

# Town Center Bank

## Independent Auditor's Report and Financial Statements

December 31, 2016 and 2015

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**Town Center Bank**  
**December 31, 2016 and 2015**

**Contents**

**Independent Auditor's Report .....1**

**Financial Statements**

Balance Sheets..... 3  
Statements of Comprehensive Income (Loss)..... 4  
Statements of Shareholders' Equity ..... 6  
Statements of Cash Flows ..... 7  
Notes to Financial Statements ..... 9

## Independent Auditor's Report

Board of Directors  
Town Center Bank  
Frankfort, Illinois

We have audited the accompanying financial statements of Town Center Bank, which comprise the balance sheets as of December 31, 2016 and 2015, and the related statements of comprehensive income (loss), shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

### Management's Responsibility for the Financial Statements

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

### Auditor's Responsibility

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

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

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

Board of Directors  
Town Center Bank  
Page 2

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Town Center Bank as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

*BKD, LLP*

Oakbrook Terrace, Illinois  
February 17, 2017

**Town Center Bank**  
**Balance Sheets**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

**Assets**

	<u>2016</u>	<u>2015</u>
Cash and due from banks	\$ 895	\$ 643
Interest-bearing deposits with banks	3,834	6,670
Federal funds sold	1,559	1,522
Cash and cash equivalents	<u>6,288</u>	<u>8,835</u>
Securities available-for-sale, at fair value	31,103	32,733
Loans, net of allowance for loan losses of \$817 in 2016 and \$1,339 in 2015	55,996	61,378
Federal Home Loan Bank stock	74	214
Premises and equipment, net	442	480
Accrued interest receivable and other assets	<u>395</u>	<u>517</u>
Total assets	<u>\$ 94,298</u>	<u>\$ 104,157</u>

**Liabilities and Shareholders' Equity**

**Liabilities**

Deposits		
Noninterest bearing	\$ 13,149	\$ 14,934
Interest bearing	71,257	77,714
Total deposits	<u>84,406</u>	<u>92,648</u>
Federal Home Loan Bank advances	-	2,000
Accrued interest payable and other liabilities	<u>151</u>	<u>194</u>
Total liabilities	<u>84,557</u>	<u>94,842</u>

**Shareholders' Equity**

Common stock \$1 par value; 3,234,000 shares authorized at December 31, 2016 and 2015; 2,333,660 shares issued and outstanding at December 31, 2016 and 2015	2,333	2,333
Additional paid-in capital	20,680	20,680
Accumulated deficit	(13,042)	(13,739)
Accumulated other comprehensive income (loss)	<u>(230)</u>	<u>41</u>
Total shareholders' equity	<u>9,741</u>	<u>9,315</u>
Total liabilities and shareholders' equity	<u>\$ 94,298</u>	<u>\$ 104,157</u>

**Town Center Bank**  
**Statements of Comprehensive Income (Loss)**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**Years Ended December 31, 2016 and 2015**

	<u>2016</u>	<u>2015</u>
<b>Interest Income</b>		
Loans, including fees	\$ 2,926	\$ 2,979
Securities	715	719
Federal funds sold and other	<u>61</u>	<u>29</u>
Total interest income	<u>3,702</u>	<u>3,727</u>
<b>Interest Expense</b>		
Deposits	519	578
Federal Home Loan Bank advances	<u>19</u>	<u>28</u>
Total interest expense	<u>538</u>	<u>606</u>
<b>Net Interest Income</b>	3,164	3,121
<b>Recovery From Loan Losses</b>	<u>(550)</u>	<u>-</u>
<b>Net Interest Income After Provision for Loan Losses</b>	<u>3,714</u>	<u>3,121</u>
<b>Noninterest Income</b>		
Service charges on deposits	96	104
Mortgage banking income	209	130
Net gain on sales of securities available-for-sale	-	102
Other income	<u>74</u>	<u>73</u>
Total noninterest income	<u>379</u>	<u>409</u>
<b>Noninterest Expense</b>		
Salaries and employee benefits	\$ 1,503	\$ 1,410
Occupancy and equipment	432	407
Data processing	604	564
Professional fees	227	400
FDIC Deposit Insurance	88	147
Advertising and marketing	58	45
Other real estate expense, net of rental income	-	(1)
Other	<u>484</u>	<u>482</u>
Total noninterest expense	<u>3,396</u>	<u>3,454</u>
<b>Net Income</b>	<u>697</u>	<u>76</u>

**Town Center Bank**  
**Statements of Comprehensive Income (Loss)**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**Years Ended December 31, 2016 and 2015**

	<b>2016</b>	<b>2015</b>
<b>Other Comprehensive Income (Loss)</b>		
Holding losses on securities available-for-sale	\$ (271)	\$ (169)
Reclassification adjustment for net gains included in income	-	(102)
Total other comprehensive income (loss)	(271)	(271)
<b>Comprehensive Income (Loss)</b>	\$ 426	\$ (195)
<b>Basic and Diluted Net Income Per Share</b>	\$ 0.30	\$ 0.03
<b>Basic and Diluted Weighted Average Common Shares Outstanding</b>	2,333,660	2,333,660

**Town Center Bank**  
**Statements of Shareholders' Equity**  
(Dollar Amounts in Thousands, Except Share and Per Share Data)  
**Years Ended December 31, 2016 and 2015**

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
<b>Balance, January 1, 2015</b>	\$ 2,333	\$ 20,680	\$ (13,815)	\$ 312	\$ 9,510
Net income	-	-	76	-	76
Other comprehensive loss	-	-	-	(271)	(271)
<b>Balance, December 31, 2015</b>	2,333	20,680	(13,739)	41	9,315
Net income	-	-	697	-	697
Other comprehensive loss	-	-	-	(271)	(271)
<b>Balance, December 31, 2016</b>	<u>\$ 2,333</u>	<u>\$ 20,680</u>	<u>\$ (13,042)</u>	<u>\$ (230)</u>	<u>\$ 9,741</u>



**Town Center Bank**  
**Statements of Cash Flows**  
(Dollar Amounts in Thousands, Except Share and Per Share Data)  
Years Ended December 31, 2016 and 2015

	<b>2016</b>	<b>2015</b>
<b>Operating Activities</b>		
Net income	\$ 697	\$ 76
Items not requiring (providing) cash		
Recovery from loan losses	(550)	-
Gain on sales of other real estate owned	-	(62)
Loss on disposal of premises and equipment	-	7
Depreciation of premises and equipment	146	115
Net amortization of securities	196	268
Net change in deferred loan origination fees and costs	76	189
Net gain on sales of securities available-for-sale	-	(102)
Changes in		
Net change in accrued interest receivable and other assets	83	(60)
Net change in accrued interest payable and other liabilities	(43)	(57)
	<u>605</u>	<u>374</u>
<b>Investing Activities</b>		
Securities available-for-sale		
Sales	-	9,721
Maturities, prepayments and calls	6,552	8,247
Purchases	(5,389)	(16,862)
Net (increase) decrease in loans, including purchases of loans	5,856	(4,766)
Proceeds from sales of other real estate owned	-	328
Decrease in receivable from loan servicer	39	54
Decrease in Federal Home Loan Bank stock	140	238
Purchases of premises and equipment	(108)	(95)
	<u>7,090</u>	<u>(3,135)</u>
<b>Financing Activities</b>		
Net decrease in deposits	(8,242)	(3,996)
Decrease in borrowed money	(2,000)	-
	<u>(10,242)</u>	<u>(3,996)</u>

**Town Center Bank**  
**Statements of Cash Flows**  
(Dollar Amounts in Thousands, Except Share and Per Share Data)  
**Years Ended December 31, 2016 and 2015**

	<u>2016</u>	<u>2015</u>
<b>Net Decrease in Cash and Cash Equivalents</b>	\$ (2,547)	\$ (6,757)
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>8,835</u>	<u>15,592</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u><u>\$ 6,288</u></u>	<u><u>\$ 8,835</u></u>
<b>Supplemental Cash Flows Information</b>		
Interest paid	\$ 553	\$ 612
<b>Supplemental Noncash Disclosures</b>		
Unrealized losses on securities available-for-sale	\$ 271	\$ 271

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

**Note 1: Summary of Significant Accounting Policies**

***Nature of Operations***

Town Center Bank (Bank) provides financial services through its offices in Frankfort and New Lenox, Illinois. Its primary deposit products are checking, savings and term certificate accounts, and its primary lending products are residential mortgage, commercial, commercial real estate, construction, land development 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. The customers' ability to repay their loans is dependent on the real estate and general economic conditions in the area.

***Use of Estimates***

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral.

The Bank's loans are generally secured by specific items of collateral including real property, consumer assets and business assets. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on local economic conditions.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Bank to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

***Cash and Cash Equivalents***

Cash and cash equivalents include cash, deposits with other financial institutions and federal funds sold. Net cash flows are reported for customer loan and deposit transactions.

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

***Securities***

Accounting principles generally accepted in the United States of America require that debt and equity securities be classified into one of three reporting categories and accounted for as follows: (1) held-to-maturity securities reported at amortized cost, (2) trading securities reported at fair value with unrealized gains and losses included in earnings and (3) available-for-sale securities reported at fair value with unrealized gains and losses net of related taxes reported as an increase or decrease in other comprehensive income (loss).

Securities held-to-maturity are securities that the Bank has the intent and ability to hold to maturity and are carried at cost adjusted for amortization of premium and accretion of discount, generally computed using the interest method.

The amortization of premiums and accretion of discounts are recognized as adjustments to interest income in a manner that approximates the level-yield method. Realized gains and losses on securities sold are computed based on the adjusted cost of the specific securities sold.

Securities available-for-sale are securities that are intended to be held for indefinite periods of time, but which may not be held to maturity. These securities may be used as a part of the Bank's asset/liability management strategy and may be sold in response to changes in interest rates, deterioration of issuer's creditworthiness, or due to a desire to increase capital or liquidity.

Realized securities gains and losses are determined on a specific identification basis and are reported in the statement of comprehensive income (loss) as securities gains and losses.

***Loans Held for Sale***

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. At December 31, 2016 and 2015, there were no loans held for sale.

Mortgage loans held for sale are generally sold with servicing rights released. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold. Gains and losses on sales of mortgage loans are included in mortgage loan origination fees.

***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 deferred loan fees and costs and an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

For all classes of loans, interest income is discontinued at the time a loan is 90 days delinquent unless the loan is well secured and in process of collection. Past due status is based on the contractual terms of the loan. In all cases, for all classes of loans, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. A loan is moved to nonaccrual status in accordance with the Bank's policy, typically after 90 days of nonpayment.

For all classes of loans, all interest accrued but not received for loans placed on nonaccrual are reversed against 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.

***Concentration of Credit Risk***

Most of the Bank's business activity is with customers located in the south and west suburbs of Chicago, Illinois. Therefore, the Bank's exposure to credit risk is significantly affected by changes in the economy in the Chicago area. There are no significant concentrations of loans to any one industry or customer, except that, the customers' ability to repay their loans is dependent on the real estate and general economic conditions in the area.

***Allowance for Loan Losses***

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

The allowance for loan losses is evaluated on a regular basis by management. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance consists of general, allocated and unallocated components, as further described below.

***General Component***

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following loan segments: commercial, commercial real estate, residential real estate and installment. Management uses a rolling average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquencies; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

lending management and staff; and national and local economic trends and conditions. There were no changes in the Bank's policies or methodology pertaining to the general component of the allowance for loan losses during 2016 and 2015.

The qualitative factors are determined based on the various risk characteristics of each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

Residential Real Estate

Loans in this segment primarily include owner-occupied 1-4 family residences secured by 1<sup>st</sup> liens and home equity loans secured by 2<sup>nd</sup> liens. The Bank generally does not originate loans with a loan-to-value ratio greater than 80 percent and does not generally grant loans that would be classified as subprime upon origination. All loans in this segment are collateralized by residential real estate and repayment is dependent on the credit quality of the individual borrower or borrowers. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment.

Commercial Real Estate

Loans in this segment are primarily income-producing properties throughout the Chicago area. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, will have an effect on the credit quality in this segment. Management obtains rent rolls annually and continually monitors the cash flows of these loans. Loans in this segment also include speculative real estate development loans for which payment is derived from sale of the property. Credit risk is affected by cost overruns, time to sell at an adequate price, and market conditions.

Commercial

Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer spending, will have an effect on the credit quality in this segment.

Consumer

Loans in this segment are generally to individuals and are supported by non-real estate collateral. The repayment is dependent on the credit quality of the individual borrower.

*Allocated Component*

The allocated component relates to loans that are classified as impaired. Based on internal credit ratings, loans are evaluated for impairment on a loan-by-loan basis. Impairment is measured by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows (or collateral value) of the impaired loan is lower

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

than the carrying value of that loan. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment.

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

The Bank periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring (TDR). All TDRs are classified as impaired.

***Unallocated Component***

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general reserves in the portfolio.

***Transfers of Financial Assets***

Transfers of financial assets, such as loans, 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 Bank, 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 Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

***Other Real Estate Owned***

Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

***Federal Home Loan Bank (FHLB) Stock***

The Bank is a member of FHLB Chicago. 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.

***Premises and Equipment***

Premises and equipment are stated at cost less accumulated depreciation. Depreciation expense is recognized on the straight-line method. Banking equipment is generally depreciated over 5 years. Furniture and fixtures are depreciated over estimated useful lives generally ranging from 5 to 15 years. Leasehold improvements are depreciated on the straight-line basis over the shorter of the lease term, including expected renewal periods, or estimated useful life of the asset.

***Long-term Assets***

Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

***Loan Commitments and Related Financial Instruments***

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

***Stock-based Compensation***

Compensation cost is recognized for stock options 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. Compensation cost is recognized over the required service period, generally defined as the vesting period.

***Income Taxes***

Income tax expense 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 bases 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.



**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

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

***Earnings (Loss) Per Common Share***

Basic earnings (loss) per common share is net income (loss) divided by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per common share include the dilutive effect of additional potential common shares issuable under stock options and warrants. Options and warrants will have a dilutive effect only when the average market price over the reporting period for the stock exceeds the exercise price. Dilutive earnings per share does not assume the exercise of instruments that would have an antidilutive effect on earnings per share.

***Comprehensive Income (Loss)***

Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available-for-sale which are also recognized as separate components of shareholders' equity.

***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 such matters that will have a material effect on the financial statements.

***Interest Rate Risk***

The Bank assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, fair values of the Bank's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Bank. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Bank's overall interest rate risk.

**Town Center Bank**  
**Notes to Financial Statements**  
(Dollar Amounts in Thousands, Except Share and Per Share Data)  
**December 31, 2016 and 2015**

**Dividend Restriction**

Banking regulations require maintaining certain capital levels that may limit the amount of dividends paid by the Bank to shareholders. Since the Bank has an accumulated deficit at December 31, 2016, there are no retained earnings available for dividends.

**Fair Value of Financial Instruments**

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

**Note 2: Securities**

The amortized cost and fair value of securities available-for-sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows at year end:

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
<b>December 31, 2016</b>				
Securities available-for-sale				
U.S. Government Agencies	\$ 1,843	\$ -	\$ (17)	\$ 1,826
Mortgage-backed securities - residential	5,306	-	(58)	5,248
Collateralized mortgage obligations - residential	<u>24,184</u>	<u>75</u>	<u>(230)</u>	<u>24,029</u>
Total securities available-for-sale	<u>\$ 31,333</u>	<u>\$ 75</u>	<u>\$ (305)</u>	<u>\$ 31,103</u>
<b>December 31, 2015</b>				
Securities available-for-sale				
Mortgage-backed securities - residential	\$ 4,700	\$ 1	\$ (23)	\$ 4,678
Collateralized mortgage obligations - residential	<u>27,992</u>	<u>176</u>	<u>(113)</u>	<u>28,055</u>
Total securities available-for-sale	<u>\$ 32,692</u>	<u>\$ 177</u>	<u>\$ (136)</u>	<u>\$ 32,733</u>

Mortgage-backed securities and collateralized mortgage obligations are not due at a single maturity date.

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

At year-end 2016 and 2015, there were no holdings of securities of any one issuer, other than the U.S. Government and its sponsored entities and agencies, in an amount greater than 10% of shareholders' equity.

Securities pledged at year-end 2016 had a carrying amount of \$11,747 and were pledged to secure public deposits and federal funds purchased line of credit.

The following table summarize securities with unrealized losses at December 31, 2016 and December 31, 2015, aggregated by major security type and length of time in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or More		Fair Value	Total Unrealized Loss
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss		
<b>December 31, 2016</b>						
U.S. Government Agencies	\$ 818	\$ (17)	\$ -	\$ -	\$ 818	\$ (17)
Mortgage-backed securities - residential	2,299	(24)	2,099	(34)	4,398	(58)
Collateralized mortgage obligations - residential	8,093	(122)	7,522	(108)	15,615	(230)
	<u>\$ 11,210</u>	<u>\$ (163)</u>	<u>\$ 9,621</u>	<u>\$ (142)</u>	<u>\$ 20,831</u>	<u>\$ (305)</u>
<b>December 31, 2015</b>						
Mortgage-backed securities - residential	\$ 2,563	\$ (23)	\$ -	\$ -	\$ 2,563	\$ (23)
Collateralized mortgage obligations - residential	9,058	(70)	1,925	(43)	10,983	(113)
	<u>\$ 11,621</u>	<u>\$ (93)</u>	<u>\$ 1,925</u>	<u>\$ (43)</u>	<u>\$ 13,546</u>	<u>\$ (136)</u>

Sales of available-for-sale securities were as follows for the years ended December 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Sale proceeds	\$ -	\$ 9,721
Gross gains	-	123
Gross losses	-	(21)

Management evaluates securities for other-than-temporary impairment as economic or market concerns warrant such evaluation. Consideration is given to the length of time and extent to which fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

**Note 3: Loans**

Loans at December 31, 2016 and 2015, were as follows:

	<u>2016</u>	<u>2015</u>
Residential real estate		
1-4 family, owner occupied	\$ 8,119	\$ 11,019
1-4 family, non-owner occupied	1,368	1,332
Commercial real estate		
Commercial, owner occupied	14,846	13,263
Commercial, non-owner occupied	17,353	19,006
Construction	518	-
Land development	2,831	3,365
Farmland	812	929
Commercial	6,018	7,181
Consumer		
Indirect, automobile loans	85	288
Consumer, non-real estate	4,536	5,931
	<u>56,486</u>	<u>62,314</u>
Deferred loan origination fees and costs, net	327	403
Allowance for loan losses	<u>(817)</u>	<u>(1,339)</u>
Loans, net	<u>\$ 55,996</u>	<u>\$ 61,378</u>

The following tables present the activity in the allowance for loan losses by class of loans for the years ended December 31, 2016 and 2015:

	<u>Beginning Balance</u>	<u>Provision for (Recovery of) Loan Losses</u>	<u>Loans Charged Off</u>	<u>Recoveries</u>	<u>Ending Balance</u>
December 31, 2016					
Residential real estate					
1-4 family, owner occupied	\$ 89	\$ 44	\$ -	\$ 5	\$ 138
1-4 family, non-owner occupied	26	-	-	-	26
Commercial real estate					
Commercial, owner occupied	133	46	-	-	179
Commercial, non-owner occupied	683	(516)	-	-	167
Construction	-	5	-	-	5
Land development	20	104	-	-	124
Farmland	13	54	-	-	67
Commercial	325	(267)	-	16	74
Consumer					
Indirect, auto	3	(6)	-	5	2
Consumer, non-real estate	47	(14)	-	2	35
	<u>\$ 1,339</u>	<u>\$ (550)</u>	<u>\$ -</u>	<u>\$ 28</u>	<u>\$ 817</u>

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

	Beginning Balance	Provision (Benefit) for Loan Losses	Loans Charged Off	Recoveries	Ending Balance
December 31, 2015					
Residential real estate					
1-4 family, owner occupied	\$ 190	\$ (14)	\$ (96)	\$ 9	\$ 89
1-4 family, non-owner occupied	3	95	(72)	-	26
Commercial real estate					
Commercial, owner occupied	104	29	-	-	133
Commercial, non-owner occupied	153	530	-	-	683
Construction	2	(2)	-	-	-
Land development	480	(460)	-	-	20
Farmland	15	(2)	-	-	13
Commercial	252	(157)	-	230	325
Consumer					
Indirect, auto	11	(15)	-	7	3
Consumer, non-real estate	50	(4)	(30)	31	47
	<u>\$ 1,260</u>	<u>\$ -</u>	<u>\$ (198)</u>	<u>\$ 277</u>	<u>\$ 1,339</u>

The following table presents the balance in the allowance for loan losses by class of loans based on impairment method as of December 31, 2016:

	Allowance for Loan Losses			Loan Balances		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
Residential real estate						
1-4 family, owner occupied	\$ 98	\$ 40	\$ 138	\$ 800	\$ 7,319	\$ 8,119
1-4 family, non-owner occupied	-	26	26	277	1,091	1,368
Commercial real estate						
Commercial, owner occupied	-	179	179	-	14,846	14,846
Commercial, non-owner occupied	-	167	167	-	17,353	17,353
Construction	-	5	5	-	518	518
Land development	-	124	124	-	2,831	2,831
Farmland	-	67	67	-	812	812
Commercial	-	74	74	-	6,018	6,018
Consumer						
Indirect automobile loans	-	2	2	-	85	85
Consumer, non-real estate	-	35	35	-	4,536	4,536
Total	<u>\$ 98</u>	<u>\$ 719</u>	<u>\$ 817</u>	<u>\$ 1,077</u>	<u>\$ 55,409</u>	<u>\$ 56,486</u>

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

The following table presents the balance in the allowance for loan losses by class of loans based on impairment method as of December 31, 2015:

	Allowance for Loan Losses			Loan Balances		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
Residential real estate						
1-4 family, owner occupied	\$ -	\$ 89	\$ 89	\$ 347	\$ 10,672	\$ 11,019
1-4 family, non-owner occupied	-	26	26	92	1,240	1,332
Commercial real estate						
Commercial, owner occupied	-	133	133	-	13,263	13,263
Commercial, non-owner occupied	-	683	683	-	19,006	19,006
Construction	-	-	-	-	-	-
Land development	-	20	20	-	3,365	3,365
Farmland	-	13	13	-	929	929
Commercial	-	325	325	-	7,181	7,181
Consumer						
Indirect automobile loans	-	3	3	-	288	288
Consumer, non-real estate	-	47	47	-	5,931	5,931
Total	<u>\$ -</u>	<u>\$ 1,339</u>	<u>\$ 1,339</u>	<u>\$ 439</u>	<u>\$ 61,875</u>	<u>\$ 62,314</u>

The following table presents information related to loans individually evaluated for impairment for December 31, 2016 and 2015:

	2016			2015		
	Average Balance	Interest Income Recognized	Cash Income Recognized	Average Balance	Interest Income Recognized	Cash Income Recognized
Residential real estate						
1-4 family, owner occupied	\$ 443	\$ 34	\$ 34	\$ 353	\$ 25	\$ 25
1-4 family, non-owner occupied	102	15	15	160	11	11
Commercial real estate						
Commercial, owner occupied	-	-	-	-	-	-
Commercial, non-owner occupied	-	-	-	-	-	-
Construction	-	-	-	-	-	-
Land development	-	-	-	-	-	-
Farmland	-	-	-	-	-	-
Commercial	-	-	-	-	-	-
Consumer						
Indirect automobile loans	-	-	-	-	-	-
Consumer, non-real estate	-	-	-	-	-	-
Total	<u>\$ 545</u>	<u>\$ 49</u>	<u>\$ 49</u>	<u>\$ 513</u>	<u>\$ 36</u>	<u>\$ 36</u>

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

The following table presents information related to loans individually evaluated for impairment as of December 31, 2016:

	<b>Unpaid Principal Balance</b>	<b>Partial Charge-Offs</b>	<b>Loan Balance</b>	<b>Allowance for Loan Losses Allocated</b>
With no related allowance recorded				
Residential real estate				
1-4 family, owner occupied	\$ 471	\$ 134	\$ 337	\$ -
1-4 family, non-owner occupied	349	72	277	-
Commercial real estate				
Commercial, owner occupied	-	-	-	-
Commercial, non-owner occupied	-	-	-	-
Construction	-	-	-	-
Land development	-	-	-	-
Farmland	-	-	-	-
Commercial	-	-	-	-
Consumer				
Indirect, auto	-	-	-	-
Consumer, non-real estate	-	-	-	-
	<u>820</u>	<u>206</u>	<u>614</u>	<u>-</u>
With an allowance recorded				
Residential real estate				
1-4 family, owner occupied	463	-	463	98
1-4 family, non-owner occupied	-	-	-	-
Commercial real estate				
Commercial, owner occupied	-	-	-	-
Commercial, non-owner occupied	-	-	-	-
Construction	-	-	-	-
Land development	-	-	-	-
Farmland	-	-	-	-
Commercial	-	-	-	-
Consumer				
Indirect, auto	-	-	-	-
Consumer, non-real estate	-	-	-	-
	<u>463</u>	<u>-</u>	<u>463</u>	<u>98</u>
	<u>\$ 1,283</u>	<u>\$ 206</u>	<u>\$ 1,077</u>	<u>\$ 98</u>

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

The following table presents information related to loans individually evaluated for impairment as of December 31, 2015:

	<b>Unpaid Principal Balance</b>	<b>Partial Charge-Offs</b>	<b>Loan Balance</b>	<b>Allowance for Loan Losses Allocated</b>
With no related allowance recorded				
Residential real estate				
1-4 family, owner occupied	\$ 482	\$ 134	\$ 347	\$ -
1-4 family, non-owner occupied	163	72	92	-
Commercial real estate				
Commercial, owner occupied	-	-	-	-
Commercial, non-owner occupied	-	-	-	-
Construction	-	-	-	-
Land development	-	-	-	-
Farmland	-	-	-	-
Commercial	-	-	-	-
Consumer				
Indirect, auto	-	-	-	-
Consumer, non-real estate	-	-	-	-
	<u>645</u>	<u>206</u>	<u>439</u>	<u>-</u>
With an allowance recorded				
Residential real estate				
1-4 family, owner occupied	-	-	-	-
1-4 family, non-owner occupied	-	-	-	-
Commercial real estate				
Commercial, owner occupied	-	-	-	-
Commercial, non-owner occupied	-	-	-	-
Construction	-	-	-	-
Land development	-	-	-	-
Farmland	-	-	-	-
Commercial	-	-	-	-
Consumer				
Indirect, auto	-	-	-	-
Consumer, non-real estate	-	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$ 645</u>	<u>\$ 206</u>	<u>\$ 439</u>	<u>\$ -</u>



**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

The following tables present the aging of the past due loans as of December 31, 2016 and 2015, by class of loans. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

	Year Ended December 31, 2016						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than or Equal to 90 Days Past Due	Total Past Due	Nonaccrual	Loans Not Past Due	Total
Residential real estate							
1-4 family, owner occupied	\$ -	\$ -	\$ -	\$ -	\$ 463	\$ 7,656	\$ 8,119
1-4 family, non-owner occupied	-	-	-	-	195	1,173	1,368
Commercial real estate							
Commercial, owner occupied	-	-	-	-	-	14,846	14,846
Commercial, non-owner occupied	-	-	-	-	-	17,353	17,353
Construction	-	-	-	-	-	518	518
Land development	-	-	-	-	-	2,831	2,831
Farmland	-	-	-	-	-	812	812
Commercial	-	-	-	-	-	6,018	6,018
Consumer							
Indirect, automobile loans	-	-	-	-	-	85	85
Consumer, non-real estate	-	26	-	26	-	4,510	4,536
<b>Total</b>	<u>\$ -</u>	<u>\$ 26</u>	<u>\$ -</u>	<u>\$ 26</u>	<u>\$ 658</u>	<u>\$ 55,802</u>	<u>\$ 56,486</u>

  

	Year Ended December 31, 2015						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than or Equal to 90 Days Past Due	Total Past Due	Nonaccrual	Loans Not Past Due	Total
Residential real estate							
1-4 family, owner occupied	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 11,019	\$ 11,019
1-4 family, non-owner occupied	-	92	65	157	-	1,175	1,332
Commercial real estate							
Commercial, owner occupied	3,014	-	-	3,014	-	10,249	13,263
Commercial, non-owner occupied	-	-	-	-	-	19,006	19,006
Construction	-	-	-	-	-	-	-
Land development	-	-	-	-	-	3,365	3,365
Farmland	-	-	-	-	-	929	929
Commercial	76	-	-	76	-	7,105	7,181
Consumer							
Indirect, automobile loans	-	-	-	-	-	288	288
Consumer, non-real estate	-	51	-	51	-	5,880	5,931
<b>Total</b>	<u>\$ 3,090</u>	<u>\$ 143</u>	<u>\$ 65</u>	<u>\$ 3,298</u>	<u>\$ -</u>	<u>\$ 59,016</u>	<u>\$ 62,314</u>

***Troubled Debt Restructurings***

The Bank has not allocated specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2016 and 2015. The Bank has not committed to lend additional amounts as of December 31, 2016 and 2015, to customers with outstanding loans that are classified as troubled debt restructurings.

During the year ending December 31, 2016 and 2015, there were no loans that were modified as troubled debt restructurings.

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

A loan is considered to be in payment default once it is 60 days contractually past due under the modified terms.

***Credit Quality Indicators***

The Bank 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 Bank analyzes loans individually by classifying the loans as to credit risk. This analysis includes non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed generally on a monthly basis but no less than quarterly.

***Loans Rated Watch***

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

***Loans Rated Substandard***

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

***Loans Rated 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.

Loans not meeting the criteria above that are analyzed individually as part of the above-described process are considered to be pass rated loans. Included in pass rated loans are homogenous residential real estate loans that are monitored based on the past due status of the loan. Management evaluates the risk category of these loans when a loan becomes delinquent or a borrower requests a concession. Loans listed as not rated are indirect automobile and consumer, non-real estate loans and are monitored based on the past due status of the loan.

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

As of December 31, 2016 and 2015, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

	Year Ended December 31, 2016					
	Not Rated	Pass	Watch	Substandard	Doubtful	Total
Residential real estate						
1-4 family, owner occupied	\$ -	\$ 7,185	\$ 134	\$ 800	\$ -	\$ 8,119
1-4 family, non-owner occupied	-	795	-	573	-	1,368
Commercial real estate						
Commercial, owner occupied	-	14,480	366	-	-	14,846
Commercial, non-owner occupied	-	16,469	-	884	-	17,353
Construction	-	349	-	169	-	518
Land development	-	1,868	271	692	-	2,831
Farmland	-	812	-	-	-	812
Commercial	-	5,323	695	-	-	6,018
Consumer						
Indirect, automobile loans	85	-	-	-	-	85
Consumer, non-real estate	4,536	-	-	-	-	4,536
<b>Total</b>	<b>\$ 4,621</b>	<b>\$ 47,281</b>	<b>\$ 1,466</b>	<b>\$ 3,118</b>	<b>\$ -</b>	<b>\$ 56,486</b>

  

	Year Ended December 31, 2015					
	Not Rated	Pass	Watch	Substandard	Doubtful	Total
Residential real estate						
1-4 family, owner occupied	\$ -	\$ 10,097	\$ 152	\$ 770	\$ -	\$ 11,019
1-4 family, non-owner occupied	-	871	-	461	-	1,332
Commercial real estate						
Commercial, owner occupied	-	12,878	385	-	-	13,263
Commercial, non-owner occupied	-	18,093	-	913	-	19,006
Construction	-	-	-	-	-	-
Land development	-	2,286	347	732	-	3,365
Farmland	-	138	791	-	-	929
Commercial	-	7,181	-	-	-	7,181
Consumer						
Indirect, automobile loans	288	-	-	-	-	288
Consumer, non-real estate	5,931	-	-	-	-	5,931
<b>Total</b>	<b>\$ 6,219</b>	<b>\$ 51,544</b>	<b>\$ 1,675</b>	<b>\$ 2,876</b>	<b>\$ -</b>	<b>\$ 62,314</b>

**Town Center Bank**  
**Notes to Financial Statements**  
(Dollar Amounts in Thousands, Except Share and Per Share Data)  
**December 31, 2016 and 2015**

**Note 4: Premises and Equipment**

Premises and equipment at December 31, 2016 and 2015, were as follows:

	<u>2016</u>	<u>2015</u>
Furniture and equipment	\$ 901	\$ 830
Leasehold improvements	<u>578</u>	<u>578</u>
	1,479	1,408
Less accumulated depreciation	<u>(1,037)</u>	<u>(928)</u>
	<u>\$ 442</u>	<u>\$ 480</u>

Depreciation expense was \$146 and \$115 in 2016 and 2015, respectively.

The Bank leases its offices under operating leases. Rent expense, including certain common area expenses such as real estate taxes, was \$223 and \$227 in 2016 and 2015, respectively. Rent commitments, before considering renewal options that generally are present, are as follows:

2017	\$ 154
2018	156
2019	130
Thereafter	<u>-</u>
	<u>\$ 440</u>

**Note 5: Other Real Estate Owned**

Activity in other real estate owned was as follows for the years ended December 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Balance at beginning of year	\$ -	\$ 266
Additions	-	-
Proceeds from sales	-	(328)
Net gain on sale of real estate owned	-	62
Provision for valuation allowance	<u>-</u>	<u>-</u>
Balance at end of year	<u>\$ -</u>	<u>\$ -</u>

**Town Center Bank**  
**Notes to Financial Statements**  
(Dollar Amounts in Thousands, Except Share and Per Share Data)  
**December 31, 2016 and 2015**

**Note 6: Deposits**

Deposits at December 31, 2016 and 2015, are as follows:

	<u>2016</u>	<u>2015</u>
Noninterest-bearing demand deposits	\$ 13,149	\$ 14,934
Interest-bearing deposits		
Interest-bearing demand (NOW)	10,712	5,740
Money market accounts	29,930	31,661
Savings accounts	2,965	2,878
Certificates of deposit, less than \$100	5,193	6,930
Certificates of deposit, \$100 through \$250	21,778	29,451
Certificates of deposit, greater than \$250	679	1,054
	<u>\$ 84,406</u>	<u>\$ 92,648</u>

Schedule of maturities of certificates of deposit were as follows:

2017	\$ 20,091
2018	4,876
2019	1,030
2020	798
2021	855
	<u>\$ 27,650</u>

The Bank had no brokered deposits included in certificate of deposits as of December 31, 2016 and 2015.

**Note 7: Federal Home Loan Bank Advances**

At December 31, 2015, the Bank had \$2,000 of advances from the Federal Home Loan Bank of Chicago (FHLB) with an interest rate of 1.40% maturing in September 2017. This advance was prepaid by the Bank during 2016.

**Note 8: Federal Reserve Bank Borrowings**

The Bank is eligible to borrow through a line of credit with the Federal Reserve Bank of Chicago discount window. The line of credit is collateralized by pledged home equity line of credit loans approximating \$1,800 at December 31, 2016. The Bank is eligible to borrow a total amount of up

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

to approximately \$1,260. There were no outstanding borrowings from the Federal Reserve Bank at or during the years ending December 31, 2016 or 2015.

**Note 9: Income Taxes**

Income tax expense for the years ended December 31, 2016 and 2015, consists of:

	<u>2016</u>	<u>2015</u>
Net operating loss carryforward	\$ 52	\$ (46)
Deferred income tax (benefit)	297	(89)
Change in valuation allowance	<u>(349)</u>	<u>135</u>
Income tax expense	<u>\$ -</u>	<u>\$ -</u>

Year-end deferred tax assets and liabilities as of December 31, 2016 and 2015, were due to the following:

	<u>2016</u>	<u>2015</u>
Deferred tax assets		
Organization costs	\$ 91	\$ 121
Net operating loss carryforwards	5,087	5,169
Other	<u>-</u>	<u>7</u>
Gross deferred tax assets	<u>5,178</u>	<u>5,297</u>
Deferred tax liabilities		
Depreciation	(48)	(32)
Allowance for loan losses	(263)	(41)
Other	<u>(21)</u>	<u>(29)</u>
Gross deferred tax liabilities	<u>(332)</u>	<u>(102)</u>
Valuation allowance for deferred tax assets	<u>(4,846)</u>	<u>(5,195)</u>
Net deferred tax asset (liability)	<u>\$ -</u>	<u>\$ -</u>

The net operating losses are being carried forward and will be available to reduce future taxable income. The federal net operating loss carryforward of approximately \$12,634 will begin to expire in 2026 if not utilized. The state loss carryforward of approximately \$12,492 will begin to expire in 2022 if not utilized. A valuation allowance was established as the Bank has not generated any taxable income to date and, accordingly, has not yet demonstrated that it is likely to utilize the loss carryforwards prior to their statutory expiration dates.

The effective tax rate differs from the federal statutory rate due to the establishment of the valuation allowance discussed above, which offsets the current year income tax benefit. The Bank

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

does not expect the total amount of unrecognized tax benefits to significantly change in the next twelve months.

The Bank is subject to U.S. federal income tax as well as income tax of the State of Illinois. The Bank is no longer subject to examination by taxing authorities for years before 2013.

There were no interest and penalties recorded in the statement of operations for the years ended December 31, 2016 and 2015.

**Note 10: Related Party Transactions**

Loans to principal officers, directors, and their affiliates were as follows for the years ended December 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Beginning balance	\$ 2,267	\$ 2,771
New loans	936	-
Net decrease in existing lines of credit	<u>(317)</u>	<u>(504)</u>
Ending balance	<u>\$ 2,886</u>	<u>\$ 2,267</u>

Deposits from principal officers, directors, and their affiliates at December 31, 2016 and 2015, were \$3,391 and \$1,867, respectively.

The Chairman of the Board as well as other members of the Board of Directors of the Bank are shareholders and Board members of the Bank's core banking process system entity. Fees paid for core banking process system totaled \$286 and \$289 in 2016 and 2015, respectively.

**Note 11: Stock Options and Warrants**

The Board of Directors granted options to buy Bank stock to officers and employees under the Bank's Stock Incentive Plan, which provides for the issuance of options to purchase up to 432,000 shares of the Bank's common stock. The Bank believes that such awards better align the interests of its employees with those of its shareholders. Stock option awards were granted with an exercise price of \$10, which was the initial offering price of the Bank's common stock in 2006. Option awards have a vesting period of three years and have a ten-year contractual term. In 2012, there were 423,000 of available options which were cancelled in 2012. The Board of Directors approved the re-granting of these options with an exercise price of \$3 in 2012. These options were then granted in 2013. In 2016, the Board of Directors approved an amendment to extend the plan until 2026. The fair value of options, as of the grant date, is expensed over the vesting period.

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

The fair value of each option award is estimated on the date of grant using an option valuation model (Black-Scholes). Expected volatilities have been based on historical volatilities of the SNL MicroCap Bank index. 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 grant date.

On August 18, 2015, 36,000 options granted to an employee were amended to expire five years from the employee's retirement date of September 30, 2015.

On October 19, 2016, the Bank re-granted 35,000 employee options which had expired on October 17, 2016, at an exercise price of \$3. These options are fully vested and mature on October 19, 2026.

A summary of the activity in the stock option plan for 2016 follows:

	<b>Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term (Years)</b>
Outstanding at beginning of year	412,000	\$ 3	7.49
Expired	35,000		
Granted	35,000		
Exercised	-		
Forfeited	-		
	<u>412,000</u>		
Outstanding at end of year	<u>412,000</u>	\$ 3	6.88

There was no stock option expense in 2016 and 2015.

The Bank's organizers and all of its initial shareholders had been granted warrants to purchase common stock, which vested immediately. The Bank's organizers, who are also initial shareholders, were granted 10,000 warrants each, or 210,000 warrants in total, to purchase one share of common stock at \$10 per share. These warrants expired on September 18, 2016.

**Note 12: Regulatory Capital Requirements**

Banks are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action.



**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

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.

Actual and required capital amounts and ratios are presented below as of December 31, 2016 and 2015.

	Actual		Required for Capital Adequacy Purposes		Regulatory Requirements	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2016						
Total Capital (to Risk-Weighted Assets)	\$ 10,788	15.6%	\$ 5,517	8.0%	\$ 8,276	12.0%
Tier 1 Capital (to Risk-Weighted Assets)	9,971	14.5%	2,759	4.0%	N/A	N/A
Common Equity Tier 1 Capital (to Risk-Weighted Assets)	9,971	14.5%	N/A	N/A	N/A	N/A
Tier 1 Capital (to Average Assets)	9,971	10.2%	7,839	8.0%	7,839	8.0%
As of December 31, 2015						
Total Capital (to Risk-Weighted Assets)	\$ 10,228	13.5%	\$ 6,076	8.0%	\$ 9,113	12.0%
Tier 1 Capital (to Risk-Weighted Assets)	9,274	12.2%	3,038	4.0%	N/A	N/A
Common Equity Tier 1 Capital (to Risk-Weighted Assets)	9,274	12.2%	N/A	N/A	N/A	N/A
Tier 1 Capital (to Average Assets)	9,274	8.7%	8,491	8.0%	8,491	8.0%

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

**Note 13: Commitments**

Some financial instruments, such as loan commitments, credit lines, letters of credit and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, 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 are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The contractual amounts of financial instruments with off-balance-sheet risk at year end were as follows as of December 31, 2016 and 2015:

	<b>2016</b>		<b>2015</b>
Unused lines of credit - variable rate	\$ 14,155	\$	16,111
Standby letters of credit - variable rate	191		151

**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 value:

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

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

**Securities**

The fair values for 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

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

***Impaired Loans***

The Bank does not record loans at fair value on a recurring basis. However, on occasion, a loan is considered impaired and an allowance for loan loss is established. A loan is considered impaired when it is probable that all of the principal and interest due under the original terms of the loan may not be collected. Once a loan is identified as impaired, management will measure impairment. The fair value of loans is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. Impaired loans that are valued based on the present value of future cash flows are not considered in the fair value hierarchy.

***Assets and Liabilities Measured on a Recurring Basis***

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

	<b>Fair Value Measurements at Reporting Date Using</b>			
	<b>Fair Value</b>	<b>Quoted Prices in Active Markets for Identical Assets/ Liabilities (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
Assets at December 31, 2016				
Securities available-for-sale				
U.S. Government Agencies	\$ 1,826	\$ -	\$ 1,826	\$ -
Mortgage-backed securities - residential	5,248	-	5,248	-
Collateralized mortgage obligations - residential	24,029	-	24,029	-
	<u>\$ 31,103</u>	<u>\$ -</u>	<u>\$ 31,103</u>	<u>\$ -</u>

**Town Center Bank**  
**Notes to Financial Statements**  
(Dollar Amounts in Thousands, Except Share and Per Share Data)  
**December 31, 2016 and 2015**

	<u>Fair Value Measurements at Reporting Date Using</u>			
	<u>Fair Value</u>	<u>Quoted Prices in Active Markets for Identical Assets/ Liabilities (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Assets at December 31, 2015				
Securities available-for-sale				
Mortgage-backed securities - residential	\$ 4,678	\$ -	\$ 4,678	\$ -
Collateralized mortgage obligations - residential	<u>28,055</u>	<u>-</u>	<u>28,055</u>	<u>-</u>
	<u>\$ 32,733</u>	<u>\$ -</u>	<u>\$ 32,733</u>	<u>\$ -</u>

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

	<u>Fair Value Measurements Using</u>				
	<u>Total</u>	<u>Quoted Prices in Active Markets for for Identical Assets/ Liabilities (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>	<u>Total Gains (Losses)</u>
Assets at December 31, 2016					
Impaired loans	<u>\$ 979</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 979</u>	<u>\$ (98)</u>
Assets at December 31, 2015					
Impaired loans	<u>\$ 439</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 439</u>	<u>\$ (68)</u>

Impaired loans that were considered collateral dependent had a carrying amount of \$1,077 and \$439, with a valuation allowance of \$98 and \$0 as of December 31, 2016 and 2015, respectively. Collateral dependent impaired loans were adjusted to the fair value, less costs to sell, of the underlying collateral securing these loans resulting in certain losses. The losses are not recorded directly as an adjustment to current earnings, but rather as a component in determining the allowance for loan losses.

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2016:

	<b>Fair Value</b>	<b>Valuation Technique(s)</b>	<b>Unobservable Input(s)</b>	<b>Range of Input (Weighted Average)</b>
Impaired loans				
December 31, 2016	\$ 979	Sales comparison approach	Adjustments to comparable sale prices	-4% to 2% (-0.2%)
December 31, 2015	\$ 429	Sales comparison approach	Adjustments to comparable sale prices	-4% to 2% (0.7%)

The carrying amounts and estimated fair values of financial instruments at December 31, 2016, is as follows:

	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>
Financial assets		
Cash and cash equivalents	\$ 6,288	\$ 6,288
Securities available-for-sale	31,103	31,103
Loans, net	55,996	57,096
Federal Home Loan Bank stock	74	N/A
Accrued interest receivable	247	247
Financial liabilities		
Deposits	\$ 84,406	\$ 81,199
Accrued interest payable	22	22

The carrying amounts and estimated fair values of financial instruments at December 31, 2015, is as follows:

	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>
Financial assets		
Cash and cash equivalents	\$ 8,835	\$ 8,835
Securities available-for-sale	32,733	32,733
Loans, net	61,378	62,033
Federal Home Loan Bank stock	214	N/A
Accrued interest receivable	303	303

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>
Financial liabilities		
Deposits	\$ 92,648	\$ 90,432
Accrued interest payable	35	35
Federal Home Loan Bank advances	2,000	1,995

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

*Cash and Cash Equivalents*

The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

*FHLB Stock*

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

*Loans*

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

*Deposits*

The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (*i.e.*, their carrying amounts). The carrying amounts of interest-bearing deposits without maturity dates and variable-rate certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on like-term certificates of deposit.

*FHLB Advances*

The fair values of the Bank's FHLB advances are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

**Town Center Bank**  
**Notes to Financial Statements**  
**(Dollar Amounts in Thousands, Except Share and Per Share Data)**  
**December 31, 2016 and 2015**

*Accrued Interest Receivable/Payable*

The carrying amounts of accrued interest approximate fair value resulting in a Level 2 classification.

*Off-Balance-Sheet Instruments*

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

**Note 15: Earnings per Share**

The factors used in the basic and diluted income per share computations for the years ended December 31, 2016 and 2015, follow:

	<b>2016</b>	<b>2015</b>
Net income	\$ 697	\$ 76
Weighted average common shares outstanding	2,333,660	2,333,660
Basic and diluted income per common share	\$ 0.30	\$ 0.03

**Note 16: Subsequent Events**

The Bank evaluated its December 31, 2016 financial statements for subsequent events through the date of the Independent Auditor's Report, which is the date the financial statements were available to be issued. The Company is not aware of any subsequent events that would require recognition in its financial statements.