand deposits	59,274	6.0	0.29
Money market and savings deposits	259,449	26.1	0.62
Time deposits	373,762	37.6	1.20
Total deposits	$ 994,456	100.0%	0.63%

The following table shows the contractual maturity of time deposits, including CDARs and IRA deposits and other brokered funds, of $100 thousand and over that were outstanding as of the date presented.

(Dollars in thousands)	December 31, 2019
Maturing in:	
3 months or less	$ **121**
3 months to 6 months	**97,420**
6 months to 1 year	**99,078**
1 year or greater	**127,288**
Total	$ **323,907**

Borrowings

Total debt outstanding at December 31, 2019 was $256.7 million, an increase of $142.2 million from $114.5 million at December 31, 2018. The increase in total borrowings was primarily due to increases of $145.0 million in long-term FHLB advances and $29.5 million in subordinated notes, partially offset by a decrease of $30.0 million in short-term FHLB advances and $2.5 million in our FHLB line of credit. The increase in total borrowings as well as the issuance of the $30.0 million subordinated notes reflected management's efforts to fund the liquidity needs of the Company.

At December 31, 2019, FHLB advances were secured by a blanket lien on $408.9 million of real estate-related loans, and repurchase agreements were secured by securities with a fair value of $1.2 million. At December 31, 2018, FHLB advances were secured by a blanket lien on $372.5 million of real estate-related loans, and repurchase agreements were secured by securities with a fair value of $1.0 million.

As of December 31, 2019, the Company had $45.0 million of subordinated notes outstanding and debt issuance costs of $560 thousand related to these subordinated notes. As of December 31, 2018, the Company had $15.0 million of subordinated notes outstanding and debt issuance costs of $109 thousand related to these subordinated notes.

The $15.0 million of subordinated notes issued on December 21, 2015 bear a fixed interest rate of 6.375% per annum, payable semiannually through December 15, 2020. The notes will bear a floating interest rate of three-month LIBOR plus 477 basis points payable quarterly after December 15, 2020 through maturity. The notes mature no later than December 15, 2025, and the Company has the option to redeem or prepay any or all of the subordinated notes without premium or penalty any time after December 15, 2020 or upon an occurrence of a Tier 2 capital event or tax event.

The $30.0 million of subordinated notes issued on December 18, 2019 bear a fixed interest rate of 4.75% per annum, payable semiannually through December 18, 2024. The notes will bear a floating interest rate of three-month SOFR plus 311 basis points payable quarterly after December 18, 2024 through maturity. The notes mature no later than December 18, 2029, and the Company has the option to redeem any or all of the subordinated notes without premium or penalty any time after December 18, 2024 or upon the occurrence of a Tier 2 capital event or tax event.

Selected financial information pertaining to the components of our short-term borrowings for the periods and as of the dates indicated is as follows:

	For the year ended December 31,		
(Dollars in thousands)	**2019**	**2018**	**2017**
Securities sold under agreements to repurchase			
Average daily balance	**$ 547**	$ 4,210	$ 971
Weighted-average rate during period	**0.30%**	1.83%	0.30%
Amount outstanding at period end	**$ 851**	$ 609	$ 1,319
Weighted-average rate at period end	**0.30%**	0.30%	0.30%
Maximum month-end balance	**$ 866**	$ 12,847	$ 1,533
FHLB Advances			
Average daily balance	**$ 26,952**	$ 47,581	$ 64,095
Weighted-average rate during period	**2.32%**	2.04%	0.96%
Amount outstanding at period end	**$ 60,000**	$ 90,000	$ 35,000
Weighted-average rate at period end	**1.61%**	2.54%	1.25%
Maximum month-end balance	**$ 95,000**	$ 125,000	$ 120,000
FHLB Line of Credit			
Average daily balance	**$ 93**	$ 3,279	$ 4,223
Weighted-average rate during period	**2.85%**	2.10%	1.31%
Amount outstanding at period end	**$ —**	$ 2,520	$ —
Weighted-average rate at period end	**—%**	2.87%	—%
Maximum month-end balance	**$ 895**	$ 37,081	$ 27,459
Federal funds purchased			
Average daily balance	**$ 1,679**	$ 873	$ —
Weighted-average rate during period	**2.75%**	2.52%	—%
Amount outstanding at period end	**$ 5,000**	$ 5,000	$ —
Weighted-average rate at period end	**1.90%**	2.50%	—%
Maximum month-end balance	**$ 15,000**	$ 15,000	$ —

Capital Resources

Shareholders' equity is influenced primarily by earnings, dividends, the Company's sales and repurchases of its common stock and changes in accumulated other comprehensive income caused primarily by fluctuations in unrealized gains or losses, net of taxes, on available for sale securities.

Shareholders' equity increased $18.9 million to $170.7 million at December 31, 2019 as compared to $151.8 million at December 31, 2018. The increase in shareholders' equity was primarily impacted by $16.1 million of net income generated during the year ended December 31, 2019 as well as an increase of $5.3 million of other comprehensive income due to increases in net unrealized gains on available-for-sale securities, partially offset by $2.2 million of stock repurchased through the share buyback program and $1.2 million of dividends declared on our common stock during the year ended December 31, 2019.

The following table summarizes the changes in our shareholders' equity for the periods indicated below:

(Dollars in thousands)	For the year ended December 31, 2019	2018	2017
Balance at beginning of period	**$ 151,760**	$ 107,960	$ 96,571
Net income	**16,111**	14,386	9,841
Other comprehensive income (loss)	**5,344**	(801)	343
Initial public offering of 1,150,765 shares of common stock, net of issuance costs	**—**	29,030	—
Redeemed stock	**(2,165)**	—	—
Dividends declared	**(1,236)**	(895)	—
Exercise of stock options	**219**	1,279	605
Stock-based compensation expense	**670**	801	600
Balance at end of period	**$ 170,703**	$ 151,760	$ 107,960

We strive to maintain an adequate capital base to support our activities in a safe and sound manner while at the same time attempting to maximize shareholder value. We assess capital adequacy against the risk inherent in our balance sheet, recognizing that unexpected loss is the common denominator of risk and that common equity has the greatest capacity to absorb unexpected loss.

We are subject to various regulatory capital requirements both at the Company and at the Bank level. Failure to meet minimum capital requirements could result in certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have an adverse material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting policies. We have consistently maintained regulatory capital ratios at or above the well-capitalized standards.

The Basel III Rule requires the Company and the Bank to maintain a capital conservation buffer of common equity capital of greater than 2.5% above the minimum risk-weighted assets ratios, which is the fully phased-in amount of the capital conservation buffer. The capital conservation buffer requirement was 2.5% as of December 31, 2019 and 1.875% as of December 31, 2018, which is reflected in the table below.

At December 31, 2019, the Company and the Bank met all the capital adequacy requirements to which they were subject.

The summary below compares the actual capital ratios with the minimum quantitative measures established by regulation to ensure capital adequacy:

	Actual Capital Ratio	Capital Adequacy Regulatory Requirement	Capital Adequacy Regulatory Requirement + Capital Conservation Buffer(1)	Well Capitalized Regulatory Requirement
December 31, 2019				
Common equity tier 1 to risk-weighted assets:				
Consolidated	**11.72%**	**4.50%**	**7.00%**	
Bank	**12.27%**	**4.50%**	**7.00%**	**6.50%**
Tier 1 capital to risk-weighted assets:				
Consolidated	**11.72%**	**6.00%**	**8.50%**	
Bank	**12.27%**	**6.00%**	**8.50%**	**8.00%**
Total capital to risk-weighted assets:				
Consolidated	**15.99%**	**8.00%**	**10.50%**	
Bank	**13.24%**	**8.00%**	**10.50%**	**10.00%**
Tier 1 capital to average assets (leverage ratio):				
Consolidated	**10.41%**	**4.00%**	**4.00%**	
Bank	**10.96%**	**4.00%**	**4.00%**	**5.00%**
December 31, 2018				
Common equity tier 1 to risk-weighted assets:				
Consolidated	11.82%	4.50%	6.38%	
Bank	12.12%	4.50%	6.38%	6.50%
Tier 1 capital to risk-weighted assets:				
Consolidated	11.82%	6.00%	7.88%	
Bank	12.12%	6.00%	7.88%	8.00%
Total capital to risk-weighted assets:				
Consolidated	14.00%	8.00%	9.88%	
Bank	13.07%	8.00%	9.88%	10.00%
Tier 1 capital to average assets (leverage ratio):				
Consolidated	10.21%	4.00%	4.00%	
Bank	10.48%	4.00%	4.00%	5.00%

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(1) Reflects the capital conservation buffer of 2.5% and 1.875% applicable during 2019 and 2018, respectively.

Contractual Obligations

In the ordinary course of our operations, we enter into certain contractual obligations. Total contractual obligations at December 31, 2019 were $700.3 million, an increase of $93.1 million, from $607.2 million at December 31, 2018. The increase of $93.1 million was due to increases of $145.0 million in long-term FHLB advances, $29.5 million in subordinated notes net of debt issuance costs, and $2.7 million in operating lease obligations, partially offset by a decrease of $51.8 million in time deposits and $32.3 million in short-term borrowings.

The following tables present our contractual obligations as of December 31, 2019 and December 31, 2018.

	Contractual Maturities as of December 31, 2019				
(Dollars in thousands)	**Less Than One Year**	**One to Three Years**	**Three to Five Years**	**Over Five Years**	**Total**
Operating lease obligations	**$ 1,341**	**$ 2,351**	**$ 2,149**	**$ 4,736**	**$ 10,577**
Short-term borrowings	**65,851**	**—**	**—**	**—**	**65,851**
Long-term borrowings	**—**	**11,375**	**30,000**	**105,000**	**146,375**
Subordinated notes	**—**	**—**	**—**	**44,440**	**44,440**
Time deposits	**392,839**	**39,855**	**378**	**—**	**433,072**
Total	**$ 460,031**	**$ 53,581**	**$ 32,527**	**$ 154,176**	**$ 700,315**

	Contractual Maturities as of December 31, 2018				
(Dollars in thousands)	**Less Than One Year**	**One to Three Years**	**Three to Five Years**	**Over Five Years**	**Total**
Operating lease obligations	$ 1,160	$ 1,849	$ 1,628	$ 3,235	$ 7,872
Short-term borrowings	98,129	—	—	—	98,129
Long-term borrowings	—	—	1,445	—	1,445
Subordinated notes	—	—	—	14,891	14,891
Time deposits	408,408	74,055	2,409	—	484,872
Total	$ 507,697	$ 75,904	$ 5,482	$ 18,126	$ 607,209

Off-Balance Sheet Arrangements

In the normal course of business, the Company offers a variety of financial instruments with off-balance sheet risk to meet the financing needs of its customers. These financial instruments include outstanding commitments to extend credit, credit lines, commercial letters of credit and standby letters of credit. These are agreements to provide credit, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies used for loans are used to make such commitments, including obtaining collateral at exercise of the commitment.

We maintain an allowance to cover probable losses inherent in our financial instruments with off-balance sheet risk. At December 31, 2019, the allowance for off-balance sheet risk was $318 thousand, compared to $38 thousand at December 31, 2018, and was included in "Other liabilities" on our consolidated balance sheets. The increase in the allowance for off-balance sheet risk as compared to December 31, 2018 was due to a change in the assumptions within the calculation for provision of unfunded commitments, which resulted in a better representation of our line of credit utilization.

A summary of the contractual amounts of our exposure to off-balance sheet risk is as follows.

	December 31, 2019		December 31, 2018	
(Dollars in thousands)	**Fixed Rate**	**Variable Rate**	**Fixed Rate**	**Variable Rate**
Commitments to make loans	**$ 16,276**	**$ 20,128**	$ 8,608	$ 10,900
Unused lines of credit	**28,723**	**288,086**	18,672	229,490
Unused standby letters of credit and commercial letters of credit	**4,895**	**—**	3,861	232

Of the total unused lines of credit of $316.8 million at December 31, 2019, $49.8 million was comprised of undisbursed construction loan commitments. The Company expects to have sufficient access to liquidity to fund its off-balance sheet commitments.

Liquidity

Liquidity management is the process by which we manage the flow of funds necessary to meet our financial commitments on a timely basis and at a reasonable cost and to take advantage of earnings enhancement opportunities. These financial commitments include withdrawals by depositors, credit commitments to borrowers, expenses of our operations, and capital expenditures. Liquidity is monitored and closely managed by the Bank's Asset and Liability Committee (ALCO), a group of senior officers from the finance, enterprise risk management, treasury, and lending areas, as well as two board members. It is ALCO's responsibility to ensure we have the necessary level of funds available for normal operations as well as maintain a contingency funding policy to ensure that potential liquidity stress events are planned for and quickly identified, and management has plans in place to respond. ALCO has created policies which establish limits and require measurements to monitor liquidity trends, including modeling and management reporting that identifies the amounts and costs of all available funding sources. In addition, we have implemented modeling software that projects cash flows from the balance sheet under a broad range of potential scenarios, including severe changes in the economic environment.

At December 31, 2019, we had liquid assets of $257.5 million, compared to $213.7 million at December 31, 2018. Liquid assets include cash and due from banks, federal funds sold, interest-bearing deposits with banks and unencumbered securities available-for-sale.

The Bank is a member of the FHLB, which provides short- and long-term funding to its members through advances collateralized by real estate-related assets and other select collateral, most typically in the form of debt securities. The actual borrowing capacity is contingent on the amount of collateral available to be pledged to the FHLB. As of December 31, 2019, we had $205.0 million of outstanding borrowings from the FHLB, and these advances were secured by a blanket lien on $408.9 million of real estate-related loans. Based on this collateral and the approved policy limits, the Company is eligible to borrow up to an additional $103.7 million from the FHLB. Additionally, the Bank can borrow up to $130.0 million through the unsecured lines of credit it has established with nine other banks, as well as $4.9 million through a secured line with the Federal Reserve Bank.

Further, because the Bank is "well capitalized," it can accept wholesale funding up to 40% of total assets, or approximately $633.0 million, based on current policy limits at December 31, 2019. Management believed that as of December 31, 2019, we had adequate resources to fund all of our commitments.

The following liquidity ratios compare certain assets and liabilities to total deposits or total assets.

	December 31, 2019	December 31, 2018
Investment securities available-for-sale to total assets	**11.41%**	14.42%
Loans to total deposits	**108.12**	99.29
Interest-earning assets to total assets	**95.58**	95.31
Interest-bearing deposits to total deposits	**71.30**	72.73

Item 7A – Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates. Interest-rate risk is the risk to earnings and equity value arising from changes in market interest rates and arises in the normal course of business to the extent that there is a divergence between the amount of our interest-earning assets and the amount of interest-bearing liabilities that are prepaid/withdrawn, re-price, or mature in specified periods. We seek to achieve consistent growth in net interest income and equity while managing volatility arising from shifts in market interest rates. ALCO oversees market risk management, monitoring risk measures, limits, and policy guidelines for managing the amount of interest-rate risk and its effect on net interest income and capital. Our Board of Directors approves policy limits with respect to interest rate risk.

Interest Rate Risk

Interest rate risk management is an active process that encompasses monitoring loan and deposit flows complemented by investment and funding activities. Effective interest rate risk management begins with understanding the dynamic characteristics of assets and liabilities and determining the appropriate interest rate risk position given business activities, management objectives, market expectations and ALCO policy limits and guidelines.

Interest rate risk can come in a variety of forms, including repricing risk, basis risk, yield curve risk and option risk. Repricing risk is the risk of adverse consequences from a change in interest rates that arises because of differences in the timing of when those interest rate changes impact our assets and liabilities. Basis risk is the risk of adverse consequence resulting from unequal change in the spread between two or more rates for different instruments with the same maturity. Yield curve risk is the risk of adverse consequence resulting from unequal changes in the spread between two or more rates for different maturities for the same or different instruments. Option risk in financial instruments arises from embedded options such as options provided to borrowers to make unscheduled loan prepayments, options provided to debt issuers to exercise call options prior to maturity, and depositor options to make withdrawals and early redemptions.

We regularly review our exposure to changes in interest rates. Among the factors we consider are changes in the mix of interest-earning assets and interest-bearing liabilities, interest rate spreads and repricing periods. ALCO reviews, on at least a quarterly basis, our interest rate risk position.

The interest rate risk position is measured and monitored at the Bank using net interest income simulation models and economic value of equity sensitivity analysis that capture both short-term and long-term interest-rate risk exposure.

Modeling the sensitivity of net interest income and the economic value of equity to changes in market interest rates is highly dependent on numerous assumptions incorporated into the modeling process. The models used for these measurements rely on estimates of the potential impact that changes in interest rates may have on the value and prepayment speeds on all components of our loan portfolio, investment portfolio, as well as embedded options and cash flows of other assets and liabilities. Balance sheet growth assumptions are also included in the simulation modeling process. The analysis provides a framework as to what our overall sensitivity position is as of our most recent reported position and the impact that potential changes in interest rates may have on net interest income and the economic value of our equity.

Net interest income simulation involves forecasting net interest income under a variety of interest rate scenarios including instantaneous shocks.

The estimated impact on our net interest income as of December 31, 2019 and December 31, 2018, assuming immediate parallel moves in interest rates is presented in the table below. The main driver of the changes noted between the two periods below is due to the adoption of ASU No. 2016-01 and the incorporation of exit pricing into the net interest income model as of December 31, 2019.

	December 31, 2019		December 31, 2018	
Change in rates	Following 12 months	Following 24 months	Following 12 months	Following 24 months
+400 basis points	**5.8 %**	**1.9 %**	1.8 %	(1.0)%
+300 basis points	**5.2**	**2.6**	1.8	(0.2)
+200 basis points	**4.2**	**2.7**	1.5	0.4
+100 basis points	**2.7**	**2.1**	1.3	0.8
-100 basis points	**(4.0)**	**(3.9)**	(0.9)	(0.8)

Management strategies may impact future reporting periods, as our actual results may differ from simulated results due to the timing, magnitude, and frequency of interest rate changes, the difference between actual experience and the characteristics assumed, as well as changes in market conditions. Market-based prepayment speeds are factored into the analysis for loan and securities portfolios. Rate sensitivity for transactional deposit accounts is modeled based on both historical experience and external industry studies.

We use economic value of equity sensitivity analysis to understand the impact of interest rate changes on long-term cash flows, income, and capital. Economic value of equity is based on discounting the cash flows for all balance sheet instruments under different interest rate scenarios. Deposit premiums are based on external industry studies and utilizing historical experience.

The table below presents the change in our economic value of equity as of December 31, 2019 and December 31, 2018, assuming immediate parallel shifts in interest rates.

Change in rates	December 31, 2019	December 31, 2018
+400 basis points	**(39.4)%**	(38.1)%
+300 basis points	**(28.4)**	(28.5)
+200 basis points	**(17.8)**	(18.3)
+100 basis points	**(8.1)**	(8.4)
-100 basis points	**6.6**	7.9

Item 8 - Financial Statements and Supplementary Data

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Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors
Level One Bancorp, Inc.

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheet of Level One Bancorp, Inc. (the Company) as of December 31, 2019; the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the year ended December 31, 2019; and the related notes (collectively referred to as the financial statements). In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and the results of its operations and its cash flows for the year ended December 31, 2019 in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on the Company's financial statements based on our audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting in accordance with the PCAOB. As part of our audit, we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion in accordance with the standards of the PCAOB.

Our audit included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Report on Prior Year Financial Statements

The financial statements of Level One Bancorp, Inc. as of and for the years ended December 31, 2018 and 2017 were audited by other auditors, whose report dated March 22, 2019 expressed an unqualified opinion on those statements.

Plante & Moran, PLLC

We have served as the Company's auditor since 2019.
Auburn Hills, Michigan
March 13, 2020

Crowe LLP
Independent Member Crowe Global

Report of Independent Registered Public Accounting Firm

Shareholders and the Board of Directors of Level One Bancorp, Inc.
Farmington Hills, Michigan

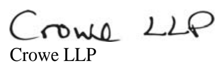
Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheet of Level One Bancorp, Inc. (the "Company") as of December 31, 2018, the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the years ended December 31, 2018 and 2017, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018, and the results of its operations and its cash flows for the years ended December 31, 2018 and 2017, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.


Crowe LLP

We have served as the Company's auditor from 2007 to 2019.

South Bend, Indiana
March 22, 2019

LEVEL ONE BANCORP, INC.

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	December 31, 2019	December 31, 2018
Assets		
Cash and cash equivalents	**$ 103,930**	$ 33,296
Securities available-for-sale	**180,905**	204,258
Federal Home Loan Bank stock	**11,475**	8,325
Mortgage loans held for sale, at fair value	**13,889**	5,595
Loans:		
Originated loans	**1,158,138**	1,041,898
Acquired loans	**69,471**	84,667
Total loans	**1,227,609**	1,126,565
Less: Allowance for loan losses	**(12,674)**	(11,566)
Net loans	**1,214,935**	1,114,999
Premises and equipment, net	**13,838**	13,242
Goodwill	**9,387**	9,387
Other intangible assets, net	**376**	447
Bank-owned life insurance	**12,167**	11,866
Income tax benefit	**1,217**	2,467
Other assets	**22,780**	12,333
Total assets	**$ 1,584,899**	$ 1,416,215
Liabilities		
Deposits:		
Noninterest-bearing demand deposits	**$ 325,885**	$ 309,384
Interest-bearing demand deposits	**62,586**	52,804
Money market and savings deposits	**313,885**	287,575
Time deposits	**433,072**	484,872
Total deposits	**1,135,428**	1,134,635
Borrowings	**212,225**	99,574
Subordinated notes	**44,440**	14,891
Other liabilities	**22,103**	15,355
Total liabilities	**1,414,196**	1,264,455
Shareholders' equity		
Common stock, no par value per share:		
Authorized—20,000,000 shares		
Issued and outstanding—7,715,491 shares at December 31, 2019 and 7,750,216 shares at December 31, 2018	**89,345**	90,621
Retained earnings	**77,766**	62,891
Accumulated other comprehensive income (loss), net of tax	**3,592**	(1,752)
Total shareholders' equity	**170,703**	151,760
Total liabilities and shareholders' equity	**$ 1,584,899**	$ 1,416,215

See accompanying notes to the consolidated financial statements.

LEVEL ONE BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME

	For the year ended December 31,		
(In thousands, except per share data)	**2019**	**2018**	**2017**
Interest income			
Originated loans, including fees	**$ 56,956**	$ 49,076	$ 39,812
Acquired loans, including fees	**6,375**	9,186	12,231
Securities:			
Taxable	**3,509**	2,939	1,746
Tax-exempt	**2,305**	1,657	955
Federal funds sold and other	**1,303**	966	863
Total interest income	**70,448**	63,824	55,607
Interest Expense			
Deposits	**16,941**	11,055	6,267
Borrowed funds	**1,378**	1,330	797
Subordinated notes	**1,074**	1,015	1,014
Total interest expense	**19,393**	13,400	8,078
Net interest income	**51,055**	50,424	47,529
Provision expense for loan losses	**1,383**	412	1,416
Net interest income after provision for loan losses	**49,672**	50,012	46,113
Noninterest income			
Service charges on deposits	**2,547**	2,556	2,543
Net gain (loss) on sales of securities	**1,174**	(71)	208
Mortgage banking activities	**7,880**	2,330	1,698
Net gain (loss) on sale of commercial loans	**(45)**	11	146
Other charges and fees	**2,655**	2,229	1,907
Total noninterest income	**14,211**	7,055	6,502
Noninterest expense			
Salary and employee benefits	**28,775**	25,781	21,555
Occupancy and equipment expense	**4,939**	4,425	4,208
Professional service fees	**1,808**	1,672	2,314
Acquisition and due diligence fees	**539**	—	—
Marketing expense	**1,107**	1,033	930
Data processing expense	**2,374**	2,146	1,912
Printing and supplies expense	**340**	441	477
Other expense	**4,487**	4,180	4,655
Total noninterest expense	**44,369**	39,678	36,051
Income before income taxes	**19,514**	17,389	16,564
Income tax provision	**3,403**	3,003	6,723
Net income	**$ 16,111**	$ 14,386	$ 9,841
Per common share data:			
Basic earnings per common share	**$ 2.08**	$ 1.95	$ 1.54
Diluted earnings per common share	**$ 2.05**	$ 1.91	$ 1.49
Cash dividends declared per common share	**$ 0.16**	$ 0.12	$ —
Weighted average common shares outstanding—basic	**7,655**	7,377	6,388
Weighted average common shares outstanding—diluted	**7,770**	7,524	6,610

See accompanying notes to the consolidated financial statements.

LEVEL ONE BANCORP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	For the year ended December 31,		
(Dollars in thousands)	**2019**	**2018**	**2017**
Net income	**$ 16,111**	$ 14,386	$ 9,841
Other comprehensive income:			
Unrealized holding gains (losses) on securities available-for-sale arising during the period	**7,939**	(1,085)	735
Reclassification adjustment for (gains) losses included in income	**(1,174)**	71	(208)
Tax effect[1]	**(1,421)**	213	(184)
Net unrealized gains (losses) on securities available-for-sale, net of tax	**5,344**	(801)	343
Total comprehensive income, net of tax	**$ 21,455**	$ 13,585	$ 10,184

[1] Includes $247 thousand, $(15) thousand, and $73 thousand of tax expense (benefit) related to reclassification adjustment for gains included in income for the years ended December 31, 2019, 2018, and 2017, respectively.

See accompanying notes to the consolidated financial statements.

LEVEL ONE BANCORP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Dollar in thousands)	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at January 1, 2017	$ 58,306	$ 39,391	$ (1,126)	$ 96,571
Net income	—	9,841	—	9,841
Other comprehensive income	—	—	343	343
Exercise of stock options (57,506 shares)	605	—	—	605
Stock-based compensation expense, net of tax impact	600	—	—	600
Balance at December 31, 2017	$ 59,511	$ 49,232	$ (783)	$ 107,960
Net income	—	14,386	—	14,386
Other comprehensive loss	—	—	(801)	(801)
Reclass of tax reform adjustments due to early adoption of ASU 2018-02	—	168	(168)	—
Initial public offering of 1,150,765 shares of common stock, net of issuance costs	29,030	—	—	29,030
Common stock dividends declared ($0.12 per share)	—	(895)	—	(895)
Exercise of stock options (127,494 shares)	1,279	—	—	1,279
Stock-based compensation expense, net of tax impact	801	—	—	801
Balance at December 31, 2018	**$ 90,621**	**$ 62,891**	**$ (1,752)**	**$ 151,760**
Net income	**—**	**16,111**	**—**	**16,111**
Other comprehensive income	**—**	**—**	**5,344**	**5,344**
Redeemed stock (90,816 shares)	**(2,165)**	**—**	**—**	**(2,165)**
Common stock dividends declared ($0.16 per share)	**—**	**(1,236)**	**—**	**(1,236)**
Exercise of stock options (21,550 shares)	**219**	**—**	**—**	**219**
Stock-based compensation expense, net of tax impact	**670**	**—**	**—**	**670**
Balance at December 31, 2019	**$ 89,345**	**$ 77,766**	**$ 3,592**	**$ 170,703**

See accompanying notes to the consolidated financial statements.

LEVEL ONE BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)	For the year ended December 31, 2019	2018	2017
Cash flows from operating activities			
Net income	**$ 16,111**	$ 14,386	$ 9,841
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation of fixed assets	**1,323**	1,332	1,369
Amortization of core deposit intangibles	**146**	220	234
Stock-based compensation expense	**713**	815	613
Provision expense for loan losses	**1,383**	412	1,416
Net securities premium amortization	**1,735**	1,327	871
Net (gain) loss on sales of securities	**(1,174)**	71	(208)
Originations of loans held for sale	**(272,714)**	(90,361)	(64,184)
Proceeds from sales of loans	**270,363**	91,091	69,753
Net gain on sales of loans	**(7,835)**	(2,341)	(1,844)
Accretion on acquired purchase credit impaired loans	**(2,313)**	(3,794)	(5,340)
Gain on sale of other real estate owned and repossessed assets	**—**	(44)	(237)
Increase in cash surrender value of life insurance, net of 1035 exchange charge	**(301)**	(324)	(328)
Amortization of debt issuance costs	**62**	47	58
Excess tax benefits	**18**	108	27
Net (increase) decrease in accrued interest receivable and other assets	**(9,544)**	382	(1,546)
Net increase in accrued interest payable and other liabilities	**6,151**	4,810	1,667
Net cash provided by operating activities	**4,124**	18,137	12,162
Cash flows from investing activities			
Net increase in loans	**(97,660)**	(88,069)	(75,780)
Principal payments on securities available-for-sale	**16,521**	9,368	8,850
Purchases of securities available-for-sale	**(56,810)**	(68,694)	(74,225)
Purchases of FHLB Stock	**(3,150)**	(22)	(2,475)
Additions to premises and equipment	**(2,019)**	(1,159)	(913)
Proceeds from:			
Sale of securities available-for-sale	**69,846**	3,625	14,803
Sale of other real estate owned and repossessed assets	**—**	822	885
Net cash used in investing activities	**(73,272)**	(144,129)	(128,855)
Cash flows from financing activities			
Net increase in deposits	**793**	14,253	195,458
Change in short-term borrowings	**(32,278)**	61,810	(31,820)
Issuances of long-term FHLB advances	**145,000**	—	—
Repayment of long-term FHLB advances	**—**	(10,000)	(4,506)
Net proceeds from issuance of subordinated debt	**29,487**	—	—
Change in secured borrowing	**(71)**	(69)	1,514
Net proceeds from issuance of common stock related to initial public offering	**—**	29,030	—
Share buyback - redeemed stock	**(2,165)**	—	—
Common stock dividends paid	**(1,160)**	(662)	—
Proceeds from exercised stock options	**219**	1,279	605
Payments related to tax-withholding for share based compensation awards	**(43)**	(14)	(13)
Net cash provided by financing activities	**139,782**	95,627	161,238
Net change in cash and cash equivalents	**70,634**	(30,365)	44,545
Beginning cash and cash equivalents	**33,296**	63,661	19,116
Ending cash and cash equivalents	**$ 103,930**	$ 33,296	$ 63,661
Supplemental disclosure of cash flow information:			
Interest paid	**$ 19,493**	$ 12,634	$ 7,427
Taxes paid	**2,916**	2,120	4,625
Transfer from loans held for sale to loans held for investment	**2,186**	544	1,587
Transfer from loans to other real estate owned	**921**	108	385
Transfer from premises and equipment to other assets	**—**	18	1,793

See accompanying notes to the consolidated financial statements.

LEVEL ONE BANCORP, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2019

NOTE 1—BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Nature of Operations:

Level One Bancorp, Inc. (the "Company" “we,” “our,” or “us”) is a financial holding company headquartered in Farmington Hills, Michigan. As of December 31, 2019, its wholly owned bank subsidiary, Level One Bank (the "Bank"), had 14 offices, including 8 banking centers (our full service branches) in Oakland County, one banking center in each of Detroit and Grand Rapids, Michigan’s two largest cities, one banking center in Sterling Heights, one banking center in Ann Arbor and one mortgage loan production office in Ann Arbor.

The Bank is a Michigan banking corporation with depository accounts insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation (the "FDIC"). The Bank provides a wide range of business and consumer financial services in southeastern Michigan and west Michigan. Its primary deposit products are checking, interest-bearing demand, money market and savings, and term certificate accounts, and its primary lending products are commercial real estate, commercial and industrial, residential real estate, and consumer loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Commercial loans are expected to be repaid from cash flow from operations of businesses. Other financial instruments, which potentially represent concentrations of credit risk, include federal funds sold.

The Company's subsidiary, Hamilton Court Insurance Company ("Hamilton Court"), is a wholly owned insurance subsidiary of the Company that provides property and casualty insurance coverage to the Company and the Bank and reinsurance to ten other third party insurance captives for which insurance may not be currently available or economically feasible in the insurance marketplace. Hamilton Court was designed to insure the risks of the Company and the Bank by providing additional insurance coverage for deductibles, excess limits and uninsured exposures. Hamilton Court is incorporated in Nevada.

Merger with Ann Arbor Bancorp, Inc.:

On January 2, 2020, the Company completed its previously announced acquisition of Ann Arbor Bancorp, Inc. (“AAB”) and its wholly owned subsidiary, Ann Arbor State Bank. The transaction was completed pursuant to a merger of the Company’s wholly owned merger subsidiary (“Merger Sub”) with and into AAB, pursuant to the Agreement and Plan of Merger, dated as of August 12, 2019, among the Company, Merger Sub and AAB. The Company paid aggregate consideration of approximately $67.9 million in cash. The Company expects to have approximately $1.4 million in expenses related to the acquisition in the first quarter of 2020.

As of December 31, 2019, Ann Arbor State Bank had total assets of $319.4 million, total loans of $222.1 million and total deposits of $267.7 million. Refer to footnote 19, "Subsequent "Events", for further discussion on the acquisition of AAB.

Initial Public Offering:

On April 24, 2018, the Company sold 1,150,765 shares of common stock in its initial public offering, including 180,000 shares of common stock pursuant to the exercise in full by the underwriters of their option to purchase additional shares. The aggregate offering price for the shares sold by the Company was $32.2 million, and after deducting $2.1 million of underwriting discounts and $1.1 million of offering expenses paid to third parties, the Company received total net proceeds of $29.0 million from the initial public offering. In addition, certain selling shareholders participated in the offering and sold an aggregate of 229,235 shares of our common stock at an aggregate offering price of $6.4 million. The Company did not receive any proceeds from the sales of shares by the selling shareholders.

Basis of Presentation:

The accompanying consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and conform to predominant practices within the banking industry. Management of the Company has made a number of estimates and assumptions related to the reporting of assets and liabilities to prepare the consolidated financial statements in conformity with GAAP. Actual results may differ from those estimates. In the opinion of management, all adjustments, consisting of normal recurring accruals considered necessary for a fair presentation of the results of operations for annual periods presented herein, have been included. Some items in the

prior year financial statements were reclassified to conform to the current presentation. Such items had no impact on net income or shareholder's equity.

Principles of Consolidation:

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, the Bank and Hamilton Court, after elimination of significant intercompany transactions and accounts.

Business Combinations

The Company accounts for business combinations under the acquisition method of accounting. Under the acquisition method, tangible and intangible identifiable assets acquired, liabilities assumed and any noncontrolling interests in the acquiree are recorded at fair value as of the acquisition date. The Company includes the results of operations of the acquired companies in the consolidated statements of income from the date of acquisition. Transaction costs and costs to restructure the acquired company are expensed as incurred. Goodwill is recognized as the excess of the acquisition price over the estimated fair value of the net assets acquired. If the fair value of the net assets acquired is greater than the acquisition price, a bargain purchase gain is recognized and recorded in noninterest income.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, amounts due from banks, which includes amounts on deposit with the Federal Reserve, interest-bearing deposits with banks or other financial institutions and federal funds sold. Generally, federal funds are sold for one-day periods, but not longer than 30 days.

Investment Securities

Investment securities consist of debt securities of the U.S. Treasury, government sponsored entities, states, counties, municipalities, corporations, agency mortgage-backed securities and non-agency mortgage-backed securities. Securities transactions are recorded on a trade date basis. Securities are classified as available for sale when the Company intends to sell them before maturity. Available-for-sale securities are recorded at fair value. Unrealized gains and losses, net of the related tax effect, on available-for-sale securities are included in other comprehensive income and the related accumulated unrealized holding gains and losses are reported as a separate component of shareholders' equity until realized.

On a quarterly basis, the Company makes an assessment to determine whether there have been any events or circumstances to indicate that a security for which there is an unrealized loss is impaired on an other than temporary basis. This determination requires significant judgment. A decline in the fair value of any available-for-sale security below cost that is deemed other than temporary results in a charge to earnings and the establishment of a new cost basis for the security. In estimating other-than-temporary impairment ("OTTI") losses, we consider the severity and duration of the impairment; the financial condition and near-term prospects of the issuer, which for debt securities considers external credit ratings and recent downgrades; projected cash flows on covered non-agency mortgage-backed securities; and the intent and ability of the Company to hold the security for a period of time sufficient for a recovery in value. Management evaluates securities for other-than-temporary impairment more frequently when economic or market conditions warrant such an evaluation.

Interest income includes amortization of purchase premiums or discounts. Premiums and discounts on securities are amortized on the level-yield method. Gains and losses on sales are recorded on the trade date and determined using the specific identification method. Also, when applicable, realized gains and losses are reported as a reclassification adjustment, net of tax, in other comprehensive income.

Federal Home Loan Bank (FHLB) Stock

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

Loans Held for Sale

Loans held for sale consist of loans originated with the intent to sell. Loans held for sale are carried at fair value, determined individually, as of the balance sheet date. The Company believes the fair value method better reflects the economic risks associated with these loans. Fair value measurements on loans held for sale are based on quoted market prices for similar loans in the secondary market, market quotes from anticipated sales contracts and commitments, or contract prices from firm sales commitments. Fair value includes the servicing value of the loans as well as any accrued interest. The changes in the fair value of loans held for sale are reflected in mortgage banking activities on the consolidated statements of income.

Loans held for sale are sold with either servicing rights released or servicing rights retained. In addition to the Small Business Administration and United States Department of Agriculture guaranteed loans, which are sold with servicing retained, the Company started selling loans held for sale with servicing retained directly to FNMA during the third quarter of 2019. Refer to mortgage servicing rights section below for further discussion.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of unamortized deferred loan fees and costs and net of any purchase premiums and discounts. Interest income is recorded on the accrual basis in accordance with the terms of the respective loan. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income without anticipating prepayments.

Loans are considered delinquent when principal or interest payments are past due 30 days or more; delinquent loans may remain on accrual status between 30 days and 89 days past due. Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. Interest income on mortgage and commercial loans is discontinued when principal or interest payments are past due 90 days, unless the loan is well-secured and in process of collection. Consumer loans are typically charged off no later than 120 days past due. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Interest received on such loans is accounted for on the cash-basis or cost recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Certain Purchased Loans

The Company purchases individual loans and groups of loans, some of which have shown evidence of credit deterioration since origination. These purchased credit impaired (“PCI”) loans are recorded at the amount paid or at fair value at acquisition in a business combination, such that there is no carryover of the seller’s allowance for loan losses. After acquisition, losses are recognized by an increase in the provision for loan losses.

These PCI loans are accounted for individually or aggregated into pools of loans based on common risk characteristics such as credit grade, loan type, and date of origination. The Company estimates the amount and timing of expected cash flows for each purchased loan or pool, and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan or pool *(*accretable yield). The excess of the loan’s or pool’s contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

Over the life of the loan or pool, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, an impairment loss is recognized by establishing an allocation for the loan or pool in the allowance for loan losses. If the present value of expected cash flows is greater than the carrying amount, it is recognized, prospectively, as loan interest income.

Allowance for Loan Losses

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

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Loans over $250 thousand are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan’s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous

loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures.

Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings, are classified as impaired, regardless of size, and are measured for impairment based upon the present value of estimated future cash flows using the loan’s effective rate at inception or, if considered collateral dependent, based upon the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

An allowance for loan losses for purchased credit impaired loans is recorded when projected future cash flows decrease. The measurement of impairment on these loans or pools of loans is based upon the excess of the loan or pool’s carrying value over the present value of the projected future cash flows, discounted at the last accounting yield applicable to the loan or pool of loans.

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the most recent 36 months. The historical loss estimates are established by loan type including commercial and industrial and commercial real estate. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: local and national economic conditions; trends in underwriting standards and lending policies; trends in portfolio volume, maturity and composition (impact of credit concentrations); experience, ability and depth of lending management and staff; trends in delinquencies and nonaccruals; results of independent loan review; change in value for collateral dependent loans; high loan growth; unseasoned bank portfolio; specialized financing; and other factors (legal, regulatory, competition). The following portfolio segments have been identified:

Commercial real estate loans are secured by a mortgage lien on the real estate property. Owner-occupied real estate loans generally are considered to carry less risk than non-owner occupied real estate (properties) because the Company considers them to be less sensitive to the condition of the commercial real estate market. Repayment is based on the operations of the business. Investment real estate loans rely on rental income for loan repayment, which involves risk such as rent rollover, tenants going out of business, and competitive properties in the area. Construction and land development loans generally are considered the riskiest class of commercial real estate, due to possible cost overruns, contractor/lien issues, loss of tenant, etc. Risk of loss is managed by adherence to standard loan policies that establish certain levels of performance prior to the extension of a loan to the borrower.

Commercial and Industrial loans have varying degrees of risk, but overall are considered to have less risk than commercial real estate. These loans are generally short-term in nature and are almost always backed by collateral. Unsecured commercial loans are supported by strong borrower(s)/guarantor(s) in terms of liquidity, net worth, cash flow, etc. Collateral security of these loans is relatively liquid (i.e., accounts receivable, inventory, equipment) and readily available to cover potential loan loss. Credit risk is managed through standardized loan policies, established and authorized credit limits, portfolio management and the diversification of industries.

Consumer and Residential Real Estate loan portfolios, unlike commercial, tend to be composed of many relatively homogeneous loans. Loan repayment is based on personal cash flow. To assess the risk of a consumer loan request, loan purpose, collateral, debt to income ratio, credit bureau report, and cash flow/employment verification are analyzed. A certain level of security is provided through liens on credits supported by collateral.

Economic conditions that affect consumers in the Bank’s market have a direct impact on the credit quality of these loans. Higher levels of unemployment, lower levels of income growth and weaker economic growth are factors that may adversely impact consumer loan credit quality.

The majority of residential real estate loans originated by the Bank conform to secondary market underwriting standards and are sold within a short timeframe to unaffiliated third parties, including the future servicing rights to the loans. The credit underwriting standards for these loans require a certain level of documentation, verifications, valuations, and overall credit performance of the borrower.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Leasehold improvements are amortized over the shorter of the life of the asset or the expected term of the lease.

We periodically review the carrying value of our long-lived assets to determine if impairment has occurred or whether changes in circumstances have occurred that would require a revision to the remaining useful life. In making such determination, we evaluate the performance, on an undiscounted basis, of the underlying operations or assets which give rise to such amount.

Other Real Estate Owned ("OREO") and Repossessed Assets

Other real estate owned and repossessed assets represent properties/assets acquired through acquisition, foreclosure, repossession process or other proceedings, and are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Fair value for OREO is based on an appraisal performed upon foreclosure. Property is evaluated regularly to ensure the recorded amount is supported by its fair value less estimated costs to dispose. After the initial foreclosure appraisal, fair value is generally determined by an annual appraisal unless known events warrant adjustments to the recorded value. Revenue from the operations of OREO is included in other income in the consolidated statements of income, and expense from the operations of OREO and decreases in valuations are included in other expense in the consolidated statements of income.

Goodwill and Other Intangible Assets

Goodwill resulting from business combinations is generally determined as the excess of the fair value of the consideration transferred over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently if events and circumstances exists that indicate that a goodwill impairment test should be performed. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on our balance sheet.

Mortgage Servicing Rights

When loans are sold with servicing retained, the servicing rights are carried at the lower of the initial capitalized amount, net of accumulated amortization, or estimated fair value. The servicing rights are amortized in proportion to and over the period of estimated net servicing income.

Servicing rights are evaluated for impairment on a quarterly basis based upon the fair value obtained from an independent third party valuation model requiring the incorporation of assumptions that market participants would use in estimating future net servicing income, which include estimates of prepayment speeds, discount rate, cost to service, contractual servicing fee income, ancillary income, late fees, replacement reserves and other economic factors that are determined based on current market conditions.

Servicing fee income is recorded for fees earned for servicing loans and is based on contractual percentage of the outstanding principal or a fixed amount per loan. Servicing fees totaled $43 thousand, $117 thousand and $145 thousand for the years ended December 31, 2019, 2018 and 2017, respectively, most of which related to servicing fees earned on SBA loans sold with servicing retained during the year ended December 31, 2019.

Bank-owned Life Insurance

The Bank has purchased life insurance policies on certain key executives and senior managers. 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.

Derivatives

All derivatives are recognized on the consolidated balance sheet as a component of other assets or other liabilities at their fair value.

Customer-initiated derivatives refer to the Company utilizing interest rate derivatives to provide a service to certain qualifying customers to help facilitate their respective risk management strategies. Therefore, these derivatives are not used to manage interest rate risk in the Company's assets or liabilities. The Company generally takes offsetting positions with dealer counterparties to mitigate the valuation risk of the customer-initiated derivatives. Income primarily results in the spread between the customer derivatives and offsetting dealer positions. The gains or losses derived from changes in fair value are recognized in current earnings during the period of change in other non-interest income on the consolidated statements of income.

Commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of these mortgage loans are accounted for as freestanding derivatives. Fair values of these mortgage

derivatives are estimated based on changes in mortgage interest rates from the date the interest on the loan is locked. The Company enters into forward commitments for the future delivery of mortgage loans when interest rate locks are entered into in order to hedge the change in interest rates resulting from its commitments to fund the loans. Changes in the fair values of these derivatives are included in mortgage banking activities in the consolidated statements of income.

Secured borrowing

Transfers of financial assets that do not qualify for sale accounting are reported as secured borrowings. Accordingly, the related assets remain on the Company's balance sheet and continue to be reported and accounted for as if the transfer had not occurred. Cash proceeds from these transfers are reported as liabilities, with attributable interest expense recognized over the life of the related transactions.

Loan Commitments and Related Financial Instruments

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

Loss Contingencies

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

Stock-Based Compensation

Compensation cost is recognized for stock options and restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards as there is no market or performance metrics that must be met. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. Additionally, the Company accounts for forfeitures as they occur.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale, net of taxes and reclassifications.

Income Taxes

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

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

Transfers of Financial Assets

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

Dividend Restriction

Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the holding company or by the holding company to shareholders. The total amount of dividends which may be paid out at any date is also generally limited to retained earnings.

Operating Segments

While chief decision-makers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Operating segment results are not reviewed by senior management to make resource allocation or performance decisions. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable operating segment.

Emerging Growth Company Status:

The Company is an "emerging growth company," as defined in the Jumpstart Our Business Startups Act of 2012 (the JOBS Act). Section 107 of the JOBS Act provides that an emerging growth company can take advantage of an extended transition period when complying with new or revised accounting standards. In other words, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have elected to take advantage of this extended transition period, which means these financial statements, as well as financial statements we file in the future for as long as we remain an emerging growth company, will be subject to all new or revised accounting standards generally applicable to private companies.

Impact of Recently Adopted Accounting Standards:

Revenue Recognition

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09 "Revenue from Contracts with Customers (Topic 606)," which provides a framework for revenue recognition that replaces the existing industry and transaction specific requirements under the existing standards. ASU 2014-09 requires an entity to apply a five-step model to determine when to recognize revenue and at what amount. The model specifies that revenue should be recognized when (or as) an entity transfers control of goods or services to a customer at the amount in which the entity expects to be entitled. Depending on whether certain criteria are met, revenue should be recognized either over time, in a manner that depicts the entity's performance, or at a point in time, when control of the goods or services are transferred to the customer.

The amendments of ASU 2014-09 may be applied either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application. The Company adopted ASU 2014-09 and related issuances on January 1, 2019, with no cumulative effect adjustment to opening retained earnings required upon implementation of this standard. The adoption of this guidance does not result in changes to how revenue is recognized or the timing of recognition from our method prior to adoption. Revenue is recognized when obligations, under the terms of a contract with our customer, are satisfied, which generally occurs when services are performed. Revenue is measured as the amount of consideration we expect to receive in exchange for providing services.

The Company performed an analysis of the impact of adoption of this ASU, reviewing revenue recorded from service charges on deposit accounts, gains (losses) on other real estate owned and other assets, debit card interchange fees, and merchant processing fees.

Service fees on deposit accounts - The fees are generated from a depositor’s option to purchase services offered under the contract and are only considered a contract when the depositor exercises their option to purchase these services. Therefore we deem the term of our contracts with depositors to be day-to-day and do not extend beyond the services already provided.

Debit card interchange fees - We collect interchange fee income when debit cards that we have issued to our customers, are used in merchant transactions. Our performance obligation is satisfied and revenue is recognized at the point we initiate the payment of funds from a customer’s account to a merchant account.

Merchant processing fees - We receive referral fees for referring our customers to a merchant servicer. Fees are immaterial and recognized as received.

Gain (Loss) on sale of other real estate owned - The Company records income or expense only upon consummation of the sale of the real estate.

Financial Instruments

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," to improve the accounting for financial instruments. This ASU requires equity investments with readily determinable fair values to be measured at fair value with changes recognized in net income regardless of classification. For equity investments without a readily determinable fair value, the value of the investment would be measured at cost minus impairment, if any, plus or minus changes resulting from observable price

changes in orderly transactions for the identical or a similar investment of the same issuer instead of fair value, unless a qualitative assessment indicates impairment. Additionally, this ASU requires the separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements, as well as the required use of exit pricing when measuring the fair value of financial instruments for disclosure purposes. The guidance became effective for the Company for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019, and was to be applied prospectively with a cumulative effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The Company adopted ASU 2016-01 and related issues on January 1, 2019 and determined that the implementation of this standard did not have a material impact to our consolidated financial statements.

Impact of Recently Issued Accounting Standards:

Leases

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)," to improve transparency and comparability across entities regarding leasing arrangements. This ASU requires the recognition of a separate lease liability representing the required discounted lease payments over the lease term and a separate lease asset representing the right to use the underlying asset during the same lease term. Additionally, this ASU provides clarification regarding the identification of certain components of contracts that would represent a lease as well as requires additional disclosures to the notes of the financial statements.

The guidance is effective for the Company for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020, and is to be applied under an optional transition method. In November 2019, the FASB issued ASU No. 2019-10, "Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842)" to delay the effective date for the leases standard to fiscal years beginning after December 15, 2019 and interim periods within fiscal years beginning after December 15, 2020 for the Company. As an emerging growth company, the Company is eligible for the delayed effective date. The Company is planning to adopt this new guidance within the delayed time frame noted above. The Company is currently evaluating the impact of adopting this new guidance on the consolidated financial statements but does not expect that the adoption will have a material impact. Additionally, the Company does not expect to significantly change operating lease agreements prior to adoption.

Allowance for Credit Losses

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments," to replace the current incurred loss methodology for recognizing credit losses, which delays recognition until it is probable a loss has been incurred, with a methodology that reflects an estimate of all expected credit losses and considers additional reasonable and supportable forecasted information when determining credit loss estimates. This impacts the calculation of the allowance for credit losses for all financial assets measured under the amortized cost basis, including PCI loans at the time of and subsequent to acquisition. Additionally, credit losses related to available-for-sale debt securities would be recorded through the allowance for credit losses and not as a direct adjustment to the amortized cost of the securities.

In November 2019, the FASB issued ASU No. 2019-10, "Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842)" to delay the effective date for the credit losses standard to fiscal years beginning after December 15, 2022, including interim periods within those fiscal years, for certain entities, such as smaller reporting companies. As a smaller reporting company, the Company is eligible for the delayed effective date. The Company is currently evaluating the impact of the delay on its implementation project plan as well as the impact of adopting this new guidance on the consolidated financial statements, current systems and processes. At this time, the Company is reviewing potential methodologies for estimating expected credit losses using reasonable and supportable forecast information and has identified certain data and system requirements. Once adopted, we expect our allowance for loan losses to increase through a one-time adjustment to retained earnings; however, until our evaluation is complete, the estimated increase in allowance will be unknown. The Company is planning to adopt this new guidance within the delayed time frame noted above.

NOTE 2—SECURITIES

The following table summarizes the amortized cost and fair value of the available-for-sale securities portfolio at December 31, 2019 and December 31, 2018 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income (loss).

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2019				
State and political subdivision	**$ 89,304**	**$ 4,463**	**$ (20)**	**$ 93,747**
Mortgage-backed securities: residential	**10,609**	**82**	**(126)**	**10,565**
Mortgage-backed securities: commercial	**8,567**	**224**	**(12)**	**8,779**
Collateralized mortgage obligations: residential	**8,541**	**39**	**(51)**	**8,529**
Collateralized mortgage obligations: commercial	**22,891**	**300**	**(10)**	**23,181**
U.S. Treasury	**1,976**	**23**	**—**	**1,999**
SBA	**22,051**	**87**	**(154)**	**21,984**
Asset backed securities	**10,390**	**—**	**(306)**	**10,084**
Corporate bonds	**2,030**	**20**	**(13)**	**2,037**
Total available-for-sale	**$ 176,359**	**$ 5,238**	**$ (692)**	**$ 180,905**
December 31, 2018				
U.S. government sponsored entities & agencies	$ 2,404	$ 4	$ (11)	$ 2,397
State and political subdivision	75,093	657	(604)	75,146
Mortgage-backed securities: residential	10,114	4	(379)	9,739
Mortgage-backed securities: commercial	12,594	17	(229)	12,382
Collateralized mortgage obligations: residential	18,916	51	(296)	18,671
Collateralized mortgage obligations: commercial	32,390	98	(500)	31,988
U.S. Treasury	21,232	—	(751)	20,481
SBA	15,856	—	(168)	15,688
Asset backed securities	3,872	—	(30)	3,842
Corporate bonds	14,006	18	(100)	13,924
Total available-for-sale	$ 206,477	$ 849	$ (3,068)	$ 204,258

The proceeds from sales of securities and the associated gains and losses for the periods below are as follows:

	For the year ended December 31,		
(Dollars in thousands)	2019	2018	2017
Proceeds	**$ 69,846**	$ 3,625	$ 14,803
Gross gains	**1,566**	2	217
Gross losses	**(392)**	(73)	(9)

The amortized cost and fair value of securities are shown in the table below by contractual maturity. Actual timing may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2019	
(Dollars in thousands)	Amortized Cost	Fair Value
Within one year	**$ 2,812**	**$ 2,801**
One to five years	**20,805**	**21,059**
Five to ten years	**33,948**	**34,890**
Beyond ten years	**118,794**	**122,155**
Total	**$ 176,359**	**$ 180,905**

Securities pledged at December 31, 2019 and December 31, 2018 had a carrying amount of $27.3 million and $22.7 million, respectively, and were pledged to secure Federal Home Loan Bank ("FHLB") advances, a Federal Reserve Bank line of credit, repurchase agreements, deposits and mortgage derivatives.

As of December 31, 2019, the Bank held 56 tax-exempt state and local municipal securities totaling $40.1 million backed by the Michigan School Bond Loan Fund. Other than the aforementioned investments, at December 31, 2019 and December 31, 2018, there were no holdings of securities of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10% of shareholders' equity.

The following table summarizes securities with unrealized losses at December 31, 2019 and December 31, 2018 aggregated by security type and length of time in a continuous unrealized loss position:

	Less than 12 Months		12 Months or Longer		Total	
(Dollars in thousands)	Fair value	Unrealized Losses	Fair value	Unrealized Losses	Fair value	Unrealized Losses
December 31, 2019						
Available-for-sale						
State and political subdivision	**$ 5,109**	**$ (20)**	**$ 305**	**$ —**	**$ 5,414**	**$ (20)**
Mortgage-backed securities: residential	**4,022**	**(39)**	**3,982**	**(87)**	**8,004**	**(126)**
Mortgage-backed securities: commercial	**1,769**	**(11)**	**430**	**(1)**	**2,199**	**(12)**
Collateralized mortgage obligations: residential	**770**	**(1)**	**4,631**	**(50)**	**5,401**	**(51)**
Collateralized mortgage obligations: commercial	**—**	**—**	**1,716**	**(10)**	**1,716**	**(10)**
SBA	**3,961**	**(13)**	**12,405**	**(141)**	**16,366**	**(154)**
Asset backed securities	**8,220**	**(232)**	**1,864**	**(74)**	**10,084**	**(306)**
Corporate bonds	**489**	**(13)**	**—**	**—**	**489**	**(13)**
Total available-for-sale	**$ 24,340**	**$ (329)**	**$ 25,333**	**$ (363)**	**$ 49,673**	**$ (692)**
December 31, 2018						
Available-for-sale						
U.S. government sponsored entities & agencies	$ 978	$ (11)	$ —	$ —	$ 978	$ (11)
State and political subdivision	5,121	(25)	27,667	(579)	32,788	(604)
Mortgage-backed securities: residential	2,595	(4)	6,393	(375)	8,988	(379)
Mortgage-backed securities: commercial	1,967	(8)	8,944	(221)	10,911	(229)
Collateralized mortgage obligations: residential	3,814	(27)	8,958	(269)	12,772	(296)
Collateralized mortgage obligations: commercial	—	—	17,939	(500)	17,939	(500)
U.S. Treasury	—	—	20,481	(751)	20,481	(751)
SBA	12,420	(91)	3,268	(77)	15,688	(168)
Asset backed securities	3,842	(30)	—	—	3,842	(30)
Corporate bonds	7,526	(28)	2,950	(72)	10,476	(100)
Total available-for-sale	$ 38,263	$ (224)	$ 96,600	$ (2,844)	$ 134,863	$ (3,068)

As of December 31, 2019, the Company's investment portfolio consisted of 228 securities, 54 of which were in an unrealized loss position. The unrealized losses for these securities resulted primarily from changes in interest rates since purchased. The Company expects full recovery of the carrying amount of these securities and does not intend to sell the securities in an unrealized loss position nor does it believe it will be required to sell securities in an unrealized loss position before the value is recovered. The Company does not consider these securities to be other-than-temporarily impaired at December 31, 2019.

NOTE 3—LOANS

The following table presents the recorded investment in loans at December 31, 2019 and December 31, 2018. The recorded investment in loans excludes accrued interest receivable.

(Dollars in thousands)	Originated	Acquired	Total
December 31, 2019			
Commercial real estate	**$ 551,565**	**$ 53,081**	**$ 604,646**
Commercial and industrial	**403,922**	**6,306**	**410,228**
Residential real estate	**201,787**	**10,052**	**211,839**
Consumer	**864**	**32**	**896**
Total	**$ 1,158,138**	**$ 69,471**	**$ 1,227,609**
December 31, 2018			
Commercial real estate	$ 500,809	$ 61,284	$ 562,093
Commercial and industrial	375,130	8,325	383,455
Residential real estate	165,015	15,003	180,018
Consumer	944	55	999
Total	$ 1,041,898	$ 84,667	$ 1,126,565

At December 31, 2019 and December 31, 2018, the Company had residential loans held for sale, which were originated with the intent to sell, totaling $13.9 million and $5.6 million, respectively. During the years ended December 31, 2019 and 2018, the Company sold residential real estate loans with proceeds totaling $270.4 million and $91.1 million, respectively.

Nonperforming Assets

Nonperforming assets consist of loans for which the accrual of interest has been discontinued and other real estate owned obtained through foreclosure and other repossessed assets. Loans outside of those accounted for under ASC 310-30 are classified as nonaccrual when, in the opinion of management, collection of principal or interest is doubtful. The accrual of interest is discontinued when a loan is placed in nonaccrual status and any payments received reduce the carrying value of the loan. A loan may be placed back on accrual status if all contractual payments have been received and collection of future principal and interest payments are no longer doubtful. Acquired loans that are not performing in accordance with contractual terms are not reported as nonperforming because these loans are recorded in pools at their net realizable value based on the principal and interest the Corporation expects to collect on these loans. At December 31, 2019, there were $1.2 million in commitments to lend additional funds to borrowers whose loans were classified as nonaccrual.

Information as to nonperforming assets was as follows:

(Dollars in thousands)	December 31, 2019	December 31, 2018
Nonaccrual loans:		
Commercial real estate	**$ 4,832**	$ 5,927
Commercial and industrial	**11,112**	9,605
Residential real estate	**2,569**	2,915
Consumer	**16**	—
Total nonaccrual loans	**18,529**	18,447
Other real estate owned	**921**	—
Total nonperforming assets	**$ 19,450**	$ 18,447
Loans 90 days or more past due and still accruing	**$ 157**	$ 243

At December 31, 2019 and December 31, 2018, all of the loans 90 days or more past due and still accruing were PCI loans.

Loan delinquency as of the dates presented below was as follows:

(Dollars in thousands)	Current	30 - 59 Days Past Due	60 - 89 Days Past Due	90+ Days Past Due	Total
December 31, 2019					
Commercial real estate	**$ 597,892**	**$ 3,630**	**$ 1,286**	**$ 1,838**	**$ 604,646**
Commercial and industrial	**407,692**	**377**	**1,275**	**884**	**410,228**
Residential real estate	**206,002**	**3,286**	**1,429**	**1,122**	**211,839**
Consumer	**892**	**4**	**—**	**—**	**896**
Total	**$ 1,212,478**	**$ 7,297**	**$ 3,990**	**$ 3,844**	**$ 1,227,609**
December 31, 2018					
Commercial real estate	$ 559,523	$ 497	$ —	$ 2,073	$ 562,093
Commercial and industrial	381,424	664	82	1,285	383,455
Residential real estate	174,831	2,499	1,314	1,374	180,018
Consumer	998	—	1	—	999
Total	$ 1,116,776	$ 3,660	$ 1,397	$ 4,732	$ 1,126,565

Impaired Loans:

Information as to impaired loans, excluding purchased credit impaired loans, was as follows:

(Dollars in thousands)	December 31, 2019	December 31, 2018
Nonaccrual loans	**$ 18,529**	$ 18,447
Performing troubled debt restructurings:		
Commercial and industrial	**547**	568
Residential real estate	**359**	363
Total performing troubled debt restructurings	**906**	931
Total impaired loans, excluding purchase credit impaired loans	**$ 19,435**	$ 19,378

Troubled Debt Restructurings:

The Company assesses loan modifications to determine whether a modification constitutes a troubled debt restructuring ("TDR"). This applies to all loan modifications except for modifications to loans accounted for in pools under ASC 310-30, which are not subject to TDR accounting/classification. For loans excluded from ASC 310-30 accounting, a modification is considered a TDR when a borrower is experiencing financial difficulties and the Company grants a concession to the borrower. For loans accounted for individually under ASC 310-30, a modification is considered a TDR when a borrower is experiencing financial difficulties and the effective yield after the modification is less than the effective yield at the time the loan was acquired or less than the effective yield of any re-estimation of cash flows subsequent to acquisition in association with consideration of qualitative factors included within ASC 310-40. All TDRs are considered impaired loans. The nature and extent of impairment of TDRs, including those which have experienced a subsequent default, are considered in the determination of an appropriate level of allowance for loan losses.

As of December 31, 2019 and December 31, 2018, the Company had a recorded investment in troubled debt restructurings of $3.9 million and $5.9 million, respectively. The Company allocated a specific reserve of $384 thousand for those loans at December 31, 2019 and a specific reserve of $258 thousand for those loans at December 31, 2018. The Company has not committed to lend additional amounts to borrowers whose loans have been modified. As of December 31, 2019, there were $3.0 million of nonperforming TDRs and $906 thousand of performing TDRs included in impaired loans. As of December 31, 2018, there were $5.0 million of nonperforming TDRs and $931 thousand of performing TDRs included in impaired loans.

All TDRs are considered impaired loans in the calendar year of their restructuring. A loan that has been modified can return to performing status if it satisfies a six-month performance requirement; however, it will continue to be reported as a TDR and considered impaired.

The following table presents the recorded investment of loans modified as TDRs during the years ended December 31, 2019, 2018 and 2017, by type of concession granted. In cases where more than one type of concession was granted, the loans were categorized based on the most significant concession.

	Concession type					Financial effects of modification	
(Dollars in thousands)	Principal deferral	Interest rate	Forbearance agreement	Total number of loans	Total recorded investment	Net charge-offs	Provision for loan losses
For the year ended December 31, 2019							
Commercial and industrial	**$ —**	**$ —**	**$ 332**	**2**	**$ 332**	**$ —**	**$ 174**
Total	**$ —**	**$ —**	**$ 332**	**2**	**$ 332**	**$ —**	**$ 174**
For the year ended December 31, 2018							
Commercial real estate	$ 2,073	$ —	$ —	4	$ 2,073	$ 101	$ —
Commercial and industrial	1,031	106	—	4	1,137	—	14
Residential real estate	113	—	—	2	113	—	5
Total	$ 3,217	$ 106	$ —	10	$ 3,323	$ 101	$ 19
For the year ended December 31, 2017							
Commercial real estate	$ 297	$ —	$ 1,229	2	$ 1,526	$ —	$ —
Residential real estate	784	357	—	3	1,141	—	15
Total	$ 1,081	$ 357	$ 1,229	5	$ 2,667	$ —	$ 15

On an ongoing basis, the Company monitors the performance of TDRs to their modified terms. The following table presents the number of loans modified as TDRs during the twelve months ended December 31, 2019, 2018 and 2017 for which there was a subsequent payment default, including the recorded investment as of the period end. A payment on a TDR is considered to be in default once it is greater than 30 days past due.

	For the year ended ended December 31, 2019		
(Dollars in thousands)	Total number of loans	Total recorded investment	Provision for loan losses following a subsequent default
Commercial and industrial	**1**	**$ 42**	**$ 12**
Total	**1**	**$ 42**	**$ 12**

	For the year ended December 31, 2018		
(Dollars in thousands)	Total number of loans	Total recorded investment	Provision for loan losses following a subsequent default
Commercial real estate	3	$ 2,073	$ —
Commercial and industrial	1	904	—
Total	4	$ 2,977	$ —

	For the year ended December 31, 2017		
(Dollars in thousands)	Total number of loans	Total recorded investment	Provision for loan losses following a subsequent default
Commercial real estate	1	$ 1,229	$ —
Commercial and industrial	5	—	497
Residential real estate	1	292	—
Total	7	$ 1,521	$ 497

Credit Quality Indicators:

The Company 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 Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes commercial and industrial and commercial real estate loans and is performed on an annual basis. The Company uses the following definitions for risk ratings:

Pass. Loans classified as pass are higher quality loans that do not fit any of the other categories described below. This category includes loans risk rated with the following ratings: cash/stock secured, excellent credit risk, superior credit risk, good credit risk, satisfactory credit risk, and marginal credit risk.

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 Company'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 Company 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, conditions, and values, highly questionable and improbable.

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

(Dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
December 31, 2019					
Commercial real estate	**$ 591,419**	**$ 8,325**	**$ 4,042**	**$ 860**	**$ 604,646**
Commercial and industrial	**383,756**	**8,967**	**16,527**	**978**	**410,228**
Total	**$ 975,175**	**$ 17,292**	**$ 20,569**	**$ 1,838**	**$ 1,014,874**
December 31, 2018					
Commercial real estate	$ 545,843	$ 10,240	$ 5,966	$ 44	$ 562,093
Commercial and industrial	368,189	2,841	12,425	—	383,455
Total	$ 914,032	$ 13,081	$ 18,391	$ 44	$ 945,548

For residential real estate loans and consumer loans, the Company evaluates credit quality based on the aging status of the loan and by payment activity. Residential real estate loans and consumer loans are considered nonperforming if they are 90 days or more past due. Consumer loan types are continuously monitored for changes in delinquency trends and other asset quality indicators.

The following presents residential real estate and consumer loans by credit quality:

(Dollars in thousands)	Performing	Nonperforming	Total
December 31, 2019			
Residential real estate	**$ 209,270**	**$ 2,569**	**$ 211,839**
Consumer	**880**	**16**	**896**
Total	**$ 210,150**	**$ 2,585**	**$ 212,735**
December 31, 2018			
Residential real estate	$ 177,103	$ 2,915	$ 180,018
Consumer	999	—	999
Total	$ 178,102	$ 2,915	$ 181,017

Purchased Credit Impaired Loans:

As part of the Company's previous four acquisitions, the Company acquired purchase credit impaired ("PCI") loans for which there was evidence of credit quality deterioration since origination, and we determined that it was probable that the Company would be unable to collect all contractually required principal and interest payments. The total balance of all PCI loans from these acquisitions was as follows:

(Dollars in thousand)	Unpaid Principal Balance	Recorded Investment
December 31, 2019		
Commercial real estate	**$ 6,597**	**$ 2,884**
Commercial and industrial	**556**	**135**
Residential real estate	**4,215**	**2,954**
Total PCI loans	**$ 11,368**	**$ 5,973**
December 31, 2018		
Commercial real estate	$ 10,865	$ 4,344
Commercial and industrial	511	122
Residential real estate	5,043	3,409
Total PCI loans	$ 16,419	$ 7,875

The following table reflects the activity in the accretable yield of PCI loans from past acquisitions, which includes total expected cash flows, including interest, in excess of the recorded investment.

	For the year ended December 31,		
(Dollars in thousands)	2019	2018	2017
Accretable yield at beginning of period	**$ 10,947**	$ 14,452	$ 19,893
Accretion of income	**(2,313)**	(3,794)	(5,340)
Adjustments to accretable yield	**507**	304	121
Other activity, net	**—**	(15)	(222)
Accretable yield at end of period	**$ 9,141**	$ 10,947	$ 14,452

"Accretion of income" represents the income earned on these loans for the year. "Adjustments to accretable yield" represents the net amount of accretable yield added or removed as a result of the semi-annual re-estimation of expected cash flows.

For the years ended December 31, 2019 and 2018, allowance for loans losses on PCI loans decreased by $158 thousand and $161 thousand, respectively.

Related Party Loans:

We have extended loans to certain of our directors, executive officers, principal shareholders and their affiliates. The aggregate loans outstanding to the directors, executive officers, principal shareholders and their affiliates as of December 31, 2019 and 2018 totaled approximately $4.1 million and $4.0 million, respectively. During 2019 and 2018, there were $1.1 million and $2.6 million, respectively, of new loans and other additions, while repayments and other reductions totaled $924 thousand and $731 thousand, respectively.

NOTE 4—ALLOWANCE FOR LOAN LOSSES

An allowance for loan losses is maintained to absorb probable incurred losses from the loan portfolio. The allowance for loan losses is based on management's continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of nonaccrual loans.

The Company established an allowance for loan losses associated with PCI loans (accounted for under ASC 310-30) based on credit deterioration subsequent to the acquisition date. As of December 31, 2019, the Company had six PCI loan pools and 10 non-pooled PCI loans. The Company re-estimates cash flows expected to be collected for PCI loans on a semi-annual

basis, with any decline in expected cash flows recorded as provision for loan losses on a discounted basis during the period. For any increases in cash flows expected to be collected, the Company adjusts the amount of accretable yield to be recognized on a prospective basis over the loan's remaining life.

For loans not accounted for under ASC 310-30, the Company individually evaluates certain impaired loans on a quarterly basis and establishes specific allowances for such loans, if required. A loan is considered impaired when it is probable that interest or principal payments will not be made in accordance with the contractual terms of the loan agreement. Consistent with this definition, all loans for which the accrual of interest has been discontinued (nonaccrual loans) and all TDRs are considered impaired. The Company individually evaluates nonaccrual loans with book balances of $250 thousand or more, all loans whose terms have been modified in a TDR, and certain other loans. The threshold for individual evaluation is revised on an infrequent basis, generally when economic circumstances significantly change. Specific allowances for impaired loans are estimated using one of several methods, including the estimated fair value of underlying collateral, observable market value of similar debt or discounted expected future cash flows. All other impaired loans are individually evaluated by identifying its risk characteristics and applying the standard reserve factor for the corresponding loan pool.

Loans which do not meet the criteria to be individually evaluated are evaluated in pools of loans with similar risk characteristics. Business loans are assigned to pools based on the Company's internal risk rating system. Internal risk ratings are assigned to each business loan at the time of approval and are subjected to subsequent periodic reviews by the Company's senior management, generally at least annually or more frequently upon the occurrence of a circumstance that affects the credit risk of the loan. For business loans not individually evaluated, losses inherent to the pool are estimated by applying standard reserve factors to outstanding principal balances.

The allowance for loans not individually evaluated is determined by applying estimated loss rates to various pools of loans within the portfolios with similar risk characteristics. Estimated loss rates for all pools are updated quarterly, incorporating quantitative and qualitative factors such as recent charge-off experience, current economic conditions and trends, changes in collateral values of properties securing loans (using index-based estimates), and trends with respect to past due and nonaccrual amounts.

Loans acquired in business combinations are initially recorded at fair value, which includes an estimate of credit losses expected to be realized over the remaining lives of the loans, and therefore no corresponding allowance for loan losses is recorded for these loans at acquisition. Methods utilized to estimate any subsequently required allowance for loan losses for acquired loans not deemed credit-impaired at acquisition are similar to originated loans; however, the estimate of loss is based on the unpaid principal balance less any remaining purchase discount.

Loans individually evaluated for impairment are presented below.

(Dollars in thousands)	Recorded investment with no related allowance	Recorded investment with related allowance [1]	Total recorded investment	Contractual principal balance	Related allowance [1]
December 31, 2019					
Individually evaluated impaired loans:					
Commercial real estate	**$ 4,832**	**$ —**	**$ 4,832**	**$ 5,156**	**$ —**
Commercial and industrial	**10,739**	**913**	**11,652**	**12,521**	**363**
Residential real estate	**1,197**	**189**	**1,386**	**1,570**	**22**
Total	**$ 16,768**	**$ 1,102**	**$ 17,870**	**$ 19,247**	**$ 385**
December 31, 2018					
Individually evaluated impaired loans:					
Commercial real estate	$ 5,898	$ 3,991	$ 9,889	$ 13,076	$ 815
Commercial and industrial	5,892	4,059	9,951	10,411	526
Residential real estate	1,666	3,255	4,921	6,604	101
Total	$ 13,456	$ 11,305	$ 24,761	$ 30,091	$ 1,442

[1] December 31, 2018 individually evaluated impaired loans included $7.2 million of PCI loans with a related allowance of $920 thousand. December 31, 2019 individually evaluated impaired loans do not include PCI loans with a related allowance.

(Dollars in thousands)	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
For the year ended December 31, 2019			
Individually evaluated impaired loans [1]:			
Commercial real estate	**$ 4,233**	**$ 2**	**$ 209**
Commercial and industrial	**8,514**	**43**	**573**
Residential real estate	**1,904**	**29**	**9**
Total	**$ 14,651**	**$ 74**	**$ 791**
For the year ended December 31, 2018			
Individually evaluated impaired loans [1]:			
Commercial real estate	$ 9,471	$ 1,622	$ 142
Commercial and industrial	7,673	91	112
Residential real estate	5,182	369	—
Total	$ 22,326	$ 2,082	$ 254
For the year ended December 31, 2017			
Individually evaluated impaired loans [1]:			
Commercial real estate	$ 8,145	$ 1,710	$ —
Commercial and industrial	17,738	238	—
Residential real estate	5,361	303	—
Total	$ 31,244	$ 2,251	$ —

[1] December 31, 2018 and 2017 individually evaluated impaired loans included PCI loans, whereas December 31, 2019 individually evaluated impaired loans excluded PCI loans.

Activity in the allowance for loan losses and the allocation of the allowance for loans was as follows:

(Dollars in thousands)	Commercial Real Estate	Commercial and Industrial	Residential Real Estate	Consumer	Total
For the year ended December 31, 2019					
Allowance for loan losses:					
Beginning balance	**$ 5,227**	**$ 5,174**	**$ 1,164**	**$ 1**	**$ 11,566**
Provision for loan losses	**632**	**533**	**143**	**75**	**1,383**
Gross chargeoffs	**(92)**	**(438)**	**—**	**(106)**	**(636)**
Recoveries	**6**	**246**	**77**	**32**	**361**
Net (chargeoffs) recoveries	**(86)**	**(192)**	**77**	**(74)**	**(275)**
Ending allowance for loan losses	**$ 5,773**	**$ 5,515**	**$ 1,384**	**$ 2**	**$ 12,674**
For the year ended December 31, 2018					
Allowance for loan losses:					
Beginning balance	$ 4,852	$ 5,903	$ 950	$ 8	$ 11,713
Provision (benefit) for loan losses	464	(269)	191	26	412
Gross chargeoffs	(112)	(1,283)	(47)	(35)	(1,477)
Recoveries	23	823	70	2	918
Net (chargeoffs) recoveries	(89)	(460)	23	(33)	(559)
Ending allowance for loan losses	$ 5,227	$ 5,174	$ 1,164	$ 1	$ 11,566
For the year ended December 31, 2017					
Allowance for loan losses:					
Beginning balance	$ 4,124	$ 5,932	$ 1,030	$ 3	$ 11,089
Provision (benefit) for loan losses	1,071	478	(136)	3	1,416
Gross chargeoffs	(360)	(697)	(85)	—	(1,142)
Recoveries	17	190	141	2	350
Net (chargeoffs) recoveries	(343)	(507)	56	2	(792)
Ending allowance for loan losses	$ 4,852	$ 5,903	$ 950	$ 8	$ 11,713

(Dollars in thousands)	Commercial Real Estate	Commercial and Industrial	Residential Real Estate	Consumer	Total
December 31, 2019					
Allowance for loan losses:					
Individually evaluated for impairment	**$ —**	**$ 363**	**$ 22**	**$ —**	**$ 385**
Collectively evaluated for impairment	**5,062**	**5,124**	**1,339**	**2**	**11,527**
Acquired with deteriorated credit quality	**711**	**28**	**23**	**—**	**762**
Ending allowance for loan losses	**$ 5,773**	**$ 5,515**	**$ 1,384**	**$ 2**	**$ 12,674**
Balance of loans:					
Individually evaluated for impairment	**$ 4,832**	**$ 11,652**	**$ 1,386**	**$ —**	**$ 17,870**
Collectively evaluated for impairment	**596,930**	**398,441**	**207,499**	**896**	**1,203,766**
Acquired with deteriorated credit quality	**2,884**	**135**	**2,954**	**—**	**5,973**
Total loans	**$ 604,646**	**$ 410,228**	**$ 211,839**	**$ 896**	**$ 1,227,609**
December 31, 2018					
Allowance for loan losses:					
Individually evaluated for impairment	$ —	$ 504	$ 18	$ —	$ 522
Collectively evaluated for impairment	4,412	4,648	1,063	1	10,124
Acquired with deteriorated credit quality	815	22	83	—	920
Ending allowance for loan losses	$ 5,227	$ 5,174	$ 1,164	$ 1	$ 11,566
Balance of loans:					
Individually evaluated for impairment	$ 5,898	$ 9,829	$ 1,854	$ —	$ 17,581
Collectively evaluated for impairment	551,851	373,504	174,755	999	1,101,109
Acquired with deteriorated credit quality	4,344	122	3,409	—	7,875
Total loans	$ 562,093	$ 383,455	$ 180,018	$ 999	$ 1,126,565

NOTE 5—PREMISES AND EQUIPMENT

Premises and equipment were as follows at December 31, 2019 and December 31, 2018:

(Dollars in thousands)	December 31, 2019	December 31, 2018
Land	**$ 2,254**	$ 2,197
Buildings	**9,825**	9,746
Leasehold improvements	**2,714**	1,708
Furniture, fixtures and equipment	**6,539**	6,024
Total premises and equipment	**$ 21,332**	$ 19,675
Less: Accumulated depreciation	**7,494**	6,433
Net premises and equipment	**$ 13,838**	$ 13,242

Depreciation expense was $1.3 million, $1.3 million and $1.4 million for the years ended December 31, 2019, 2018 and 2017, respectively.

Most of the Company's branch facilities are rented under non-cancelable operating lease agreements. Total rent expense was $1.2 million, $1.1 million and $909 thousand for the years ended December 31, 2019, 2018 and 2017, respectively.

Rent commitments under non-cancelable operating leases (including renewal options that the Company will likely exercise) were as follows:

(Dollars in thousands)	As of December 31, 2019
2020	$ **1,341**
2021	**1,172**
2022	**1,179**
2023	**1,125**
2024	**1,024**
Thereafter	**4,736**
Total lease commitments	$ **10,577**

NOTE 6—GOODWILL AND INTANGIBLE ASSETS

Goodwill: The Company acquired two banks, Lotus Bank in March 2015 and Bank of Michigan in March 2016, which resulted in the recognition of $4.6 million and $4.8 million of goodwill, respectively. Goodwill was $9.4 million at both December 31, 2019 and December 31, 2018.

Goodwill is not amortized but is evaluated at least annually for impairment. The Company's most recent annual goodwill impairment review did not indicate that an impairment of goodwill existed. The Company also determined that no triggering events have occurred that indicated impairment from the most recent valuation date through December 31, 2019 and that the Company's goodwill was not impaired at December 31, 2019.

Acquired Intangible Assets: The Company has recorded core deposit intangibles ("CDIs") associated with each of its acquisitions. CDIs are amortized on an accelerated basis over their estimated useful lives.

The table below presents the Company's net carrying amount of CDIs:

(Dollars in thousands)	December 31, 2019	December 31, 2018
Gross carrying amount	**$ 2,045**	$ 2,045
Accumulated amortization	**(1,744)**	(1,598)
Net Intangible	**$ 301**	$ 447

Amortization expense for the CDIs was $146 thousand, $220 thousand and $234 thousand for the years ended December 31, 2019, 2018 and 2017, respectively.

As of December 31, 2019, estimated amortization expense for each of the next five years is as follows:

(Dollars in thousands)	
2020	**$ 102**
2021	**68**
2022	**53**
2023	**39**
2024	**25**

NOTE 7 - DEPOSITS

Time deposits that met or exceeded the FDIC insurance limit of $250,000 were $205.9 million and $211.7 million at December 31, 2019 and 2018, respectively. At December 31, 2019, brokered deposits totaled $67.4 million, compared to $110.3 million at December 31, 2018.

As of December 31, 2019, the scheduled maturities of total time deposits were as follows:

(Dollars in thousands)	December 31, 2019
Due in 2020	**$ 392,839**
Due in 2021	**35,552**
Due in 2022	**4,303**
Due in 2023	**356**
Due in 2024	**22**
Thereafter	**—**
Total	**$ 433,072**

Related party deposits totaled $31.3 million and $38.9 million at December 31, 2019 and 2018, respectively.

NOTE 8 —BORROWINGS AND SUBORDINATED DEBT

The following table presents the components of our short-term borrowings and long-term debt.

(Dollars in thousands)	December 31, 2019 Amount	December 31, 2019 Weighted Average Rate[1]	December 31, 2018 Amount	December 31, 2018 Weighted Average Rate[1]
Short-term borrowings:				
FHLB Advances	**$ 60,000**	**1.61%**	$ 90,000	2.54%
Securities sold under agreements to repurchase	**851**	**0.30**	609	0.30
FHLB line of credit	**—**	**—**	2,520	2.87
Federal funds purchased	**5,000**	**1.90**	5,000	2.50
Total short-term borrowings	**65,851**	**1.62**	98,129	2.53
Long-term debt:				
Secured borrowing due in 2022	**1,374**	**1.00**	1,445	1.00
FHLB advances due in 2022 to 2029[2]	**145,000**	**1.06**	—	—
Subordinated notes due in 2025 and 2029[3]	**44,440**	**5.29**	14,891	6.38
Total long-term debt	**190,814**	**2.04**	16,336	5.90
Total short-term and long-term borrowings	**$ 256,665**	**1.93%**	$ 114,465	3.01%

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[1] Weighted average rate presented is the contractual rate which excludes premiums and discounts related to purchase accounting.

[2] At December 31, 2019, the long-term FHLB advances consisted of 0.66% - 2.35% fixed rate notes and can be called through 2024 without penalty by the issuer.

[3] The December 31, 2019 balance includes subordinated notes of $45.0 million and debt issuance costs of $560 thousand. The December 31, 2018 balance includes subordinated notes of $15.0 million and debt issuance costs of $109 thousand.

The Bank is a member of the FHLB of Indianapolis, which provides short- and long-term funding collateralized by mortgage-related assets to its members. FHLB short-term borrowings bear interest at variable rates based on LIBOR. The advances were secured by a blanket lien on $408.9 million of real estate-related loans as of December 31, 2019. Based on this collateral and the Company's holdings of FHLB stock, the Company was eligible to borrow up to an additional $103.7 million from the FHLB at December 31, 2019. In addition, the Bank can borrow up to $130.0 million through the unsecured lines of credit it has established with other correspondent banks, as well as $4.9 million through a secured line with the Federal Reserve Bank. The Bank had $5.0 million outstanding federal funds purchased as of both December 31, 2019 and December 31, 2018, respectively.

At December 31, 2019, the Company had $851 thousand of securities sold under agreements to repurchase with customers, which mature overnight. These borrowings were secured by residential collateralized mortgage obligation securities with a fair value of $1.2 million at December 31, 2019.

The Company had a secured borrowing of $1.4 million as of December 31, 2019 relating to certain loan participations sold by the Company that did not qualify for sales treatment. The secured borrowing bears a fixed rate of 1.00% and matures on September 15, 2022.

As of December 31, 2019, the Company had $45.0 million outstanding subordinated notes and $560 thousand of debt issuance costs. The debt issuance costs are netted against the balance of the subordinated notes and recognized as expense over the expected term of the notes.

The $15.0 million of subordinated notes issued on December 21, 2015 bear a fixed interest rate of 6.375% per annum, payable semiannually through December 15, 2020. The notes will bear a floating interest rate of three-month LIBOR plus 477 basis points payable quarterly after December 15, 2020 through maturity. The notes mature no later than December 15, 2025, and the Company has the option to redeem or prepay any or all of the subordinated notes without premium or penalty any time after December 15, 2020 or upon an occurrence of a Tier 2 capital event or tax event.

The $30.0 million of subordinated notes issued on December 18, 2019 bear a fixed interest rate of 4.75% per annum, payable semiannually through December 18, 2024. The notes will bear a floating interest rate of three-month SOFR plus 311 basis points payable quarterly after December 18, 2024 through maturity. The notes mature no later than December 18, 2029, and the Company has the option to redeem any or all of the subordinated notes without premium or penalty any time after December 18, 2024 or upon the occurrence of a Tier 2 capital event or tax event.

NOTE 9—INCOME TAXES

The Company and its subsidiaries are subject to U.S. federal income tax. In the ordinary course of business, we are routinely subject to audit by Internal Revenue Service. Currently, the Company is subject to examination by taxing authorities for the 2016 tax return year and forward.

The current and deferred components of the provision for income taxes were as follows:

	For the year ended December 31,		
(Dollars in thousands)	**2019**	**2018**	**2017**
Current expense	**$ 3,995**	$ 2,974	$ 5,721
Remeasurement due to tax reform	**—**	—	1,293
Deferred expense (benefit)	**(592)**	29	(291)
Total	**$ 3,403**	$ 3,003	$ 6,723

A reconciliation of expected income tax expense using the federal statutory rate of 21% as of December 31, 2019 and 2018 and 35% as of December 31, 2017 and actual income tax expense is as follows:

	For the year ended December 31,		
(Dollars in thousands)	**2019**	**2018**	**2017**
Income tax expense based on federal corporate tax rate	**$ 4,098**	$ 3,651	$ 5,797
Changes resulting from:			
Tax-exempt income	**(538)**	(406)	(446)
Remeasurement due to tax reform	**—**	—	1,293
Captive insurance benefit	**(182)**	(198)	(143)
Other, net	**25**	(44)	222
Income tax expense	**$ 3,403**	$ 3,003	$ 6,723

Upon exercise or vesting of a share-based award, if the tax deduction exceeds the compensation cost that was previously recorded for financial statement purposes, this will result in an excess tax benefit. ASU 2016-09, "Compensation-Stock Compensation (718) Improvements to Employee Share-Based Payment Accounting" requires the Company to recognize all excess tax benefits or tax deficiencies through the income statement as income tax expense/benefit. Under previous GAAP guidance, any excess tax benefits were recognized in additional paid-in capital to offset current period and subsequent period tax deficiencies. The Company chose to early adopt ASU 2016-09 for which early adoption should be applied using the modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which guidance was adopted. A tax benefit of $18 thousand and $108 thousand was recorded during the years ended December 31, 2019 and 2018, respectively, as a result of share awards vesting/exercised during the year.

The tax effects of temporary differences that resulted in the significant components of deferred tax assets and liabilities at December 31, 2019 and 2018 are as follows:

(Dollars in thousands)	For the year ended December 31, 2019	2018
Deferred tax assets:		
Allowance for loan losses	**$ 2,662**	$ 2,429
Start-up/pre-opening expenses	**52**	76
Stock options	**117**	108
Deferred loan fees	**248**	213
Unrealized gain - available-for-sale securities	**—**	466
Nonaccrued Interest	**155**	156
Accrued expenses	**365**	91
Other	**378**	232
Total gross deferred tax assets	**3,977**	3,771
Deferred tax liabilities:		
Unrealized loss - available-for-sale securities	**(955)**	—
Depreciation	**(808)**	(559)
Prepaid expenses	**(239)**	(304)
Business combination adjustments	**(369)**	(521)
Partnership Investments	**(366)**	(306)
Other	**—**	(12)
Total gross deferred tax liabilities	**(2,737)**	(1,702)
Net deferred tax assets	**$ 1,240**	$ 2,069

Management has determined that a valuation allowance is not required for the deferred tax assets at December 31, 2019 because it is more likely than not that these assets could be realized through carry back to taxable income in prior years, future reversals of existing taxable temporary differences, tax planning strategies and future taxable income. This conclusion is based on the Company's historical earnings, its current level of earnings and prospects for continued growth and profitability.

There were no unrecognized tax benefits at December 31, 2019, and the Company does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months. The Company recognizes interest and/or penalties related to income tax matters in income tax expense, when applicable. The Company did not record any interest and penalties for 2019, 2018 and 2017.

On December 22, 2017, the U.S government enacted the TCJA, a comprehensive tax legislation, which reduced the federal income tax rate for C corporations from 35% to 21%, effective January 1, 2018. As a result of the reduction in the U.S corporate income tax rate from 35% to 21%, the Company recognized a $1.3 million tax expense in the consolidated statements of income for the year ended December 31, 2017 as a result of the TCJA, of which the expense recorded is primarily attributable to the remeasurement of net deferred tax assets.

The SEC issued Staff Accounting Bulletin No. 118 to address the application of GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed in reasonable detail to complete the accounting for certain income tax effects of the TCJA, thereby allowing a one-year measurement period to reflect provisional adjustments as information becomes available. The Company had adjustments in 2018 reflecting the impact of the rate reduction on various deferred items that the Company reasonably estimated at December 31, 2017, such as on partnership investments and accrued expenses, and trued up these adjustments with the filing of the 2017 tax return.

NOTE 10—STOCK BASED COMPENSATION

On March 15, 2018, the Company’s Board of Directors approved the 2018 Equity Incentive Plan ("2018 Plan"). The 2018 Plan became effective upon shareholder approval at the annual shareholders meeting held on April 17, 2018. Under the 2018 Plan, the Company can grant incentive and non-qualified stock options, stock awards, stock appreciation rights, and other incentive awards to directors and employees of, and certain service providers to, the Company and its subsidiaries. Once the 2018 Plan became effective, no further awards could be granted from the 2007 Stock Option Plan ("Stock Option Plan") or the 2014 Equity Incentive Plan ("2014 Plan"). However, any outstanding equity awards granted under the Stock Option Plan or the 2014 Plan will remain subject to the terms of such plans until the time such awards are no longer outstanding.

The Company has reserved 250,000 shares of common stock for issuance under the 2018 Plan. During the year ended December 31, 2019, the Company granted no stock options and issued 39,483 restricted stock awards under the 2018 Plan, resulting in 203,767 shares available for issuance as of December 31, 2019. During the year ended December 31, 2018, the Company granted 30,000 stock options under the Stock Option Plan, 30,271 restricted stock awards under the 2014 Plan, and 6,750 restricted stock awards under the 2018 Plan.

Stock Options

As of December 31, 2019, all of the Company's outstanding options were granted under the Stock Option Plan. The term of these options is ten years, and they vest one-third each year, over a three year period. The Company will use authorized, but unissued shares to satisfy share option exercises. The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model.

Expected volatilities are based on historical volatilities of the Company's common stock. The Company assumes all awards will vest. The expected term of options granted represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The fair value of the stock options granted during the year ended December 31, 2018 was determined using the weighted-average assumptions as of grant date shown below. There were no stock options granted during the years ended December 31, 2019 and December 31, 2017.

	December 31, 2018
Risk free interest rate	2.83%
Expected term (years)	7.0
Expected volatility	0.04%
Weighted average fair value of options granted	$4.46

The summary of our stock option activity for the years ended December 31, 2019 and 2018 is as follows:

	2019			2018		
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Options outstanding, beginning of year	**376,768**	**$ 16.26**	**5.8**	484,147	$ 13.96	4.7
Granted	—	—		30,000	24.80	
Exercised	**(21,550)**	**10.16**		(127,494)	10.04	
Forfeited	—	—		(9,885)	10.00	
Options outstanding, end of year	**355,218**	**16.63**	**5.0**	376,768	16.26	5.8
Options exercisable	**335,214**	**$ 16.14**	**4.8**	317,263	$ 15.03	5.4

The aggregate intrinsic value was $3.0 million for both options outstanding and exercisable as of December 31, 2019. The aggregate intrinsic value of options outstanding and exercisable as of December 31, 2018 was $2.4 million and $2.3 million, respectively. As of December 31, 2019, there was $50 thousand of total unrecognized compensation cost related to stock options granted under the Stock Option Plan. The cost is expected to be recognized over a weighted-average period of 1.0 year.

The total intrinsic value and cash received from options exercised, including tax benefit, was $295 thousand and $232 thousand, for the year ended December 31, 2019, $1.8 million and $1.4 million, respectively, for the year ended December 31, 2018, and $755 thousand and $605 thousand, respectively, for the year ended December 31, 2017.

Share-based compensation expense charged against income was $54 thousand, $155 thousand and $165 thousand for the years ended December 31, 2019, 2018 and 2017, respectively.

Restricted Stock Awards

A summary of changes in the Company's nonvested shares for the year ended December 31, 2019 is as follows:

Nonvested Shares	Shares		Weighted Average Grant-Date Fair Value
Nonvested at January 1, 2019	**53,770**	**$**	**24.14**
Granted	**39,483**		**23.80**
Vested	**(9,733)**		**21.69**
Forfeited	**(3,150)**		**23.99**
Nonvested at December 31, 2019	**80,370**	**$**	**24.28**

As of December 31, 2019, there was $899 thousand of total unrecognized compensation cost related to nonvested shares granted under the 2014 Plan and 2018 Plan. The cost is expected to be recognized over a weighted average period of 1.9 years. The total fair value of shares vested during the year ended December 31, 2019 was $211 thousand compared to a fair value of $311 thousand for the year ended December 31, 2018.

Total expense for restricted stock awards totaled $659 thousand, $660 thousand and $448 thousand for the years ended December 31, 2019, 2018 and 2017, respectively. For the years ended December 31, 2019, 2018, and 2017 there was $43 thousand, $14 thousand, and $13 thousand, respectively, of restricted stock redeemed to cover the payroll taxes due at the time of vesting.

NOTE 11 - OTHER BENEFIT PLANS

401(k) Plan: The Company sponsors a 401(k) plan for substantially all employees. The plan is a "safe harbor" plan by statute and requires the Company to make a 3% non-elective contribution for each eligible employee. Contributions to the plan were approximately $690 thousand, $537 thousand and $460 thousand for the years ended December 31, 2019, 2018 and 2017, respectively.

Deferred Compensation Plan: The Company's deferred compensation plan that was established in 2015 covers all executive officers. Under the plan, the Company pays each participant, or his or her beneficiary, the amount of contributions deferred plus adjustments for deemed investment experience. A liability is accrued for the obligation under these plans. The expense incurred for the deferred compensation was $261 thousand, $148 thousand and $149 thousand for the years ended December 31, 2019, 2018 and 2017, respectively, which resulted in a deferred compensation liability of $676 thousand, $415 thousand and $267 thousand as of December 31, 2019, 2018 and 2017, respectively.

NOTE 12 —OFF-BALANCE SHEET ACTIVITIES

In the normal course of business, the Company offers a variety of financial instruments with off-balance sheet risk to meet the financing needs of its customers. These financial instruments include outstanding commitments to extend credit, credit lines, commercial letters of credit and standby letters of credit. Commitments to extend credit are agreements to provide credit to a customer, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used and the total commitment amounts do not necessarily represent future cash flow requirements.

Standby letters of credit and commercial letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Standby letters of credit generally are contingent upon the failure of the customer to perform according to the terms of the underlying contract with the third party, while commercial letters of credit are issued specifically to facilitate commerce and typically result in the commitment being drawn on when the underlying transaction is consummated between the customer and the third party. These financial standby letters of credit irrevocably obligate the Company to pay a third-party beneficiary when a customer fails to repay an outstanding loan or debt instrument.

Off-balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies used for loans are used to make such commitments, including obtaining collateral at exercise of the commitment.

A summary of the contractual amounts of the Company's exposure to off-balance sheet risk is as follows:

	December 31, 2019		December 31, 2018	
(Dollars in thousands)	**Fixed**	**Variable**	**Fixed**	**Variable**
Commitments to make loans	**$ 16,276**	**$ 20,128**	$ 8,608	$ 10,900
Unused lines of credit	**28,723**	**288,086**	18,672	229,490
Unused standby letters of credit and commercial letters of credit	**4,895**	—	3,861	232

Commitments to make loans are generally made for periods of 90 days or less. The fixed rate loan commitments of $16.3 million as of December 31, 2019, had interest rates ranging from 3.9% to 8.0% and maturities ranging from 3 years to 30 years.

NOTE 13—REGULATORY CAPITAL MATTERS

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, 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 capital requirements can initiate regulatory action. Management believed as of December 31, 2019, the Company and Bank met all capital adequacy requirements to which they were subject.

The Basel III rules require the Company to maintain a capital conservation buffer of common equity capital of greater than 2.5% above the minimum risk-weighted assets ratios, which is the fully phased-in amount of the capital conservation buffer. The capital conservation buffer was 2.5% at December 31, 2019 and 1.875% at December 31, 2018.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms 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 December 31, 2019 and December 31, 2018, the Bank's capital ratios were in excess of the requirement to be "well capitalized" under the regulatory framework for prompt corrective action. There are no conditions or events that management believes have changed the Bank's category.

Actual and required capital amounts and ratios are presented below:

	Actual		For Capital Adequacy Purposes		For Capital Adequacy Purposes + Capital Conservation Buffer(1)		Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2019								
Common equity tier 1 to risk-weighted assets:								
Consolidated	**$ 157,659**	**11.72%**	**$ 60,533**	**4.50%**	**$ 94,163**	**7.00%**		
Bank	**165,199**	**12.27%**	**60,568**	**4.50%**	**94,217**	**7.00%**	**$ 87,487**	**6.50%**
Tier 1 capital to risk-weighted assets:								
Consolidated	**$ 157,659**	**11.72%**	**$ 80,711**	**6.00%**	**$ 114,341**	**8.50%**		
Bank	**165,199**	**12.27%**	**80,757**	**6.00%**	**114,406**	**8.50%**	**$ 107,676**	**8.00%**
Total capital to risk-weighted assets:								
Consolidated	**$ 215,091**	**15.99%**	**$ 107,615**	**8.00%**	**$ 141,244**	**10.50%**		
Bank	**178,191**	**13.24%**	**107,676**	**8.00%**	**141,325**	**10.50%**	**$ 134,595**	**10.00%**
Tier 1 capital to average assets (leverage ratio):								
Consolidated	**$ 157,659**	**10.41%**	**$ 60,580**	**4.00%**	**$ 60,580**	**4.00%**		
Bank	**165,199**	**10.96%**	**60,276**	**4.00%**	**60,276**	**4.00%**	**$ 75,345**	**5.00%**
December 31, 2018								
Common equity tier 1 to risk-weighted assets:								
Consolidated	$ 144,008	11.82%	$ 54,803	4.50%	$ 77,699	6.38%		
Bank	147,495	12.12%	54,780	4.50%	77,666	6.38%	$ 79,126	6.50%
Tier 1 capital to risk-weighted assets:								
Consolidated	$ 144,008	11.82%	$ 73,071	6.00%	$ 95,967	7.88%		
Bank	147,495	12.12%	73,040	6.00%	95,926	7.88%	$ 97,386	8.00%
Total capital to risk-weighted assets:								
Consolidated	$ 170,503	14.00%	$ 97,428	8.00%	$ 120,324	9.88%		
Bank	159,100	13.07%	97,386	8.00%	120,272	9.88%	$ 121,733	10.00%
Tier 1 capital to average assets (leverage ratio):								
Consolidated	$ 144,008	10.21%	$ 56,411	4.00%	$ 56,411	4.00%		
Bank	147,495	10.48%	56,309	4.00%	56,309	4.00%	$ 70,386	5.00%

(1) Reflects the capital conservation buffer of 2.5% and 1.875% applicable at December 31, 2019 and 2018, respectively.

Dividend Restrictions - The Company's primary source of cash 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, 2019, the Bank had the capacity to pay the Company a dividend of up to $37.2 million without the need to obtain prior regulatory approval.

NOTE 14—FAIR VALUE

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 company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Investment Securities: Securities available for sale are recorded at fair value on a recurring basis as follows: the fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). No securities are valued using a Level 3 approach.

Loans Held for Sale, at Fair Value: The fair value of loans held for sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan (Level 2).

Loans Measured at Fair Value: During the normal course of business, loans originated with the initial intention to sell but not ultimately sold, are transferred from held for sale to our portfolio of loans held for investment at fair value as the Company adopted the fair value option at origination. The fair value of these loans is determined by obtaining fair value pricing from a third-party software, and then layering an additional adjustment, ranging from 5 to 75 basis points, as determined by management, depending on the reason for the transfer from loans held for sale. Due to the adjustments made, the Company classifies the loans transferred from loans held for sale as recurring Level 3.

Mortgage Servicing Rights ("MSRs"): In accordance with GAAP, the Company must record impairment charges on mortgage servicing rights on a non-recurring basis when the carrying value exceeds the estimated fair value. The fair value of our MSRs is obtained from a third-party valuation company that uses a discounted cash flow valuation model which calculates the present value of estimated future net servicing cash flows, taking into consideration expected mortgage loan prepayment rates, discount rates, costs to service, contractual servicing fee income, ancillary income, late fees, replacement reserves and other economic factors that are determined based on current market conditions. The reliance on Level 3 inputs to derive at the fair value of MSRs results in a Level 3 classification.

Impaired Loans: Impaired loans are measured and recorded at fair value on a non-recurring basis. All of our nonaccrual loans and trouble debt restructured loans are considered impaired and are reviewed individually for the amount of impairment, if any. The fair value of impaired loans is estimated using one of several methods, including the fair value of the collateral or the present value of the expected future cash flows discounted at the loan's effective interest rate. For loans that are collateral dependent, the fair value of each loan’s collateral is generally based on estimated market prices from an independently prepared appraisal. 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 appraisers to adjust for differences between the comparable sales and income data available. 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. Such adjustments are considered unobservable and the fair value measurement is categorized as a Level 3 measurement.

Other Real Estate Owned: Other real estate owned assets are recorded at the lower of cost or fair value upon the transfer of a loan to other real estate owned and, subsequently, continue to be measured and carried at the lower of cost or fair value. The fair value of other real estate owned is based on recent real estate appraisals which are generally updated annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales, cost, 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 are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Other 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 either the Company or the Company's appraisal services vendor. Once received, management 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. Management monitors 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: Customer-initiated derivatives are traded in over-the counter markets where quoted market prices are not readily available. Fair value of customer-initiated derivatives is measured on a recurring basis using valuation models that use market observable inputs (Level 2).

Mortgage banking related derivatives including commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of these mortgage loans are recorded at fair value on a recurring basis. The fair value of these commitments is based on the fair value of related mortgage loans determined using observable market data (Level 2). Interest rate lock commitments are adjusted for expectations of exercise and funding. This adjustment is not considered to be material input.

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

(Dollars in thousands)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2019				
Securities available for sale:				
State and political subdivision	$ 93,747	$ —	$ 93,747	$ —
Mortgage-backed securities: residential	10,565	—	10,565	—
Mortgage-backed securities: commercial	8,779	—	8,779	—
Collateralized mortgage obligations: residential	8,529	—	8,529	—
Collateralized mortgage obligations: commercial	23,181	—	23,181	—
U.S. Treasury	1,999	—	1,999	—
SBA	21,984	—	21,984	—
Asset backed securities	10,084	—	10,084	—
Corporate bonds	2,037	—	2,037	—
Total securities available for sale	180,905	—	180,905	—
Loans held for sale	13,889	—	13,889	—
Loans measured at fair value:				
Residential real estate	4,063	—	—	4,063
Derivative assets:				
Customer-initiated derivatives	4,684	—	4,684	—
Forward contracts related to mortgage loans to be delivered for sale	34	—	34	—
Interest rate lock commitments	256	—	256	—
Total assets at fair value	$ 203,831	$ —	$ 199,768	$ 4,063
Derivative liabilities:				
Customer-initiated derivatives	4,684	—	4,684	—
Forward contracts related to mortgage loans to be delivered for sale	33	—	33	—
Total liabilities at fair value	$ 4,717	$ —	$ 4,717	$ —

(Dollars in thousands)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2018				
Securities available for sale:				
U.S. government sponsored entities and agencies	$ 2,397	$ —	$ 2,397	$ —
State and political subdivision	75,146	—	75,146	—
Mortgage-backed securities: residential	9,739	—	9,739	—
Mortgage-backed securities: commercial	12,382	—	12,382	—
Collateralized mortgage obligations: residential	18,671	—	18,671	—
Collateralized mortgage obligations: commercial	31,988	—	31,988	—
U.S. Treasury	20,481	—	20,481	—
SBA	15,688	—	15,688	—
Asset backed securities	3,842	—	3,842	—
Corporate bonds	13,924	—	13,924	—
Total securities available for sale	$ 204,258	$ —	$ 204,258	$ —
Loans held for sale	5,595	—	5,595	—
Loans measured at fair value:				
Residential real estate	4,571	—	—	4,571
Derivative assets:				
Customer-initiated derivatives	1,126	—	1,126	—
Forward contracts related to mortgage loans to be delivered for sale	22	—	22	—
Interest rate lock commitments	198	—	198	—
Total assets at fair value	$ 215,770	$ —	$ 211,199	$ 4,571
Derivative liabilities:				
Customer-initiated derivatives	1,126	—	1,126	—
Forward contracts related to mortgage loans to be delivered for sale	43	—	43	—
Total liabilities at fair value	$ 1,169	$ —	$ 1,169	$ —

There were no transfers between levels within the fair value hierarchy, within a specific category, during the year ended December 31, 2019 or 2018.

The following table summarizes the changes in Level 3 assets measured at fair value on a recurring basis.

(Dollars in thousands)	Loans held for investment
For the year ended December 31, 2019	
Beginning balance	**$ 4,571**
Transfers from loans held for sale	**2,186**
Gains (losses):	
Recorded in "Mortgage banking activities"	**126**
Repayments	**(2,820)**
Ending balance	**$ 4,063**
For the year ended December 31, 2018	
Beginning balance	$ 4,291
Transfers from loans held for sale	544
Gains (losses):	
Recorded in "Mortgage banking activities"	(108)
Repayments	(156)
Ending balance	$ 4,571

The Company has elected the fair value option for loans held for sale. These loans are intended for sale and the Company believes that 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 Company's policy on loans held for investment. There were no loans held for sale that were on nonaccrual status or 90 days past due as of December 31, 2019 or December 31, 2018.

As of December 31, 2019 and December 31, 2018, the aggregate fair value, contractual balance (including accrued interest), and gain or loss for loans held for sale carried at fair value was as follows:

(Dollars in thousands)	December 31, 2019	December 31, 2018
Aggregate fair value	**$ 13,889**	$ 5,595
Contractual balance	**13,510**	5,512
Unrealized gain	**379**	83

The total amount of gains as a result of changes in fair value of loans held for sale included in "Mortgage banking activities" for the years ended December 31, 2019, 2018 and 2017 were as follows:

	For the year ended December 31,		
(Dollars in thousands)	2019	2018	2017
Change in fair value	**$ 296**	$ 1	$ (172)

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

(Dollars in thousands)	Total	Significant Unobservable Inputs (Level 3)
December 31, 2019		
Impaired loans:		
Commercial real estate	**$ 265**	**$ 265**
Commercial and industrial	**261**	**261**
Mortgage servicing rights	**87**	**87**
Other real estate owned	**921**	**921**
Total	**$ 1,534**	**$ 1,534**
December 31, 2018		
Impaired loans:		
Commercial and industrial	$ 3,337	$ 3,337
Total	$ 3,337	$ 3,337

The Company recorded specific reserves of $161 thousand and $278 thousand to reduce the value of these loans at December 31, 2019 and December 31, 2018, respectively, based on the estimated fair value of the underlying collateral. The Company also recorded chargeoffs of $298 thousand during the year ended December 31, 2019 related to the impaired loans at fair value. There were no charge-offs related to impaired loans at fair value during the year ended December 31, 2018.

There were no write downs recorded in other real estate owned during the year ended December 31, 2019. There were no other real estate owned assets at fair value at December 31, 2018.

The table below presents quantitative information about the significant unobservable inputs for assets measured at fair value on a nonrecurring basis at December 31, 2019 and December 31, 2018:

(Dollars in thousands)	Fair value at December 31, 2019	Valuation Technique(s)	Significant Unobservable Input(s)	Discount % Range
Impaired loans	**$ 526**	Discounted appraisals; estimated net realizable value of collateral	Collateral discounts	10.00-50.00%
Mortgage servicing rights	**87**	Discounted cash flow	Prepayment speed	4.00-17.44%
			Discount rate	4.62-13.00%
Other real estate owned	**921**	Appraisal of property	Discounted appraisal value	18.00-36.00%

(Dollars in thousands)	Fair value at December 31, 2018	Valuation Technique(s)	Significant Unobservable Input(s)	Discount % Range
Impaired loans	$ 3,337	Discounted appraisals	Collateral discounts	17.00-50.00%

The carrying amounts and estimated fair values of financial instruments, excluding those previously presented unless otherwise noted, at December 31, 2019 and December 31, 2018 are noted in the table below. The estimated fair value of loans as of December 31, 2019 takes into account exit pricing as a result of our adoption of ASU No. 2016-01.

		Estimated Fair Value			
(Dollars in thousands)	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
December 31, 2019					
Financial assets:					
Cash and cash equivalents	**$ 103,930**	**$ 19,990**	**$ 83,940**	**$ —**	**$ 103,930**
Federal Home Loan Bank stock	**11,475**	**N/A**	**N/A**	**N/A**	**N/A**
Net loans	**1,214,935**	**—**	**—**	**1,203,639**	**1,203,639**
Accrued interest receivable	**4,403**	**—**	**1,236**	**3,167**	**4,403**
Financial liabilities:					
Deposits	**1,135,428**	**—**	**1,138,202**	**—**	**1,138,202**
Borrowings	**212,225**	**—**	**212,125**	**—**	**212,125**
Subordinated notes	**44,440**	**—**	**47,100**	**—**	**47,100**
Accrued interest payable	**1,574**	**—**	**1,574**	**—**	**1,574**
December 31, 2018					
Financial assets:					
Cash and cash equivalents	$ 33,296	$ 27,072	$ 6,224	$ —	$ 33,296
Federal Home Loan Bank stock	8,325	N/A	N/A	N/A	N/A
Net loans	1,114,999	—	—	1,113,648	1,113,648
Accrued interest receivable	4,207	—	1,210	2,997	4,207
Financial liabilities:					
Deposits	1,134,635	—	1,137,575	—	1,137,575
Borrowings	99,574	—	100,602	—	100,602
Subordinated notes	14,891	—	15,450	—	15,450
Accrued interest payable	1,674	—	1,674	—	1,674

The methods and assumptions, not previously presented, used to estimate fair value are described as follows:

(a) ***Cash and Cash Equivalents***

The carrying amounts of cash on hand and non-interest due from bank accounts approximate fair values and are classified as Level 1. The carrying amounts of fed funds sold and interest bearing due from bank accounts approximate fair values and are classified as Level 2.

(b) ***FHLB Stock***

It is not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

(c) ***Loans***

Fair value of loans, excluding loans held for sale, are estimated as follows: Fair values for all loans are estimated using present value of future estimated cash flows, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality, resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously.

(d) ***Deposits***

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 2 classification. Fair values for fixed and variable rate certificates of deposit are estimated using a present

value of future estimated cash flows calculation that applies interest rates currently being offered on certificates of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification**.**

(e) ***Borrowings***

The fair values of the Company's short-term and long-term borrowings are estimated using present value of future estimated cash flows using current interest rates offered to the Company for similar types of borrowing arrangements, resulting in a Level 2 classification.

(f) ***Subordinated Notes***

The fair value of the Company's subordinated notes is calculated based on present value of future estimated cash flows using current interest rates offered to the Company for similar types of borrowing arrangements, resulting in a Level 2 classification.

(g) ***Accrued Interest Receivable/Payable***

The carrying amounts of accrued interest approximate fair value resulting in a Level 3 classification for receivable and a Level 2 classification for payable, consistent with their associated assets/liabilities.

NOTE 15—DERIVATIVES

The Company executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. These interest rate swaps are simultaneously hedged by offsetting interest rate swaps that the Company executes with a third party, such that the Company minimizes its net risk exposure resulting from such transactions with approved, reputable, independent counterparties with substantially matching terms. The agreements are considered standalone derivatives, and changes in the fair value of derivatives are reported in earnings as non-interest income.

Credit risk arises from the possible inability of counterparties to meet the terms of their contracts. The Company's exposure is limited to the replacement value of the contracts rather than the notional, principal or contract amounts. There are provisions in the agreements with the counterparties that allow for certain unsecured credit exposure up to an agreed threshold. Exposures in excess of the agreed thresholds are collateralized. In addition, the Company minimizes credit risk through credit approvals, limits, and monitoring procedures.

Commitments to fund certain mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of mortgage loans to third party investors are considered derivatives. It is the Company's practice to enter into forward commitments for the future delivery of residential mortgage loans when interest rate lock commitments are entered into in order to economically hedge the effect of changes in interest rates resulting from its commitments to fund the loans. These mortgage banking derivatives are not designated in hedge relationships. Fair values were estimated based on changes in mortgage interest rates from the date of the commitments. Changes in the fair values of these mortgage-banking derivatives are included in mortgage banking activities.

The following table presents the notional amount and fair value of the Company's derivative instruments held or issued in connection with customer initiated and mortgage banking activities:

(Dollars in thousands)	December 31, 2019		December 31, 2018	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Included in other assets:				
Customer-initiated and mortgage banking derivatives:				
Customer-initiated derivatives	**$ 103,941**	**$ 4,684**	$ 35,733	$ 1,126
Forward contracts related to mortgage loans to be delivered for sale	**6,018**	**34**	5,241	22
Interest rate lock commitments	**25,519**	**256**	18,375	198
Total derivatives included in other assets	**$ 135,478**	**$ 4,974**	$ 59,349	$ 1,346
Included in other liabilities:				
Customer-initiated and mortgage banking derivatives:				
Customer-initiated derivatives	**$ 103,941**	**$ 4,684**	$ 35,733	$ 1,126
Forward contracts related to mortgage loans to be delivered for sale	**20,633**	**33**	11,195	43
Interest rate lock commitments	**928**	**—**	—	—
Total derivatives included in other liabilities	**$ 125,502**	**$ 4,717**	$ 46,928	$ 1,169

In the normal course of business, the Company may decide to settle a forward contract rather than fulfill the contract. Cash received or paid in this settlement manner is included in "Mortgage banking activities" in the consolidated statements of income and is considered a cost of executing a forward contract. The following table presents the gains (losses) related to derivative instruments reflecting the changes in fair value:

(Dollars in thousands)	Location of Gain (Loss)	For th year ended December 31,		
		2019	2018	2017
Forward contracts related to mortgage loans to be delivered for sale	Mortgage Banking Activities	**$ (509)**	$ (69)	$ (106)
Interest rate lock commitments	Mortgage Banking Activities	**58**	142	(28)
Total gain (loss) recognized in income		**$ (451)**	$ 73	$ (134)

Balance Sheet Offsetting:

Certain financial instruments, including customer-initiated derivatives and interest rate swaps, may be eligible for offset in the consolidated balance sheets and/or subject to master netting arrangements or similar agreements. The Company is a party to master netting arrangements with its financial institution counterparties; however, the Company does not offset assets and liabilities under these arrangements for financial statement presentation purposes based on an accounting policy election. The table below presents information about the Company's financial instruments that are eligible for offset.

(Dollars in thousands)	Gross amounts recognized	Gross amounts offset in the statements of financial condition	Net amounts presented in the statements of financial condition	Gross amounts not offset in the statements of financial position		Net amount
				Financial instruments	Collateral (received)/posted	
December 31, 2019						
Offsetting derivative assets:						
Customer initiated derivatives	**$ 4,684**	**$ —**	**$ 4,684**	**$ —**	**$ —**	**$ 4,684**
Offsetting derivative liabilities:						
Customer initiated derivatives	**4,684**	**—**	**4,684**	**—**	**4,375**	**309**
December 31, 2018						
Offsetting derivative assets:						
Customer initiated derivatives	$ 1,126	$ —	$ 1,126	$ —	$ —	$ 1,126
Offsetting derivative liabilities:						
Customer initiated derivatives	1,126	—	1,126	—	1,020	106

NOTE 16—PARENT COMPANY FINANCIAL STATEMENTS

Balance Sheets—Parent Company

(Dollars in thousands)	December 31, 2019	December 31, 2018
Assets		
Cash and cash equivalents	**$ 35,210**	$ 9,690
Investment in banking subsidiary	**178,240**	155,248
Investment in captive insurance subsidiary	**1,668**	1,622
Income tax benefit	**520**	393
Other assets	**99**	21
Total assets	**$ 215,737**	$ 166,974
Liabilities		
Subordinated notes	**$ 44,440**	$ 14,891
Accrued expenses and other liabilities	**594**	323
Total liabilities	**45,034**	15,214
Shareholders' equity	**170,703**	151,760
Total liabilities and shareholders' equity	**$ 215,737**	$ 166,974

Statements of Income and Comprehensive Income—Parent Company

(Dollars in thousands)	For the year ended December 31, 2019	2018	2017
Income			
Dividend income from captive subsidiary	$ 860	$ —	$ —
Total income	860	—	—
Expenses			
Interest on borrowed funds	$ 4	$ —	$ —
Interest on subordinated notes	1,074	1,015	1,015
Other expenses	1,196	715	1,222
Total expenses	2,274	1,730	2,237
Loss before income taxes and equity in undistributed net earnings of subsidiaries	(1,414)	(1,730)	(2,237)
Income tax benefit	427	425	686
Equity in undistributed earnings of subsidiaries	17,098	15,691	11,392
Net income	$ 16,111	$ 14,386	$ 9,841
Other comprehensive income (loss)	5,344	(801)	343
Total comprehensive income, net of tax	$ 21,455	$ 13,585	$ 10,184

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Statements of Cash Flows—Parent Company

(Dollars in thousands)	For the year ended December 2019	2018	2017
Cash flows from operating activities			
Net income	**$ 16,111**	$ 14,386	$ 9,841
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiaries	**(17,098)**	(15,691)	(11,392)
Stock based compensation expense	**74**	314	329
(Increase) decrease in other assets, net	**(205)**	(45)	1,271
Increase (decrease) in other liabilities, net	**257**	(79)	215
Net cash provided by (used in) operating activities	**(861)**	(1,115)	264
Cash flows from investing activities			
Capital contributions to captive subsidiary	**—**	—	(250)
Capital infusion to subsidiaries	**—**	(20,000)	—
Net cash used in investing activities	**—**	(20,000)	(250)
Cash flows from financing activities			
Net proceeds from issuance of common stock related to initial public offering	**—**	29,030	—
Net proceeds from issuance of subordinated debt	**29,487**	—	—
Share buyback - redeemed stock	**(2,165)**	—	—
Common stock dividends paid	**(1,160)**	(662)	—
Proceeds from exercised stock options	**219**	1,279	605
Net cash provided by financing activities	**26,381**	29,647	605
Net increase in cash and cash equivalents	**25,520**	8,532	619
Beginning cash and cash equivalents	**9,690**	1,158	539
Ending cash and cash equivalents	**$ 35,210**	$ 9,690	$ 1,158

NOTE 17—EARNINGS PER SHARE

Beginning in the second quarter of 2019, the Company has elected to prospectively use the two-class method in calculating earnings per share due to the unvested restricted stock awards qualifying as participating securities. The two-class method is used in the calculation of basic and diluted earnings per share. Under the two-class method, earnings available to common shareholders for the period are allocated between common shareholders and participating securities according to dividends declared (or accumulated) and participating rights in undistributed earnings.

Average shares of common stock for diluted net income per common share include shares to be issued upon the exercise of stock options granted under the Company's share-based compensation plans and restricted stock awards.

The calculation of basic and diluted earnings per share using the two-class method for the year ended December 31, 2019 was as follows:

(In thousands, except per share data)		For the year ended December 31, 2019
Net income	$	16,111
Net income allocated to participating securities		159
Net income allocated to common shareholders [(1)]	$	15,952
Weighted average common shares - issued		7,733
Average unvested restricted share awards		(78)
Weighted average common shares outstanding - basic		7,655
Effect of dilutive securities:		
Weighted average common stock equivalents		115
Weighted average common shares outstanding - diluted		7,770
EPS available to common shareholders		
Basic earnings per common share	$	2.08
Diluted earnings per common share	$	2.05

[(1)] Net income allocated to common shareholders for basic and diluted earnings per share may differ under the two-class method as a result of adding common share equivalents for options to dilutive shares outstanding, which alters the ratio used to allocate net income to common shareholders and participating securities for the purposes of calculating diluted earnings per share.

For the years ended December 31, 2018 and 2017, the basic and diluted earnings per share were calculated using the treasury stock method, as disclosed in the table below.

(Dollars in thousands, except per share data)	For the year ended December 31,			
		2018		2017
Basic:				
Net Income attributable to common shareholders	$	14,386	$	9,841
Weighted average common shares outstanding		7,376,507		6,388,328
Basic earnings per share	$	1.95	$	1.54
Diluted:				
Net Income attributable to common shareholders	$	14,386	$	9,841
Weighted average common shares outstanding		7,376,507		6,388,328
Add: Dilutive effects of assumed exercises of stock options		147,411		221,668
Weighted average common and dilutive potential common shares outstanding		7,523,918		6,609,996
Diluted earnings per common share	$	1.91	$	1.49

Stock options for 30,000 shares and and 26,301 shares of common stock were not considered in computing diluted earnings per common share for the years ended December 31, 2019 and 2018, respectively, because they were antidilutive. There were no antidilutive stock options for the year ended December 31, 2017.

NOTE 18 - QUARTERLY FINANCIAL DATA (UNAUDITED)

The following tables present the unaudited quarterly financial data for the years ended December 31, 2019 and 2018:

	For the year ended December 31, 2019			
(In thousands, except per share data)	**First Quarter**	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
Interest income	**$ 17,442**	**$ 17,657**	**$ 17,983**	**$ 17,366**
Interest expense	**4,724**	**5,216**	**4,995**	**4,458**
Net interest income	**12,718**	**12,441**	**12,988**	**12,908**
Provision (benefit) for loan losses	**422**	**429**	**(16)**	**548**
Net interest income after provision (benefit) for loan losses	**12,296**	**12,012**	**13,004**	**12,360**
Noninterest income	**2,286**	**3,477**	**3,858**	**4,590**
Noninterest expense	**10,368**	**11,167**	**11,539**	**11,295**
Income before income taxes	**4,214**	**4,322**	**5,323**	**5,655**
Income tax provision	**747**	**767**	**914**	**975**
Net income	**$ 3,467**	**$ 3,555**	**$ 4,409**	**$ 4,680**
Earnings per common share:				
Basic	**$ 0.45**	**$ 0.46**	**$ 0.57**	**$ 0.60**
Diluted	**0.44**	**0.45**	**0.56**	**0.60**
Cash dividends declared per common share	**0.04**	**0.04**	**0.04**	**0.04**

	For the year ended December 31, 2018			
(In thousands, except per share data)	**First Quarter**	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
Interest income	$ 14,774	$ 15,380	$ 16,629	$ 17,041
Interest expense	2,647	2,965	3,560	4,228
Net interest income	12,127	12,415	13,069	12,813
Provision (benefit) for loan losses	554	(710)	619	(51)
Net interest income after provision (benefit) for loan losses	11,573	13,125	12,450	12,864
Noninterest income	1,372	1,452	1,924	2,307
Noninterest expense	9,135	9,705	10,454	10,384
Income before income taxes	3,810	4,872	3,920	4,787
Income tax provision	642	860	665	836
Net income	$ 3,168	$ 4,012	$ 3,255	$ 3,951
Earnings per common share:				
Basic	$ 0.48	$ 0.54	$ 0.42	$ 0.51
Diluted	0.47	0.53	0.41	0.50
Cash dividends declared per common share	0.03	0.03	0.03	0.03

NOTE 19—SUBSEQUENT EVENTS

Merger with Ann Arbor Bancorp, Inc.

On January 2, 2020, the Company completed its previously announced acquisition of Ann Arbor Bancorp, Inc. ("AAB") and its wholly owned subsidiary, Ann Arbor State Bank. The transaction was completed pursuant to a merger of the Company's wholly owned merger subsidiary with and into AAB, pursuant to the Agreement and Plan of Merger, dated as of August 12, 2019, among the Company, Merger Sub and AAB. The Company paid an aggregate consideration of approximately $67.9 million in cash.

Goodwill of $26.2 million arising from the acquisition consisted largely of synergies and the cost savings resulting from the combining of the operations of the companies. The goodwill arising from the acquisition of AAB is not deductible for tax purposes.

The following table summarizes the amounts of assets acquired and liabilities assumed recognized at the acquisition date.

(Dollars in thousands)		
Cash and cash equivalents	$	38,480
Investment securities		47,416
Federal Home Loan Bank stock		923
Loans		224,059
Premises and equipment		3,205
Core deposit intangibles		3,663
Other assets		7,352
Total assets acquired		325,098
Deposits		264,820
Federal Home Loan Bank advances		15,279
Other liabilities		3,251
Total liabilities assumed		283,350
Total identifiable net assets		41,748
Goodwill		26,196
Total cash consideration	$	67,944

Loans acquired in the acquisition were initially recorded at fair value with no separate allowance for loan losses. The Company reviewed the loans at acquisition to determine which should be considered purchased credit impaired loans (i.e. loans accounted for under ASC 310-30) defining impaired loans as those that were either not accruing interest or exhibited credit risk factors consistent with nonaccrual loans at the acquisition date. Fair values for purchased loans are based on a discounted cash flow methodology that considers various factors including the type of loan and related collateral, classification status, fixed or variable interest rate, term of the loan and whether or not the loan was amortizing, and a discount rate reflecting the Company's assessment of risk inherent in the cash flow estimates. The Company accounts for purchased credit impaired loans in accordance with the provisions of ASC 310-30. The cash flows expected to be collected on purchased loans are estimated based upon the expected remaining life of the underlying loans, which includes the effects of estimated prepayments. Purchased loans are considered credit impaired if there is evidence of credit deterioration at the date of purchase and if it is probable that not all contractually required payments will be collected. Interest income, through accretion of the difference between the carrying value of the loans and the expected cash flows is recognized on the acquired loans accounted for under ASC 310-30.

Purchased loans outside the scope of ASC 310-30 are accounted for under ASC 310-20. Premiums and discounts created when the loans were recorded at their fair values at acquisition are amortized over the remaining terms of the loans as an adjustment to the related loan's yield.

(Dollars in thousands)		
Accounted for under ASC 310-30:		
Contractual cash flows	$	1,018
Contractual cash flows not expected to be collected (nonaccretable difference)		82
Expected cash flows		936
Interest component of expected cash flows (accretable yield)		35
Fair value at acquisition		901
Excluded from ASC 310-30 accounting:		
Unpaid principal and interest balance		220,986
Fair value (discount)/premium		394
Fair value at acquisition		221,380
Total fair value at acquisition	$	222,281

Item 9 - Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A – Controls and Procedures

Evaluation of disclosure controls and procedures. The Company's management, including our President and Chief Executive Officer and our Chief Financial Officer, have evaluated the effectiveness of our "disclosure controls and procedures" (as defined in Rule 13a-15(e) under the Exchange Act), as of the end of the period covered by this report. Based on such evaluation, our President and Chief Executive Officer and our Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures were effective as of that date to provide reasonable assurance that the information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its President and Chief Executive Officer and its Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Management's annual report on internal control over financial reporting. Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act). Internal control over financial reporting is designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation of reliable published financial statements. Internal control over financial reporting includes self-monitoring mechanisms, and actions are taken to correct deficiencies as they are identified.

Because of inherent limitations in any system of internal control, no matter how well designed, misstatements due to error or fraud may occur and not be detected, including the possibility of the circumvention or overriding of controls. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, internal control effectiveness may vary over time.

Management assessed the Company's internal control over financial reporting as of December 31, 2019. This assessment was based on criteria for effective internal control over financial reporting described in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, our President and Chief Executive Officer and our Chief Financial Officer assert that the Company maintained effective internal control over financial reporting as of December 31, 2019 based on the specified criteria.

Changes in internal control over financial reporting. There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rule 13a-15 (f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B – Other Information

None.

PART III

Item 10 - Directors, Executive Officers and Corporate Governance.

Information required by this item is set forth under the headings “Proposal 1 – Election of Directors,” “Delinquent Section 16(a) Reports,” and “Corporate Governance and the Board of Directors” appearing in the Company’s Proxy Statement for the 2020 annual meeting of shareholders to be filed within 120 days after December 31, 2019, which is incorporated herein by reference.

Item 11 - Executive Compensation

Information required by this item is set forth under the headings "Executive Compensation," "Corporate Governance and the Board of Directors - Director Compensation," and "Corporate Governance and the Board of Directors - Compensation
Committee Interlocks and Insider Participation" appearing in the Company's Proxy Statement for the 2020 annual meeting of
shareholders to be filed within 120 days after December 31, 2019, which is incorporated herein by reference.

Item 12 - Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Equity Compensation Plans. The following table discloses the number of outstanding options, warrants and rights granted to participants by the Company under our equity compensation plans, as well as the number of securities remaining available for future issuance under these plans as of December 31, 2019. Additional information regarding stock incentive plans is presented in Note 10 to the consolidated financial statements included pursuant to Item 8 to this Form 10-K.

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by shareholders [1]	335,214	$ 16.14	203,767
Equity compensation plans not approved by shareholders [2]	—	—	—
Total	335,214	$ 16.14	203,767

(1) Column (a) includes outstanding stock options granted from the Level One Bancorp, Inc. 2007 Stock Option Plan. Column (c) reflects the remaining share reserve under the Level One Bancorp, Inc. 2018 Equity Incentive Compensation Plan attributable to the initial 250,000 shares reserved for issuance.

(2) Reflects the Level One Bancorp, Inc. 2014 Equity Incentive Plan. As of December 31, 2019, there were no outstanding options, warrants or rights under the plan, and no additional awards may be granted under the plan.

Other information required by this item is set forth under the heading “Security Ownership of Certain Beneficial Owners” appearing in the Company’s Proxy Statement for the 2020 annual meeting of shareholders to be filed within 120 days after December 31, 2019, which is incorporated herein by reference.

Item 13 - Certain Relationships and Related Transactions, and Director Independence

Information required by this item is set forth under the headings “Certain Relationships and Related Party Transactions” and “Corporate Governance and the Board of Directors” appearing in the Company’s Proxy Statement for the 2020 annual meeting of shareholders to be filed within 120 days after December 31, 2019, which is incorporated herein by reference.

Item 14 - Principal Accountant Fees and Services.

Information required by this item is set forth under the heading "Proposal 2 - Ratification of the Appointment of Plante & Moran, PLLC as our Independent Registered Public Accounting Firm" appearing in the Company's Proxy Statement for the

2020 annual meeting of shareholders to be filed with the SEC within 120 days after December 31, 2019, which is incorporated herein by reference.

PART IV

Item 15 - Exhibits and Financial Statement Schedules

(a) The following documents are filed as part of this report:

(1) Financial Statements:

The following consolidated financial statements of the registrant and its subsidiaries are filed as part of this document under "Item 8. Financial Statements and Supplementary Data."

Consolidated Balance Sheets –December 31, 2019 and 2018
Consolidated Statements of Income – Years Ended December 31, 2019, 2018, 2017
Consolidated Statements of Comprehensive Income - Years Ended December 31, 2019, 2018, 2017
Consolidated Statements of Shareholders' Equity – Years Ended December 31, 2019, 2018, 2017
Consolidated Statements of Cash Flows – Years Ended December 31, 2019, 2018, 2017
Notes to Consolidated Financial Statements

(2) Financial Statement Schedules:

All schedules are omitted as such information is inapplicable or is included in the financial statements.

(3) Exhibits:

The exhibits are filed as part of this report and exhibits incorporated herein by reference to other documents are as follows:

Exhibit No.	Description
2.1	Agreement and Plan of Merger, dated as of August 12, 2019, among Level One Bancorp, Inc., AASB Acquisition, Inc. and Ann Arbor Bancorp, Inc. (incorporated by reference to Exhibit 2.1 to the Company's current report on Form 8-K filed August 14, 2019).†
3.1	Articles of Incorporation of Level One Bancorp, Inc. (incorporated by reference to Exhibit 3.1 to the Company's registration statement on Form S-1 (File no. 333-223866) filed March 23, 2018).
3.2	Amended and Restated Bylaws of Level One Bancorp, Inc. (incorporated by reference to Exhibit 3.2 to the Company's registration statement on Form S-1 (File no. 333-223866) filed March 23, 2018).
4.0	Description of the Company's Securities Registered Pursuant to Section 12 of the Securities Exchange Act of 1934 - filed herewith.
4.1	Form of common stock certificate of Level One Bancorp, Inc. (incorporated by reference to Exhibit 4.1 the Company's registration statement on Form S-1 (File no. 333-223866) filed March 23, 2018).
4.2	Indenture, dated as of December 18, 2019, between Level One Bancorp, Inc. and Wilmington Trust, National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K filed December 19, 2019).
4.3	Form of 4.75% Fixed-to-Floating Rate Subordinated Notes due 2029 (incorporated by reference to Exhibit 4.2 to the Company's current report on Form 8-K filed December 19, 2019).
4.4	Form of Registration Rights Agreement, dated as of December 18, 2019, among Level One Bancorp, Inc. and the purchasers party thereto (incorporated by reference to Exhibit 4.3 to the Company's current report on Form 8-K filed December 19, 2019).
10.1*	Employment Agreement, dated September 12, 2017, among Level One Bancorp, Inc., Level One Bank and Patrick Fehring (incorporated by reference to Exhibit 10.1 to the Company's registration statement on Form S-1 (File no. 333-223866) filed March 23, 2018).

10.2*	Employment Agreement, dated July 8, 2015, among Level One Bancorp, Inc., Level One Bank and Gregory Wernette (incorporated by reference to Exhibit 10.2 to the Company's registration statement on Form S-1 (File no. 333-223866) filed March 23, 2018).
10.3*	Employment Agreement, dated July 16, 2015, among Level One Bancorp, Inc., Level One Bank and David Walker (incorporated by reference to Exhibit 10.3 to the Company's registration statement on Form S-1 (File no. 333-223866) filed March 23, 2018).
10.4*	Form of Level One Bank Supplemental Executive Retirement Plan, dated June 18, 2015 (incorporated by reference to Exhibit 10.4 to the Company's registration statement on Form S-1 (File no. 333-223866) filed March 23, 2018).
10.5*	Level One Bancorp, Inc. 2007 Stock Option Plan as amended and restated April 15, 2015 (incorporated by reference to Exhibit 10.5 to the Company's registration statement on Form S-1 (File no. 333-223866) filed March 23, 2018).
10.6*	Amendment to the Level One Bancorp, Inc. 2007 Stock Option Plan, dated August 29, 2017. (incorporated by reference to Exhibit 10.6 to the Company's registration on Form S-1 (File no. 333-223866) filed March 23, 2018).
10.7*	Form of Non-Qualified Stock Option Agreement under the Level One Bancorp, Inc. 2007 Stock Option Plan (incorporated by reference to Exhibit 10.7 to the Company's registration statement on Form S-1 (File no. 333-223866) filed March 23, 2018).
10.8*	Level One Bancorp, Inc. 2014 Equity Incentive Plan (incorporated by reference to Exhibit 10.8 to the Company's registration statement on Form S-1 (File no. 333-223866) filed March 23, 2018).
10.9*	Form of Restricted Stock Award Agreement under the Level One Bancorp, Inc. 2014 Equity Incentive Plan (incorporated by reference to Exhibit 10.9 to the Company's registration statement on Form S-1 (File no. 333-223866) filed March 23, 2018).
10.10*	Form of Level One Executive Incentive Plan (incorporated by reference to Exhibit 10.10 to the Company's registration statement on Form S-1 (File no. 333-223866) filed March 23, 2018).
10.11*	Level One Bancorp, Inc. 2018 Equity Incentive Plan (incorporated by reference to Exhibit 10.11 to the Company's registration statement on Form S-1 (File no. 333-223866) filed March 23, 2018).
10.12*	Form of Level One Bancorp, Inc. 2018 Equity Incentive Plan Stock Appreciation Right Award Agreement (incorporated by reference to Exhibit 4.7 to the Company’s registration statement on Form S-8 (File no. 333-224500) filed April 27, 2018).
10.13*	Form of Level One Bancorp, Inc. 2018 Equity Incentive Plan Restricted Stock Award Agreement (incorporated by reference to Exhibit 4.8 to the Company’s registration statement on Form S-8 (File no. 333-224500) filed April 27, 2018).
10.14*	Form of Level One Bancorp, Inc. 2018 Equity Incentive Plan Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 4.9 to the Company’s registration statement on Form S-8 (File no. 333-224500) filed April 27, 2018).
10.15*	Form of Level One Bancorp, Inc. 2018 Equity Incentive Plan Nonqualified Stock Option Award Agreement (incorporated by reference to Exhibit 4.10 to the Company’s registration statement on Form S-8 (File no. 333-224500) filed April 27, 2018).
10.16*	Form of Level One Bancorp, Inc. 2018 Equity Incentive Plan Incentive Stock Option Award Agreement (incorporated by reference to Exhibit 4.11 to the Company’s registration statement on Form S-8 (File no. 333-224500) filed April 27, 2018).
10.17	Form of Level One Bank Supplemental Executive Retirement Plan Amendment by Level One Bank and acknowledged by each of Patrick J. Fehring, David C. Walker, Gregory A. Wernette, Timothy R. Mackay, Eva D. Scurlock and Melanie C. Barrett - filed herewith.

21.1	Subsidiaries of Level One Bancorp, Inc. (incorporated by reference to Exhibit 21.1 to the Company's registration statement on Form S-1 (File no. 333-223866) filed March 23, 2018).
23.1	Consent of Plante & Moran, PLLC - filed herewith.
23.2	Consent of Crowe LLP - filed herewith.
31.1	Chief Executive Officer's Certifications required by Rule 13(a)-14(a) – filed herewith.
31.2	Chief Financial Officer's Certifications required by Rule 13(a)-14(a) – filed herewith.
32.1	Chief Executive Officer Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 – filed herewith.
32.2	Chief Financial Officer Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 – filed herewith.
101	Financial information from the Company's Annual Report on Form 10-K for the year ended December 31, 2019, formatted in XBRL interactive data files pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income; (iii) Consolidated Statements of Comprehensive Income; (iv) Consolidated Statements of Changes in Shareholders' Equity; (v) Consolidated Statements of Cash Flows; and (vi) Notes to the Consolidated Financial Statements – filed herewith.

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† Schedules and/or exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Company agrees to furnish a copy of any omitted schedule or exhibit to the SEC upon request.

* Indicates management contract or compensatory plan or arrangement.

Item 16 - Form 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Level One Bancorp, Inc.

Date: March 13, 2020	By:	/s/	Patrick J. Fehring
			Patrick J. Fehring *President and Chief Executive Officer* (principal executive officer)
Date: March 13, 2020	By:	/s/	David C. Walker
			David C. Walker *Executive Vice President and Chief Financial Officer* (principal financial officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ PATRICK J. FEHRING Patrick J. Fehring	Director, President and Chief Executive Officer (principal executive officer)	March 13, 2020
/s/ DAVID C. WALKER David C. Walker	Executive Vice President and Chief Financial Officer (principal financial officer)	March 13, 2020
/s/ BARBARA A. FELTS Barbara A. Felts	Controller (principal accounting officer)	March 13, 2020
/s/ BARBARA E. ALLUSHUSKI Barbara E. Allushuski	Director	March 13, 2020
/s/ VICTOR L. ANSARA Victor L. Ansara	Director	March 13, 2020
/s/ JAMES L. BELLINSON James L. Bellinson	Director	March 13, 2020
/s/ MICHAEL A. BRILLATI Michael A. Brillati	Director	March 13, 2020
/s/ SHUKRI W. DAVID Shukri W. David	Director	March 13, 2020
/s/ THOMAS A. FABBRI Thomas A. Fabbri	Director	March 13, 2020
/s/ JACOB W. HAAS Jacob W. Haas	Director	March 13, 2020
/s/ MARK J. HERMAN Mark J. Herman	Director	March 13, 2020
/s/ STEVEN H. RIVERA Steven H. Rivera	Director	March 13, 2020
/s/ STEFAN WANCZYK Stefan Wanczyk	Director	March 13, 2020

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Section 2: EX-4 (EXHIBIT 4 DESCRIPTION OF CAPITAL STOCK LEVEL ONE)

Exhibit 4.0

DESCRIPTION OF THE COMPANY'S SECURITIES

REGISTERED PURSUANT TO SECTION 12 OF THE

SECURITIES EXCHANGE ACT OF 1934

*The common stock of Level One Bancorp, Inc. (the "Company," which is also referred to herein as "we," "our" or "us") is registered pursuant to Section 12 of the Securities Exchange Act of 1934, as amended. The following description of the material terms of the Company's common stock is only a summary. This summary does not purport to be a complete description of the terms and conditions of the Company's common stock in all respects and is subject to and qualified in its entirety by reference to the Company's Articles of Incorporation, as amended ("**Articles**") and the Company's Amended and Restated Bylaws ("**Bylaws**"), each of which are filed or incorporated by reference as an exhibit to the Company's Annual Report on Form 10-K of which this Exhibit is a part, as well as the Michigan Business Corporation Act (the "**MBCA**"), and any other documents referenced in the summary and from which the*

summary is derived. We urge you to read these documents for a more complete understanding of shareholder rights.

General

Our Articles authorize the issuance of up to 20,000,000 shares of common stock, no par value per share, and up to 50,000 shares of preferred stock, no par value per share. Our common stock is listed on the Nasdaq Global Select Market under the symbol "LEVL."

Common Stock

Governing Documents. Holders of shares of our common stock have the rights set forth in our Articles, our Bylaws and the MBCA.

Dividends and Distributions. The holders of our common stock are entitled to share equally in any dividends that our board of directors may declare from time to time out of funds legally available for dividends, subject to limitations under the MBCA and any preferential rights of holders of our then outstanding preferred stock.

Ranking. Our common stock ranks junior with respect to dividend rights and rights upon liquidation, dissolution or winding up of the Company to all other securities and indebtedness of the Company.

Upon any voluntary or involuntary liquidation, dissolution or winding up of the Company, the holders of our common stock are entitled to share equally, on a per share basis, in all of our assets available for distribution, after payment to creditors and subject to any prior distribution rights granted to holders of any then outstanding shares of preferred stock.

No Conversion Rights. Our common stock is not convertible into any other shares of our capital stock.

No Preemptive Rights. Holders of our common stock do not have any preemptive rights.

Voting Rights. The holders of our common stock are entitled to one vote per share on any matter to be voted on by the shareholders. The holders of our common stock are not entitled to cumulative voting rights with respect to the election of directors. A plurality of the shares voted shall elect all of the directors then standing for election at a meeting of shareholders at which a quorum is present.

Redemption. We have no obligation or right to redeem our common stock.

Preferred Stock

Upon authorization of our board of directors, we may issue shares of one or more series of our preferred stock from time to time. Our board of directors may, without any action by holders of common stock and except as may be otherwise provided in the terms of any series of preferred stock of which there are shares outstanding, adopt resolutions to designate and establish a new series of preferred stock. Upon establishing such a series of preferred stock, the board will determine the number of shares of preferred stock of that series that may be issued and the rights and preferences of that series of preferred stock. The rights of any series of preferred stock may include, among others:

- general or special voting rights;
- preferential liquidation rights;
- preferential cumulative or noncumulative dividend rights;

- redemption or put rights; and
- conversion or exchange rights.

We may issue shares of, or rights to purchase shares of, one or more series of our preferred stock that have been designated from time to time, the terms of which might:

- adversely affect voting or other rights evidenced by, or amounts otherwise payable with respect to, the common stock or other series of preferred stock;
- discourage an unsolicited proposal to acquire us; or
- facilitate a particular business combination involving us.

Any of these actions could have an anti-takeover effect and discourage a transaction that some or a majority of our shareholders might believe to be in their best interests or in which our shareholders might receive a premium for their stock over our then market price.

Anti-Takeover Considerations and Special Provisions of Our Articles, Bylaws and the MBCA

The MBCA and certain provisions of our Articles and Bylaws could have the effect of delaying or deferring the removal of incumbent directors or delaying, deferring or discouraging another party from acquiring control of us, even if such removal or acquisition would be viewed by our shareholders to be in their best interests. We believe that these provisions are beneficial because the negotiation they encourage could result in improved terms of any unsolicited proposal.

Authorized But Unissued Capital Stock. We have authorized but unissued shares of common stock and preferred stock, and our board of directors may authorize the issuance of one or more series of preferred stock without shareholder approval. These shares could be used by our board of directors to make it more difficult or to discourage an attempt to obtain control of us through a merger, tender offer, proxy contest or otherwise.

Number of Directors; Noncumulative Voting for Directors. Our Bylaws provide that the authorized number of directors of the Company may be fixed only by our board by resolution of a majority of the directors then in office, although such number may not be less than five nor more than twenty-five. In addition, our Articles do not allow for cumulative voting for directors, which may make it more difficult for a non-company nominee to be elected to our board of directors.

Filling of Board Vacancies; Removals. Any vacancies in our board of directors and any directorships resulting from any increase in the number of directors may be filled by the board, acting by not less than a majority of the directors then in office, although less than a quorum.

Limitation on Right to Call a Special Meeting of Shareholders. Our Bylaws provide that special meetings of shareholders may only be called by our board or our president or by the holders of not less than a majority of our outstanding shares of capital stock entitled to vote for the purpose for which the meeting is being called.

Action By Unanimous Written Consent of Shareholders. Our Bylaws provide that any action required or permitted to be taken at an annual or special meeting of shareholders may be taken without a meeting, but only if all of the shareholders entitled to vote consent in writing.

Advance Notice Provisions. Our Bylaws generally require a shareholder desiring to propose new business at a shareholder meeting to provide advance written notice to our corporate secretary, not later than 90 days nor earlier than 120 days prior to the anniversary of the preceding year's annual shareholder meeting, containing certain information about the shareholder and the business to be brought. Only business within the purposes described in the notice of the meeting may be conducted at a special meeting. This provision could delay shareholder actions that are favored by the holders of a majority of our outstanding stock until the next shareholders' meeting.

Additionally, our Bylaws provide that nominations for directors must be made in accordance with the provisions of our Bylaws, which generally require, among other things, that such nominations be provided in writing to our corporate secretary, not later than 90 days nor earlier than 120 days prior to the anniversary of the preceding year's annual shareholder meeting, and that the notice to our corporate secretary contain certain information about the shareholder and the director nominee.

Amendment of the Bylaws. Our Bylaws provide that our Bylaws may be altered, amended or repealed by our board without prior notice to or approval by our shareholders. Our Bylaws may also be altered, amended or repealed by the affirmative vote of holders of a majority of the shares of our capital stock entitled to vote at any meeting of shareholders. Accordingly, our board could take action to amend our Bylaws in a manner that could have the effect of delaying, deferring or discouraging another party from acquiring control of us.

Michigan Law. We may opt-in to the provisions of Chapter 7A of the MBCA. In general, subject to certain exceptions, Chapter 7A of the MBCA prohibits a Michigan corporation from engaging in a “business combination” with an “interested shareholder” for a period of five years following the date that such shareholder became an interested shareholder, unless: (i) prior to such date, the board of directors approved the business combination; or (ii) on or subsequent to such date, the business combination is approved by at least 90% of the votes of each class of the corporation's stock entitled to vote and by at least two-thirds of such voting stock not held by the interested shareholder or such shareholder's affiliates. The MBCA defines a “business combination” to include certain mergers, consolidations, dispositions of assets or shares and recapitalizations. An “interested shareholder” is defined by the MBCA to include a beneficial owner, directly or indirectly, of 10% or more of the voting power of the outstanding voting shares of the corporation. While our board to date has not elected to opt-in to these provisions, any future decision to do so could have an anti-takeover effect.

Federal Banking Law. The ability of a third party to acquire our stock is also limited under applicable U.S. banking laws, including regulatory approval requirements. The Bank Holding Company Act of 1956, as amended, requires any “bank holding company” to obtain the approval of the Federal Reserve before acquiring, directly or indirectly, more than 5% of our outstanding common stock. Federal law also prohibits any person or company from acquiring “control” of an FDIC-insured depository institution or its holding company without prior notice to the appropriate federal bank regulator. “Control” is conclusively presumed to exist upon the acquisition of 25% or more of the outstanding voting securities of a bank or bank holding company but may arise under certain circumstances between 10% and 24.99% ownership.

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Section 3: EX-10.17 (EXHIBIT 10.17 SERP AMENDMENT)

Exhibit 10.17

LEVEL ONE BANK

SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN

AMENDMENT

This Amendment (this “**Amendment**”) to the Level One Bank Supplemental Retirement Plan (the “**SERP**”) for (______) is hereby adopted and agreed as of December (___), 2019 (the “**Amendment Effective Date**”).

WHEREAS, Level One Bank (the “**Bank**”) and the (______) (“**Participant**”) entered into the SERP effective as of (______);

WHEREAS, Section 2.1.1 of the SERP provides for the Participant’s SERP account to be adjusted quarterly in accordance with the investment experience of the Lipper Balanced Fund Index (the “**Lipper Index**”);

WHEREAS, the Lipper Index is no longer in existence;

WHEREAS, Section 7.1 of the SERP permits the Bank’s board of directors (the “**Board**”) the right to amend, with the consent of the Participant, the SERP from time to time; and

WHEREAS, the parties agree that it is appropriate to replace the Lipper Index with the Vanguard Balanced Index Fund Investors Shares or such other balanced fund index as may be designated from time to time by the Board in its discretion;

NOW, THEREFORE, BE IT RESOLVED, that the SERP is hereby amended as follows, as of the Amendment Effective Date:

Section 1. The second to last sentence of the existing Section 2.1.1 of the SERP is hereby deleted in its entirety and replaced with the following new sentence:

> “The Account shall be adjusted quarterly in accordance with the investment experience of the Vanguard Balanced Index Fund Investors Shares or such other balanced fund index as may be designated from time to time by Committee in its discretion.”

Section 2. In all other respects the Plan shall remain in full force and effect.

IN WITNESS WHEREOF, the Bank has caused this Amendment to be executed by its duly authorized officer this (___) day of December, 2019.

Level One Bank

/s/

[Name]

[Title]

Acknowledged and agreed:

[NAME] Date

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Section 4: EX-23.1 (EXHIBIT 23.1 CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM)

Exhibit 23.1

Plante & Moran, PLLC
Suite 500
2601 Cambridge Court
Auburn Hills, MI 48326
Tel: 248.375.7100
Fax: 248.375.7101
plantemoran.com

**Consent of Independent Registered
Public Accounting Firm**

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (No. 333-224500) and on Form S-4 (No. 333-236920) of Level One Bancorp, Inc. of our report dated March 13, 2020 relating to the consolidated financial statements of Level One Bancorp, Inc., which appears in the Form 10-K for the year ended December 31, 2019.

Plante & Moran, PLLC

Auburn Hills, Michigan
March 13, 2020

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Section 5: EX-23.2 (EXHIBIT 23.2 CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM)

Exhibit 23.2

Crowe LLP
Independent Member Crowe Global

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statement on Form S-8 (No. 333-224500) and the Registration Statement on Form S-4 (No. 333-236920) of Level One Bancorp, Inc. of our report dated March 22, 2019 on the consolidated balance sheet of Level One Bancorp, Inc. as of December 31, 2018 and the consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years ended December 31, 2018 and 2017 appearing in the Annual Report on Form 10-K for Level One Bancorp, Inc for the year ended December 31, 2019.

Crowe LLP
Crowe LLP

South Bend, Indiana
March 13, 2020

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Section 6: EX-31.1 (EXHIBIT 31.1 - CEO CERTIFICATION)

Exhibit 31.1

CERTIFICATIONS REQUIRED BY

RULE 13a-14(a) OR RULE 15d-14(a)

AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Patrick J. Fehring, certify that:

1. I have reviewed this Annual Report on Form 10-K (the "Report") of Level One Bancorp, Inc. (the "Registrant");

2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Report;

4. The Registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13(a)-15(f) and 15(d)-15(f)) for the Registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and

   d) Disclosed in this Report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adverse affect the Registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

	Level One Bancorp, Inc.		
Dated as of: March 13, 2020	By:	/s/	Patrick J. Fehring
			Patrick J. Fehring
			President and Chief Executive Officer
			(principal executive officer)

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Section 7: EX-31.2 (EXHIBIT 31.2 - CFO CERTIFICATION)

Exhibit 31.2

CERTIFICATIONS REQUIRED BY

RULE 13a-14(a) OR RULE 15d-14(a)

AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, David C. Walker, certify that:

1. I have reviewed this Annual Report on Form 10-K (the "Report") of Level One Bancorp, Inc. (the "Registrant");

2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Report;

4. The Registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13(a)-15(f) and 15(d)-15(f)) for the Registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and

d) Disclosed in this Report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adverse affect the Registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Level One Bancorp, Inc.

Dated as of: March 13, 2020 By: /s/ David C. Walker

David C. Walker
Executive Vice President and Chief Financial Officer
(principal financial officer)

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Section 8: EX-32.1 (EXHIBIT 32.1 - CEO CERTIFICATION)

Exhibit 32.1

CERTIFICATIONS PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Patrick J. Fehring, President and Chief Executive Officer of Level One Bancorp, Inc. (the "Company") certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(1) The Annual Report on Form 10-K of the Company for the annual period ended December 31, 2019 (the "Report") fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Level One Bancorp, Inc.

Dated as of: March 13, 2020 By: /s/ Patrick J. Fehring

Patrick J. Fehring
President and Chief Executive Officer
(principal executive officer)

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Section 9: EX-32.2 (EXHIBIT 32.2 CFO CERTIFICATION)

Exhibit 32.2

CERTIFICATIONS PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, David C. Walker, Executive Vice President and Chief Financial Officer of Level One Bancorp, Inc. (the “Company”) certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(1) The Annual Report on Form 10-K of the Company for the annual period ended December 31, 2019 (the “Report”) fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Level One Bancorp, Inc.

Dated as of: March 13, 2020

By: /s/ David C. Walker

David C. Walker

Executive Vice President and Chief Financial Officer
(principal financial officer)

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