

2010 Annual Report

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*Totally Committed.*  
to Community Banking

2010 Board of Directors:

# Totally Committed.



**John P. Lovinger**  
Attorney  
Parker, Hayes & Lovinger, P.C.



**Judy R. Gabriele**  
Director of Development  
Hillsdale Community Health Center



**Craig S. Connor**  
President & Chief Executive Officer  
County National Bank



**Claude J. Rowley**  
President  
Rowley, Inc.



**Steven A. Wells**  
President  
Wells Equipment Sales, Inc.



**John E. Barrett**  
President  
Eagle Funeral Homes, Inc.



**David W. Pope**  
President  
Powers Clothing, Inc.



**Stephen J. Maddalena**  
General Manager  
Kentwood Office Furniture

# 2010 Executive Letter

2010 was a good year for CNB Community Bancorp, Inc. When evaluating our financial performance amid the economic backdrop in Michigan and the rest of the United States, a good year can be considered a great year. As you will see in the pages that follow, we were able to increase our profitability and at the same time register growth in most every area of the Bank. We did this while many Banks strategically shrank their balance sheets to help increase capital ratios.

2010 net profit was \$2,930,000, representing \$1.47 earnings per share, a 23% increase from 2009 and return on equity was 9.9%, up from 8.1% last year. Book value per share increased 62¢ to \$15.50 and the real dollar amount of capital growth after dividends was \$1,342,973. We were able to increase our provision for loan loss account by \$1,394,230 and the balance now stands at \$4,796,102 or 1.65% of loans outstanding. The balance sheet growth in loans, deposits and capital, coupled with a strong dividend payout of 56% of earnings certainly build shareholder value. This was achieved through the effective combined efforts of our employees, customers, shareholders and the Board of Directors.

Organizational growth was very strong during 2010. Total assets under management grew to \$702,350,762 from \$667,197,677, up 5.27%. Bank assets grew 5% to \$346,947,000. Loans serviced were \$241,073,214, up \$19,779,076 for the year. Trust assets ended the year at \$101,363,188 with several new trust accounts opened. Other assets being managed through sweep accounts and CDARS were \$12,967,360 at year end.



#### Executive Committee

Front row, left to right: **Craig S. Connor, Lois E. Howard, Dorene M. Shaw, Scott E. Evans**  
Back row, left to right: **John R. Waldron, Cindy Dwyer, Mary P. Marshall, Diane K. Clow, Spencer D. Swank**

*Totally Committed.*



#### Jackson Advisory Board

Front row, left to right: **Richard M. Craft, Donald J. Calbert, Stephen J. Maddalena**  
Back row, left to right: **Robert L. Simmons, Kurt J. Parker**

Banks continue to be impacted by historically high levels of loan losses as the economy continues to play havoc with consumers' and businesses' ability to meet debt obligations. Along with the weak economy, the collateral securing loans, which are the traditional secondary source of loan repayment, continue to be devalued as demand for residential and commercial real estate declined. Despite this situation, our net write-offs for the twelve months were 19 basis points or .19% of the ending loan portfolio balance. This was below our peer group banks, an improvement over last year's 29 basis points and below our budgeted net write-offs for the year. I must commend the staff and officers who did an outstanding job of managing and working through delinquencies and collateral disposition challenges of the past twelve months.

### Loan Portfolio

The momentum in loan growth continued in 2010. Our loan portfolio increased 11%, from \$261 million to \$290 million. This is a clear indication we are putting deposits to work within our local communities. While we continue to offer a wide variety of lending products to our customers, the majority of growth in 2010 was in the commercial loan portfolio. We have reduced risk by utilizing federal loan guaranty programs and we continue to maintain conservative lending practices. We have added experience to our lending staff, and have made prudent investments in systems and technology.

### Mortgage Lending

Even though mortgage loan originations declined 34% from our record year in 2009, the origination activity of 611 mortgages totaling \$80.8 million was a very good year and exceeded our budget by 18%. The mortgage servicing portfolio grew 8.7% and now stands at 2,396 mortgages totaling \$237 million. This growth helped boost mortgage servicing income \$87,685 to \$483,245, a 22% increase.

We continue to manage a bank portfolio of mortgages that totals 2,485 loans with a balance of \$95.5 million. This is up from \$87.6 million in 2009. This portfolio is primarily made up

of balloon and adjustable rate mortgages secured by one to four family residential properties, along with some construction loans.

During 2010, we enhanced our product offering by adding mortgage loans insured by the Federal Housing Administration (FHA). These loans allow borrowers to obtain low down payment mortgage loans insured by the FHA. This will round out the products available to our customers in the markets we serve. When you add this product to our fixed rate programs with Federal Home Loan Mortgage Corporation (Freddie Mac) and Federal Home Loan Bank of Indianapolis (FHLBI), along with specialty programs with Michigan State Housing Development Authority (MSHDA) and USDA Guaranteed Rural Housing, our mortgage originators have the products available to not only compete in any market we serve, but to also meet mortgage borrowers' credit needs.

## Loss Mitigation

All of the loan portfolios remain strong but, as expected, delinquency and foreclosures continue to be challenging. We remain well below our peers in Other Real Estate Owned (OREO). As of 12/31/2010, we had only seven properties valued at \$554,587 in OREO. We obtained four of the properties in November and December 2010. During the year we sold eleven acquired properties.

Our loss mitigation/collection department has processed 41 Home Affordable Modification Program (HAMP) loans on secondary market and 13 portfolio mortgages. In addition, we completed 29 portfolio and 15 secondary market mortgage modifications that helped keep families in their homes. Of these modifications, 74% of them are less than 30 days past due or current. The performance of our HAMP and modification programs has greatly exceeded the national average, in large part because of the local hands-on approach of our caring staff as well as the quality of our customers. These programs have benefited the customers, the Bank and our communities as we help keep more property from the large inventory of unsold homes.

## Consumer Lending

Our consumer lending area continues to grow despite the economic conditions in our markets. The portfolio of consumer and home equity loans grew 1.7% with a portfolio of \$59.6 million. In 2010, we originated 901 new loans totaling \$22.1 million. Many of those loans were for the purchase of new and used vehicles helping to stimulate economic activity in the auto-producing Michigan region. Delinquencies in these portfolios continue below industry averages.

## Jackson Market

As we near our ten-year anniversary in the Jackson market, we are proud to be the only community bank serving the entire county. Our commitment to the community is significant, as we have loaned nearly a quarter of a billion dollars in the Jackson market. We have financed a wide variety of personal and business loans in the Jackson community. Of note, during 2010, we were the lead bank on a community health center construction project with a total cost in excess of \$10 million.

Jackson is our growth market. I thank our Advisory Board for the dedicated efforts they have put forth in helping us to grow in Jackson. Our calling officers and lenders have done a superb job of getting out and seeing potential customers as they endeavor to build more banking relationships with businesses, organizations and consumers.

## Community Involvement

As other financial institutions scaled back their presence and efforts in some of our local markets, we used these events as an opportunity to promote CNB as the "local" financial institution and again touted the benefits of dealing with a community bank. As always, we participated in and supported a wide range of charitable and community activities from financial literacy programs to county fair animal auctions to Fourth of July celebrations. In fact, our Financial Literacy program was again honored by the Michigan Bankers Association as the best in our banking district.

We supported numerous community events and activities throughout the year with donations and commitments of time from our officers and staff. Some of the good causes were:

- Hillsdale Community Library's "Big Read" Project
- Ella Sharp Museum Free Lecture Series
- Hanover-Horton Fourth of July Hometown Celebration
- Big Brothers Big Sisters "Bowl for Kids' Sake"
- Hillsdale Business Association's downtown events
- Jackson Symphony Orchestra
- Hillsdale County Chamber of Commerce's Business Expo
- Jackson Lumen Christi Annual Dinner and Auction
- Hillsdale County Fourth of July Celebration
- Jackson Citizen Patriot Spelling Bee
- Hillsdale County Community Foundation's "College Night"
- School year kickoff events at Hudson Schools, Hanover- Horton Schools, Hillsdale College, Spring Arbor University
- Jackson Chamber of Commerce Business Expo (JAXPO)
- Spring Arbor Township Memorial Day Parade
- Michigan Shakespeare Festival
- Salvation Army of Jackson

## Marketing

We created new marketing plans for the trust and mortgage departments. These included leave-behind brochures and a new visual selling aid for our mortgage originators as we target realtors for new business. We continue to host two weekly radio shows, one in Jackson hosted by Bill Jors on WKHM and one in Hillsdale hosted by Tim Sullivan and Michelle Graber on WCSR.

We spent considerable time during 2010 developing an improved website that is easier to navigate. This new website is due to be launched during the first quarter of 2011 and I encourage you to take a look at CountyNationalBank.com. There you will see some of our newly developed product promotional videos dedicated to remote deposit, mortgage refinance and e-statements. Office location maps including directions and street views are available on our website. You can also view a community pictures slideshow, hot topics of interest, and our events calendar.

We rolled out the "Truth about Community Banking" marketing campaign in the 4th quarter – aimed at educating the public about the role community banks play in our economy and dispelling the myths in the media about banks' responsibility for the financial crisis.

## Technology

We continue to invest and embrace the use of more technology. This is a cost-effective way to not only stay competitive but to also find solutions that are eco-friendly. By leveraging new technologies, we were able to reduce the number of physical servers we use, thus cutting energy use and depreciation expense. In late 2010, we started testing an electronic newsletter which has gone over very well with the test group. This will be introduced "live" in the 1st quarter of 2011. We introduced iPad technology for internal meetings to help reduce the paper usage and copying expense. The number of customers using e-statements, which saves paper and postage plus gets the statement to our customers quicker, is now 4,042. We continue to work on building our internet banking customer base which now stands at 5,859, or roughly 21% of our customers.

## Trust and Investment

Our trust and investment area continues to see individuals rolling over IRAs and other employer-based retirement accounts. I believe that beyond our professional trust administration the greatest potential for growth will be in the investment area. We provide fee-based investment management, offering mutual funds, stocks, bonds and certificates of deposit, both managed and self-directed accounts. Nationally, as more consumers begin to pay down debt and save more, we have great potential for new IRAs and investment accounts.

## New Officers and Promotions

**Michelle R. Graber** was promoted from A.V.P. Compliance Officer to 2nd V.P. Compliance Officer on February 10, 2010. Michelle has been with the Bank for 12 years and has successfully spearheaded all of our compliance efforts and oversees our Community Reinvestment Act program.

**Sharon L. Burns** joined CNB as a 2nd V.P. – Controller on November 8, 2010. Sharon has a bachelor's degree in accounting and master's degree in organizational management. She was formerly with Rehmann Group and is working toward her CPA designation.

**David J. Kreger** joined CNB as an A.V.P. Commercial Loan Officer for Jackson (Cortland Office) on February 1, 2010. David has 32 years of banking experience in the Jackson market both in mortgage and commercial lending.

**Eric A. Potes** joined CNB as a Commercial Loan Officer for the Hillsdale market on January 18, 2010. Eric has 7 years' experience in banking with United Bank & Trust in customer service and most recently as a credit analyst.

**Brenda L. Carpenter** joined CNB as a Mortgage Officer for Jackson (Wisner Office) on October 11, 2010. Brenda has 34 years of banking experience, 25 of which have been in mortgage lending in the Jackson market.

## Directors

We are very happy that John E. Barrett, President of Eagle Funeral Homes, Inc., was elected to the Board in April 2010. John started in the business in 1978 while working and attending Hillsdale College. John has been active in the Hillsdale and Jonesville communities. John is very recognizable and a well respected business owner in the Hillsdale and Jonesville markets.

## The Future

Our future holds promising growth potential. As we build new banking relationships and continue to solidify existing ones, we are optimistic about CNB. Our conservative business model has served us well and we will continue to keep what we do simple, providing retail and commercial banking services to the communities we call home. Once again, all of us, Directors and employees would like to thank you for continued support of your locally owned community bank.



Craig S. Connor,  
President & C.E.O.

## 2010 Comparison Highlights

	<u>2010</u>	<u>2009</u>
<b>FOR THE YEAR:</b>		
Income before federal income taxes .....	\$ 4,114,247	\$ 3,640,621
Net income.....	2,930,247	2,389,021
Basic and diluted earnings per share .....	1.47	1.20
Cash dividends declared .....	1,635,938	1,987,917
Per share .....	0.82	1.00
<b>AT YEAR END:</b>		
Investment securities.....	\$ 23,877,532	\$ 25,542,821
Loans held for sale.....	1,316,050	194,350
Net portfolio loans.....	285,602,235	258,463,791
Total assets.....	346,947,494	330,356,388
Deposits.....	303,077,492	284,666,209
Shareholders' equity.....	30,942,608	29,599,635
Book value per share.....	15.50	14.88
Number of shares outstanding .....	1,996,673	1,989,263
Number of shareholders.....	351	346

## 2010 Five Year Comparative Financial Summary

In thousands, except per share data

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
<b>ASSETS</b>					
Cash and due from banks.....	\$ 21,270	\$ 31,103	\$ 17,308	\$ 19,518	\$ 15,281
Federal funds sold .....	470	322	879	12,479	6,609
U.S. Treasury and agency securities.....	3,966	8,076	8,394**	10,744	10,803
State, municipal and other securities .....	19,912	17,467	10,354**	13,208	8,779
Loans held for sale.....	1,316	194	553	446	1,917
Net loans .....	285,602	258,464	252,967	233,371	226,434
Other assets.....	14,411	14,730	12,685	13,169	12,550
<b>TOTAL.....</b>	<b><u>\$ 346,947</u></b>	<b><u>\$ 330,356</u></b>	<b><u>\$ 303,140</u></b>	<b><u>\$ 302,935</u></b>	<b><u>\$ 282,373</u></b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>					
Noninterest-bearing demand.....	\$ 49,199	\$ 46,814	\$ 36,904	\$ 39,194	\$ 38,742
Interest-bearing .....	253,878	237,852	219,351	217,565	200,533
Total deposits .....	303,077	284,666	256,255	256,759	239,275
FHLB advances and line of credit.....	10,328	13,490	16,050	13,077	11,577
Line of credit note payable.....	836	961	961	750	-
Other liabilities.....	1,764	1,639	997	2,312	2,125
Total shareholders' equity .....	30,942	29,600	28,877	30,037	29,396
<b>TOTAL.....</b>	<b><u>\$ 346,947</u></b>	<b><u>\$ 330,356</u></b>	<b><u>\$ 303,140</u></b>	<b><u>\$ 302,935</u></b>	<b><u>\$ 282,373</u></b>
Book value per share.....	<u>\$ 15.50</u>	<u>\$ 14.88</u>	<u>\$ 14.55</u>	<u>\$ 14.88</u>	<u>\$ 14.40</u>
Total interest and dividend income .....	\$ 17,057	\$ 16,513	\$ 17,225	\$ 18,871	\$ 16,638
Total interest expense.....	2,480	3,600	4,867	6,113	4,461
Net interest income.....	14,577	12,913	12,358	12,758	12,177
Provision for loan losses .....	1,945	1,579	661	401	270
Net interest income after provision for loan losses .....	12,632	11,334	11,697	12,357	11,907
Noninterest income .....	4,257	5,077	3,826	3,844	3,858
Noninterest expenses .....	12,775	12,770	13,038	11,786	11,490
Income before federal income taxes .....	4,114	3,641	2,485	4,415	4,275
Federal income taxes .....	1,184	1,252	954	1,346	1,413
<b>Net income.....</b>	<b><u>\$ 2,930</u></b>	<b><u>\$ 2,389</u></b>	<b><u>\$ 1,531</u></b>	<b><u>\$ 3,069</u></b>	<b><u>\$ 2,862</u></b>
Basic and diluted earnings per share .....	\$ 1.47	\$ 1.20	\$ 0.77	\$ 1.51	\$ 1.40
Return on shareholders' equity *.....	9.9%	8.1%	5.1%	10.4%	10.2%
Cash dividends per share .....	\$ 0.82	\$ 1.00	\$ 0.91	\$ 0.90	\$ 0.86

\* Based on shareholders' equity at beginning of year

\*\* There was a reclassification in 2008 to conform to the 2009 presentation



## INDEPENDENT AUDITORS' REPORT

Board of Directors and Shareholders  
CNB Community Bancorp, Inc.  
Hillsdale, Michigan

We have audited the accompanying consolidated balance sheets of *CNB Community Bancorp, Inc.* as of December 31, 2010 and 2009, and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of *CNB Community Bancorp, Inc.* as of December 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

March 2, 2011

A handwritten signature in cursive script that reads "Rehmann Lobson".

# 2010 Consolidated Balance Sheets

ASSETS	December 31,	
	2010	2009
Cash and due from banks	\$ 21,269,794	\$ 31,102,758
Federal funds sold	469,600	321,896
Cash and cash equivalents	21,739,394	31,424,654
Investment securities	23,877,532	25,542,821
Net portfolio loans	285,602,235	258,463,791
Loans held for sale	1,316,050	194,350
Accrued interest receivable	1,233,495	1,095,162
Premises and equipment, net	4,460,579	4,706,626
Goodwill	2,590,750	2,590,750
Other assets	6,127,459	6,338,234
<b>Total assets</b>	<b>\$ 346,947,494</b>	<b>\$ 330,356,388</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Deposits</b>		
Noninterest-bearing demand	\$ 49,199,371	\$ 46,813,813
NOW and MMDA	116,165,718	112,475,282
Savings	60,147,566	52,845,659
Time	77,564,837	72,531,455
Total deposits	303,077,492	284,666,209
FHLB advances and line of credit	10,327,913	13,490,354
Line of credit borrowings	835,841	960,841
Accrued interest payable	156,507	170,375
Other liabilities	1,607,133	1,468,974
<b>Total liabilities</b>	<b>316,004,886</b>	<b>300,756,753</b>
Commitments and contingencies (Notes 12, 13, 14 and 15)		
<b>Shareholders' equity</b>		
Common stock, no par value; 2,135,880 shares authorized, 1,996,673 shares issued and outstanding (1,989,263 at December 31, 2009)	10,566,140	10,419,830
Unearned restricted stock awards	(226,628)	(200,376)
Retained earnings	20,440,621	19,146,312
Accumulated other comprehensive income	162,475	233,869
<b>Total shareholders' equity</b>	<b>30,942,608</b>	<b>29,599,635</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 346,947,494</b>	<b>\$ 330,356,388</b>

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

# 2010 Consolidated Statements of Income

	Year Ended December 31,	
	2010	2009
<b>Interest and dividend income</b>		
Loans (including fees)	\$ 16,237,503	\$ 15,647,337
Debt securities		
Taxable	280,259	387,904
Tax-exempt	470,684	396,217
Federal funds sold	471	508
Dividends	67,713	80,613
<b>Total interest and dividend income</b>	<b>17,056,630</b>	<b>16,512,579</b>
<b>Interest expense</b>		
Deposits	1,916,481	2,873,852
Borrowed funds	563,133	725,738
<b>Total interest expense</b>	<b>2,479,614</b>	<b>3,599,590</b>
<b>Net interest income</b>	<b>14,577,016</b>	<b>12,912,989</b>
Provision for loan losses	1,944,989	1,579,202
<b>Net interest income, after provision for loan losses</b>	<b>12,632,027</b>	<b>11,333,787</b>
<b>Noninterest income</b>		
Service charges on deposit accounts	956,297	1,111,164
Trust fees	506,031	526,596
Net gain on loans sold	1,359,549	2,093,354
ATM service charges	711,652	634,211
Net loan servicing fees (mortgage servicing rights amortization)	78,213	(143,436)
Other income	644,803	855,123
<b>Total noninterest income</b>	<b>4,256,545</b>	<b>5,077,012</b>
<b>Noninterest expenses</b>		
Compensation and benefits	7,656,701	7,390,056
Occupancy and equipment	1,944,599	2,009,359
Professional fees	346,926	328,885
Printing, stationery and supplies	169,690	175,270
Amortization of core deposit intangibles	-	14,837
Other	2,656,409	2,851,771
<b>Total noninterest expenses</b>	<b>12,774,325</b>	<b>12,770,178</b>
<b>Income before federal income taxes</b>	<b>4,114,247</b>	<b>3,640,621</b>
Federal income taxes	1,184,000	1,251,600
<b>Net income</b>	<b>\$ 2,930,247</b>	<b>\$ 2,389,021</b>
<b>Net income per basic and diluted share of common stock</b>	<b>\$ 1.47</b>	<b>\$ 1.20</b>

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

# 2010 Consolidated Statements of Shareholders' Equity

	Common Stock		Unearned Restricted	Retained Earnings	Accumulated Other	Total Shareholders' Equity
	Shares	Amount	Stock Awards		Comprehensive Income	
<b>Balances, January 1, 2009</b>	<b>1,984,043</b>	<b>\$ 10,306,345</b>	<b>\$ (179,739)</b>	<b>\$18,745,208</b>	<b>\$ 5,221</b>	<b>\$ 28,877,035</b>
Net income	-	-	-	2,389,021	-	2,389,021
Other comprehensive income:						
Unrealized holding gain on available-for-sale securities	-	-	-	-	347,648	347,648
Related income tax	-	-	-	-	(119,000)	(119,000)
Other comprehensive income	-	-	-	-	228,648	228,648
Comprehensive income	-	-	-	2,389,021	228,648	2,617,669
Restricted stock awards, net of forfeitures (Note 16)	5,220	113,485	(20,637)	-	-	92,848
Dividends declared - \$1.00 per share of common stock	-	-	-	(1,987,917)	-	(1,987,917)
<b>Balances, December 31, 2009</b>	<b>1,989,263</b>	<b>10,419,830</b>	<b>(200,376)</b>	<b>19,146,312</b>	<b>233,869</b>	<b>29,599,635</b>
Net income	-	-	-	2,930,247	-	2,930,247
Other comprehensive loss:						
Unrealized holding loss on available-for-sale securities	-	-	-	-	(108,394)	(108,394)
Related income tax benefit	-	-	-	-	37,000	37,000
Other comprehensive loss	-	-	-	-	(71,394)	(71,394)
Comprehensive income	-	-	-	2,930,247	(71,394)	2,858,853
Restricted stock awards, net of forfeitures (Note 16)	7,410	146,310	(26,252)	-	-	120,058
Dividends declared - \$0.82 per share of common stock	-	-	-	(1,635,938)	-	(1,635,938)
<b>Balances, December 31, 2010</b>	<b>1,996,673</b>	<b>\$ 10,566,140</b>	<b>\$ (226,628)</b>	<b>\$ 20,440,621</b>	<b>\$ 162,475</b>	<b>\$ 30,942,608</b>

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

## 2010 Consolidated Statements of Cash Flows

	<b>Year Ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 2,930,247	\$ 2,389,021
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	556,385	580,151
Amortization of mortgage servicing rights	482,973	539,626
Amortization of intangibles	-	14,837
Provision for loan losses	1,944,989	1,579,202
Share-based payment, restricted stock awards	120,058	92,848
Net amortization of discounts/premiums on investments	96,837	191,015
Deferred income tax benefit	(392,000)	(33,000)
Net gain on sales of investment securities	(173,755)	(214,066)
Proceeds from sales of loans	1,008,313	1,374,331
Net gain on sold loans	(1,360,930)	(2,093,354)
Net loss (gain) on sales of foreclosed assets	98,429	(79,515)
Changes in operating assets and liabilities which provided (used) cash		
Loans held for sale	(1,325,942)	61,333
Accrued interest receivable	(138,333)	(30,163)
Accrued interest payable	(13,868)	(125,071)
Other assets	539,668	(1,121,940)
Other liabilities	564,455	123,658
<b>Net cash provided by operating activities</b>	<b>4,937,526</b>	<b>3,248,913</b>
<b>Cash flows from investing activities</b>		
Activity in available-for-sale securities		
Purchases	(1,995,625)	(14,131,272)
Maturities, calls, and principal payments	6,051,036	11,687,880
Sales	463,700	1,528,786
Activity in held-to-maturity securities		
Purchases	(10,952,669)	(10,526,529)
Maturities, calls, and principal payments	8,067,371	5,017,003
Loan principal originations and collections, net	(30,305,538)	(8,795,401)
Proceeds from sales of foreclosed assets	869,299	1,070,441
Purchases of premises and equipment	(310,338)	(282,802)
<b>Net cash used in investing activities</b>	<b>(28,112,764)</b>	<b>(14,431,894)</b>
<b>Cash flows from financing activities</b>		
Acceptances and withdrawals of deposits, net	18,411,283	28,410,709
Repayments of FHLB advances	(7,679,821)	(2,559,292)
Net borrowings on lines-of-credit	4,392,380	-
Cash dividends paid on common stock	(1,633,864)	(1,430,923)
<b>Net cash provided by financing activities</b>	<b>13,489,978</b>	<b>24,420,494</b>
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>(9,685,260)</b>	<b>13,237,513</b>
Cash and cash equivalents, beginning of year	31,424,654	18,187,141
<b>Cash and cash equivalents, end of year</b>	<b>\$ 21,739,394</b>	<b>\$ 31,424,654</b>

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

# 2010 Notes to Consolidated Financial Statements

## 1. BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Consolidation, Nature of Business, and Concentration Risks

The consolidated financial statements include the accounts of CNB Community Bancorp, Inc., a registered bank holding company (the "Corporation"), and its wholly-owned subsidiary Hillsdale County National Bank (the "Bank"), and the Bank's subsidiaries CNB Lending Services, LLC, CNB Services Corporation, and County National Financial Services. CNB Lending Services, LLC, is a mortgage banking company which is 99% owned by the Bank and 1% owned by CNB Services Corporation. CNB Services Corporation is owned 100% by the Bank and its only business activity is its 1% ownership of CNB Lending Services, LLC. All significant intercompany transactions and balances have been eliminated in consolidation.

The Bank is an independently owned community bank engaged in the business of retail and commercial banking services through its 11 full-service branches located in Hillsdale, Jackson, Lenawee and Calhoun Counties in Michigan. Active competition, principally from other commercial banks, savings banks, and credit unions, exists in the Bank's primary markets. The Bank's results of operations can be significantly affected by changes in interest rates or changes in the automotive and agricultural industries which comprise a significant portion of the local economic environment.

The Bank's primary deposit products are interest and noninterest-bearing checking accounts, savings accounts, and time deposits, and its primary lending products are residential and commercial real estate mortgages, commercial and consumer loans. The Bank does not have any significant concentrations with respect to any one industry, customer, or depositor. The Bank also provides trust services.

The Bank is a federally chartered bank and is a member of the Federal Deposit Insurance Corporation ("FDIC") Bank Insurance Fund. The Bank is subject to the regulations of the FDIC and the supervision of the Office of the Comptroller of the Currency ("OCC") and undergoes periodic examinations by these regulatory authorities. The Corporation is further subject to regulations of the Federal Reserve Board governing bank holding companies.

### Use of Estimates

The preparation of consolidated 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 as of the date of the consolidated balance sheet and reported amounts of income and expenses during the year. Actual results could differ from those estimates. Significant estimates include but are not limited to the determination of the allowance for loan losses, the fair value of certain investment securities, the carrying values of intangible assets, and the fair values of financial instruments.

### Summary of Significant Accounting Policies

Accounting policies used in the preparation of the accompanying consolidated financial statements are in conformity with accounting principles generally accepted in the United States. The principles which materially affect the determination of the financial position or results of operations of the Corporation and its subsidiary are summarized as follows:

#### *Cash and Cash Equivalents*

For the purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, and federal funds sold. Generally, federal funds are sold for a one-day period. The Corporation maintains deposit accounts in various financial institutions which generally exceed the federally insured limits or are not insured. Management does not believe the Corporation is exposed to any significant interest, credit, or other financial risk as a result of these deposits.

#### *Fair Value Measurements*

Fair value refers to the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants in the market in which the reporting entity transacts such sales or transfers based on the assumptions market participants would use when pricing an asset or liability. Assumptions are developed based on prioritizing information

within a fair value hierarchy that gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable data, such as the reporting entity's own data (Level 3).

A description of each category in the fair value hierarchy is as follows:

Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the estimates of assumptions that market participants would use in pricing the asset or liability.

For a further discussion of Fair Value Measurements, refer to Note 2 to the consolidated financial statements.

#### *Securities*

Debt securities that management has the ability and positive intent to hold to maturity are classified as held-to-maturity and are recorded at amortized cost. All other investment securities are classified as available-for-sale and recorded at fair value, with unrealized gains and losses, net of the effect of deferred income taxes, recorded in other comprehensive income (loss). Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains or losses on the sale of the available-for-sale securities are recorded in investment income on the trade date and are determined using the specific identification method.

Investment securities are reviewed at each reporting period for possible other-than-temporary impairment ("OTTI"). In determining whether an other than temporary impairment exists for debt securities, management must assert that: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. If these conditions are not met, the Corporation must recognize an other-than-temporary impairment charge through earnings for the difference between the debt security's amortized cost basis and its fair value, and such amount is included in noninterest income. For debt securities that do not meet the above criteria, and the Corporation does not expect to recover a security's amortized cost basis, the Corporation is considered other-than-temporarily impaired. For these debt securities, the Corporation separates the total impairment into the credit loss component and the amount of the loss related to other factors. In order to determine the amount of the credit loss for a debt security, the Corporation calculates the recovery value by performing a discounted cash flow analysis based on the current cash flows and future cash flows management expects to recover. The amount of the total other-than-temporary impairment related to the credit risk is recognized in earnings and is included in noninterest income. The amount of the total other-than-temporary impairment related to other risk factors is recognized as a component of other comprehensive income. For debt securities that have recognized an other-than-temporary impairment through earnings, if through subsequent evaluation there is a significant increase in the cash flow expected, the difference between the amortized cost basis and the cash flows expected to be collected is accreted as interest income.

Available for sale equity securities are reviewed for other-than-temporary impairment at each reporting date. This evaluation considers a number of factors including, but not limited to, the length of time and extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer, and management's ability and intent to hold the securities until fair value recovers. If it is determined that management does not have the ability and intent to hold the securities until recovery or that there are conditions that indicate that a security may not recover in value then the difference between the fair value and the cost of the security is recognized in earnings and is included in noninterest income. No such losses were recognized in 2010 or 2009.

#### *Restricted Investments (Included in Other Assets)*

The Bank is a member of the Federal Home Loan System and is required to invest in capital stock of the Federal Home Loan Bank of Indianapolis ("FHLBI"). The amount of the required investment is based upon the balance of the Bank's advances from the FHLBI and is carried at cost plus the par value assigned to stock dividends.

The Bank is also a member of the Federal Reserve Bank System ("FRB"). The FRB determines the amount of the required investment at the time the Bank becomes a member. The amount is carried at cost.

### **Loans**

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

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Personal loans are typically charged-off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued in the current year but not collected for loans that are placed on non-accrual or are charged-off, is reversed against interest income while interest accrued but not collected in prior years is reversed against the allowance for loan losses. The interest income on these 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 principal and interest amounts contractually due are brought current and future payments are reasonably assured. For impaired loans not classified as nonaccrual, interest income continues to be accrued over the term of the loan based on the principal amount outstanding.

### **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 the loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

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

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that management believes affect its estimate of probable losses inherent in the portfolio. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank generally does not separately identify individual residential mortgage and consumer loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

### **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 in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance of which adjustments are recognized in the consolidated statements of income.

### **Transfers of Financial Assets**

Transfers of financial assets, including mortgage loans held-for-sale, as described above, are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when 1) the assets have been legally isolated from the Bank, 2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and 3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. Other than servicing, as disclosed in Note 6, the Bank has no substantive continuing involvement related to these loans.

### **Servicing**

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Generally, purchased servicing rights are capitalized at the cost to acquire the rights. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses.

Servicing assets or liabilities are amortized in proportion to and over the period of net servicing income or net servicing loss and are assessed for impairment or increased obligation based on fair value of rights compared to amortized cost at each reporting date. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan type, and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Bank later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income. Capitalized servicing rights are reported in other assets on the consolidated balance sheets.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal, or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income, a component of noninterest income.

### **Premises and Equipment**

Land is carried at cost. Premises and equipment are carried at cost, less accumulated depreciation which is computed principally by the straight-line method based upon the estimated useful lives of the related assets, which range from 3 to 40 years. Major improvements are capitalized and appropriately amortized based upon the useful lives of the related assets or the expected terms of the leases, if shorter, using the straight-line method. Maintenance, repairs, and minor alterations are charged to current operations as expenditures occur. Management annually reviews these assets to determine whether carrying values have been impaired.

### **FDIC Insurance Premium (Included in Other Assets)**

In 2009, the Corporation was required to prepay quarterly FDIC risk-based assessments for the fourth quarter of 2009 and each of the quarters in the years ending December 31, 2010, 2011 and 2012. The assessments for 2011 through 2012 have been deferred on the accompanying December 31, 2010 and 2009 consolidated balance sheets as a prepaid asset of approximately \$1,061,000 and \$1,486,000, respectively, and are expected to be expensed on a ratable basis quarterly through December 31, 2012.

# 2010 Notes to Consolidated Financial Statements

## **Goodwill**

Goodwill consists of amounts paid in excess over the fair value of identifiable net assets acquired. Goodwill is assessed at least annually for impairment and impairment losses, if any, are recognized in the year identified.

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

In the ordinary course of business, the Bank has entered into commitments to extend credit, including commitments under commercial letters of credit and standby letters of credit. Such financial instruments are considered to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is considered insignificant, the commitments are generally recorded only when they are funded (Note 12).

## **Income Taxes**

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the federal income tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. Valuation allowances are established, where necessary, to reduce deferred tax assets to the amount expected more likely than not to be realized. Income tax expense is the tax payable or refundable for the year plus or minus the change during the year in deferred tax assets and liabilities.

The Corporation analyzes its filing positions in the jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The Corporation also treats interest and penalties attributable to income taxes, and reflects any charges for such, to the extent they arise, as a component of its noninterest expenses.

## **Net Income Per Share**

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the year, which was 1,994,008 and 1,987,355 during 2010 and 2009, respectively. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from the assumed issuance.

## **Subsequent Events**

In preparing these consolidated financial statements, the Corporation has evaluated, for potential recognition or disclosure, significant events or transactions that occurred during the period subsequent to December 31, 2010, the most recent consolidated balance sheet presented herein, through March 2, 2011, the date the accompanying consolidated financial statements were available to be issued. No such significant events or transactions were identified.

## **2. FAIR VALUE MEASUREMENTS**

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Marketable securities available-for-sale, are recorded at fair value on a recurring basis. Additionally, from time to time, the Corporation may be required to record at fair value other assets on a nonrecurring basis, such as loans, loans held for sale, foreclosed assets, mortgage servicing rights, held-to-maturity securities, and certain other assets and liabilities. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write downs of individual assets.

Following is a description of the valuation methodologies and key inputs used to measure financial assets and liabilities recorded at fair value, as well as a description of the methods and significant assumptions used to estimate fair value disclosures for financial instruments not recorded at fair value in their entirety on a recurring basis. For financial assets and liabilities recorded at fair value, the description includes an indication of the level of the fair value hierarchy in which the assets or liabilities are classified.

## **Cash and Cash Equivalents**

The carrying value of cash and short-term instruments, including Federal funds sold, approximates fair values.

## **Investment Securities**

Held-to-maturity securities are recorded at fair value on a non-recurring basis, unless an other than temporary impairment is recorded. Investment securities classified as available for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions. Level 2 securities include mortgage-backed securities issued by government-sponsored entities, municipal bonds and corporate debt securities in active markets. The Corporation did not have Level 3 investment securities valued on a recurring basis at December 31, 2010 or 2009.

## **Federal Reserve Bank and Federal Home Loan Bank Stock**

The carrying value of Federal Reserve Bank and Federal Home Loan Bank of Indianapolis Stock approximates fair value based on the redemption provisions of the Federal Reserve Bank and Federal Home Loan Bank of Indianapolis.

## **Loans Held for Sale**

Loans held for sale are carried at the lower of cost or fair value. The fair value of loans held-for-sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, the Corporation classifies loans held for sale subjected to nonrecurring fair value adjustments as Level 2. At December 31, 2010 and 2009, there was no impairment recorded for loans held for sale and, therefore, no loans held for sale were recorded at fair value on a nonrecurring basis.

## **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 fixed interest rate 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. The resulting amounts are adjusted to estimate the effect of declines, if any, in the credit quality of borrowers since the loans were originated. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with accounting standards for subsequent measurement of receivables. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, and liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2010 and 2009, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the impaired loan as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the impaired loan as nonrecurring Level 3.

### Accrued Interest Receivable

The carrying amounts reported in the consolidated balance sheets for interest receivable approximate their fair value.

### Foreclosed Assets

The carrying amounts for foreclosed assets are reported in the consolidated balance sheets under "Other assets." Upon transfer from the loan portfolio, foreclosed assets are adjusted to and subsequently carried at the lower of carrying value or fair value less costs to sell. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation classifies the foreclosed asset as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the foreclosed asset as nonrecurring Level 3.

### Mortgage Servicing Rights

Mortgage servicing rights are subject to impairment testing. A valuation model, which utilizes a discounted cash flow analysis using interest rates and prepayment speed assumptions currently quoted for comparable instruments and a discount rate determined by management, is used for impairment testing. If the valuation model reflects a value less than the carrying value, loan servicing rights are adjusted to fair value through a valuation allowance as determined by the model. As such, the Corporation classifies loan servicing rights subjected to nonrecurring fair value adjustments as a Level 3. At December 31, 2010 and 2009, there was no impairment recorded for mortgage servicing rights and, therefore, no mortgage servicing rights assets were recorded at fair value on a nonrecurring basis.

### Goodwill

Goodwill is subject to impairment testing. A projected cash flow valuation method is used in the completion of impairment testing. This valuation method requires a significant degree of management judgment. In the event the projected undiscounted net operating cash flows are less than the carrying value, the asset is recorded at fair value as determined by the valuation model. If the testing resulted in impairment, the Corporation would classify goodwill subjected to nonrecurring fair value adjustments as Level 3. At December 31, 2010 and 2009, no goodwill impairment was recorded and, therefore, no goodwill was recorded at fair value on a nonrecurring basis.

### Interest- and Noninterest-Bearing Deposits

The fair values of demand deposit accounts, such as interest- and noninterest-bearing checking, savings and money market accounts, are equal to the amounts payable on demand. Fair values for interest-bearing deposits (time deposits) with defined maturities are based on the discounted value of contractual cash flows, using interest rates currently being offered for deposits of similar maturities. The fair values for variable-interest rate certificates of deposit approximate their carrying value.

### Long-Term Borrowings

The fair values of the Corporation's long-term borrowings are estimated using discounted cash flow analyses based on the Corporation's current incremental borrowing rates for similar types of borrowing arrangements.

### Accrued Interest Payable

The carrying amounts reported in the consolidated balance sheets approximate fair values.

### Commitments to Extend Credit, Standby Letters of Credit, and Undisbursed Loans

The Corporation's unused loan commitments, standby letters of credit and undisbursed loans have no carrying amount and have been estimated to have no realizable fair value. Historically, a majority of the unused loan commitments have not been drawn upon and, generally, the Corporation does not receive fees in connection with these commitments.

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

### Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The following table sets forth by level, within the fair value hierarchy, the recorded amount of assets measured at fair value on a recurring basis as of December 31:

2010	Assets at Fair Value			
	Level 1	Level 2	Level 3	Total
Investment securities available-for-sale:				
Government-sponsored enterprises	\$ -	\$ 1,006,250	\$ -	\$ 1,006,250
Mortgage-backed securities	-	2,950,901	-	2,950,901
Money market preferred securities	-	466,340	-	466,340
Preferred stock	385,600	397,060	-	782,660
<b>Total assets at fair value</b>	<b>\$ 385,600</b>	<b>\$ 4,820,551</b>	<b>\$ -</b>	<b>\$ 5,206,151</b>

### 2009

Investment securities available-for-sale:				
Government-sponsored enterprises	\$ -	\$ 3,773,985	\$ -	\$ 3,773,985
Mortgage-backed securities	-	4,290,686	-	4,290,686
Money market preferred securities	-	466,340	-	466,340
Preferred stock	873,800	281,000	-	1,154,800
<b>Total assets at fair value</b>	<b>\$ 873,800</b>	<b>\$ 8,812,011</b>	<b>\$ -</b>	<b>\$ 9,685,811</b>

The following table sets forth a summary of changes in the fair value of the Corporation's Level 3 assets measured at fair value on a recurring basis:

	Money Market Preferred Securities
<b>2009</b>	
Balance of recurring Level 3 assets at January 1, 2009	\$ 399,350
Total gains or losses (realized/unrealized):	
Included in earnings-realized	-
Included in earnings-unrealized	-
Included in other comprehensive income	-
Purchases, sales, issuances and settlements, net	-
Transfers in and/or out of Level 3	(399,350)
<b>Balance of recurring Level 3 assets at December 31, 2009</b>	<b>\$ 0</b>

### Assets Recorded at Fair Value on a Nonrecurring Basis

The following table sets forth by level, within the fair value hierarchy, the recorded amount of assets measured at fair value on a nonrecurring basis as of December 31:

2010	Total Carrying Value			
	Level 1	Level 2	Level 3	Total
Impaired loans (1)	\$ -	\$ -	\$ 1,485,898	\$ 1,485,898
<b>2009</b>				
Impaired loans (1)	\$ -	\$ -	\$ 1,305,886	\$ 1,305,886
Foreclosed assets (2)	-	-	164,925	164,925

# 2010 Notes to Consolidated Financial Statements

- (1) Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$1,485,898 and \$1,305,886 as of December 31, 2010 and 2009, respectively, resulting in an additional provision for loan losses of \$645,272 and \$300,000 for the years then ended.
- (2) Foreclosed assets, which are carried at the lower of carrying value or fair value, were written down from cost to \$164,925, resulting in a charge of \$11,325 to earnings for the year ended December 31, 2009.

## **Estimated Fair Values of Financial Instruments Not Recorded at Fair Value in their Entirety on a Recurring Basis**

Disclosure of the estimated fair values of financial instruments, which differ from carrying values, often requires the use of estimates. In cases where quoted market values in an active market are not available, the Corporation uses present value techniques and other valuation methods to estimate the fair values of its financial instruments. These valuation methods require considerable judgment and the resulting estimates of fair value can be significantly affected by the assumptions made and methods used. The methodologies for estimating fair value of financial assets and financial liabilities on a recurring and nonrecurring basis are disclosed above.

The carrying amount and estimated fair value of financial instruments not recorded at fair value in their entirety on a recurring basis on the Corporation's consolidated balance sheets are as follows (in thousands):

	2010		2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Assets</b>				
Cash and cash equivalents	\$ 21,739	\$ 21,739	\$ 31,425	\$ 31,425
Investment securities held-to-maturity	18,671	18,625	15,857	15,823
Federal Reserve Bank stock	324	324	324	324
Federal Home Loan Bank of Indianapolis stock	802	802	804	804
Loans held for sale	1,316	1,316	194	194
Net loans	285,602	289,918	258,464	265,063
Mortgage servicing rights	1,371	2,058	1,299	1,964
Accrued interest receivable	1,233	1,233	1,095	1,095
<b>Liabilities</b>				
Deposits	\$ 303,077	\$ 303,473	\$ 284,666	\$ 285,147
FHLB advances and LOC	10,328	10,371	13,490	13,461
Line of credit	836	836	961	961
Accrued interest payable	156	156	170	170

## 3. INVESTMENT SECURITIES

The amortized cost and fair value of non-trading investment securities, including gross unrealized gains and losses, are summarized as follows as of December 31:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>2010</b>				
<b>Available-for-Sale</b>				
Debt securities:				
Government-sponsored enterprises	\$ 1,001,418	\$ 4,832	\$ -	\$ 1,006,250
Mortgage-backed securities	2,870,858	80,043	-	2,950,901
Total debt securities	3,872,276	84,875	-	3,957,151
Money market preferred securities	466,340	-	-	466,340
Preferred stock	621,060	161,600	-	782,660
<b>Total available-for-sale</b>	<b>4,959,676</b>	<b>246,475</b>	<b>-</b>	<b>5,206,151</b>
<b>Held-to-Maturity</b>				
State and municipal	16,944,506	49,820	106,634	16,887,692
Mortgage-backed securities	8,860	206	-	9,066
Certificates of deposit	1,718,015	10,360	-	1,728,375
<b>Total held-to-maturity</b>	<b>18,671,381</b>	<b>60,386</b>	<b>106,634</b>	<b>18,625,133</b>
<b>Total</b>	<b>\$ 23,631,057</b>	<b>\$ 306,861</b>	<b>\$ 106,634</b>	<b>\$ 23,831,284</b>

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>2009</b>				
<b>Available-for-Sale</b>				
Debt securities:				
Government-sponsored enterprises	\$ 3,765,884	\$ 8,101	\$ -	\$ 3,773,985
Mortgage-backed securities	4,187,658	103,028	-	4,290,686
Total debt securities	7,953,542	111,129	-	8,064,671
Money market preferred securities	466,340	-	-	466,340
Preferred stock	911,060	359,800	116,060	1,154,800
<b>Total available-for-sale</b>	<b>9,330,942</b>	<b>470,929</b>	<b>116,060</b>	<b>9,685,811</b>
<b>Held-to-Maturity</b>				
State and municipal	14,138,319	58,176	97,738	14,098,757
Mortgage-backed securities	11,318	302	-	11,620
Certificates of deposit	1,707,373	5,290	-	1,712,663
<b>Total held-to-maturity</b>	<b>15,857,010</b>	<b>63,768</b>	<b>97,738</b>	<b>15,823,040</b>
<b>Total</b>	<b>\$ 25,187,952</b>	<b>\$ 534,697</b>	<b>\$ 213,798</b>	<b>\$ 25,508,851</b>

Investment securities with carrying values of approximately \$1,025,000 and \$2,422,000 as of December 31, 2010 and 2009, respectively, were pledged to secure public deposits or for other purposes as required by law.

The amortized cost and fair value of held-to-maturity and available-for-sale debt securities grouped by contractual maturity at December 31, 2010, are summarized as follows:

	Maturing				Securities With Variable Monthly Payments	Total
	Due in One Year or Less	Due After One Year Through Five Years	Due After Five Years Through Ten Years	Due After Ten Years		
<b>Available-for-Sale Debt Securities</b>						
Government-sponsored enterprises	\$ 1,001,418	\$ -	\$ -	\$ -	\$ -	\$ 1,001,418
Mortgaged-backed securities	-	-	-	-	2,870,858	2,870,858
<b>Total available-for-sale debt securities</b>	<b>1,001,418</b>				<b>2,870,858</b>	<b>3,872,276</b>
<b>Held-to-Maturity</b>						
State and municipal	7,722,166	2,806,668	5,001,725	1,413,947	-	16,944,506
Mortgage-backed securities	-	-	-	-	8,860	8,860
Certificates of deposit	1,471,015	247,000	-	-	-	1,718,015
<b>Total held-to-maturity</b>	<b>9,193,181</b>	<b>3,053,668</b>	<b>5,001,725</b>	<b>1,413,947</b>	<b>8,860</b>	<b>18,671,381</b>
<b>Total amortized cost</b>	<b>\$10,194,599</b>	<b>\$ 3,053,668</b>	<b>\$5,001,725</b>	<b>\$1,413,947</b>	<b>\$2,879,718</b>	<b>\$22,543,657</b>
<b>Fair value</b>	<b>\$10,209,587</b>	<b>\$ 3,081,938</b>	<b>\$4,969,701</b>	<b>\$1,361,090</b>	<b>\$2,959,968</b>	<b>\$22,582,284</b>

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Because of their variable payments, mortgage-backed securities are not reported by a specific maturity grouping.

During 2010 and 2009, proceeds from sales of available-for-sale securities amounted to \$463,700 and \$1,528,786, respectively. Gross realized gains amounted to \$173,755 and \$214,066 during 2010 and 2009, respectively. There were no gross realized losses during 2010 or 2009.

#### 4. LOANS

The Bank grants mortgage, commercial and consumer loans to customers situated primarily in Hillsdale, Jackson, Lenawee and Calhoun Counties. The ability of the Bank's debtors to honor their repayment obligations is dependent upon the real estate and general economic conditions of this region. Substantially all of the consumer and residential mortgage loans are secured by various items of property, while commercial loans are secured primarily by business assets, real estate, and personal guarantees. At December 31, 2010 and 2009, approximately 76% and 74%, respectively, of the portfolio is secured by residential and commercial real estate properties, and approximately 1% of the loan portfolio is unsecured in both years.

Major loan classifications, excluding loans held for sale, are summarized as follows at December 31:

	2010	2009
Mortgage loans on real estate:		
Residential 1-4 family	\$ 75,585,773	\$ 67,138,860
Commercial	100,749,284	81,930,717
Home equity lines of credit	36,261,295	34,225,307
Construction	8,925,368	9,074,240
	221,521,720	192,369,124
Commercial	43,600,617	42,153,819
Consumer installment	23,301,051	24,639,169
Tax exempt	1,793,886	2,325,849
	290,217,274	261,487,961
Total loans	290,217,274	261,487,961
Net deferred loan origination costs	181,063	377,701
Allowance for loan losses	(4,796,102)	(3,401,871)
<b>Net loans</b>	<b>\$ 285,602,235</b>	<b>\$ 258,463,791</b>

At December 31, 2010, scheduled maturities of loans with fixed rates of interest are summarized as follows:

One year or less	\$ 13,124,563
One to five years	89,694,598
Over five years	60,794,411
<b>Total</b>	<b>\$ 163,613,572</b>

Variable rate loans subject to repricing amounted to \$126,603,702 as of December 31, 2010.

The following is a summary of information pertaining to impaired and nonaccrual loans as of and for the years ended December 31:

	2010	2009
Impaired loans without a valuation allowance	\$ 1,938,313	\$ 4,260,915
Impaired loans with a valuation allowance	2,431,170	1,605,886
<b>Total impaired loans</b>	<b>\$ 4,369,483</b>	<b>\$ 5,866,801</b>
Valuation allowance related to impaired loans	\$ 945,272	\$ 300,000
Loans on nonaccrual status	\$ 4,371,307	\$ 2,946,227
Loans past due 90 days accruing interest	\$ 1,125,022	\$ 2,175,529
Average investment in impaired loans	\$ 6,372,000	\$ 6,834,000
Interest income recognized on impaired loans	\$ 121,812	\$ 268,847
Interest income recognized on a cash basis on impaired loans	\$ -	\$ -

No additional funds were committed to be advanced to customers whose loans were classified as nonaccrual or restructured at December 31, 2010.

#### 5. ALLOWANCES FOR LOAN AND FORECLOSED ASSET LOSSES

The following is a summary of the changes in the allowance for loan losses during the years ended December 31:

	2010	2009
<b>Balance, beginning of year</b>	<b>\$ 3,401,871</b>	<b>\$ 2,571,412</b>
Loans charged off	(636,534)	(836,203)
Recoveries	85,776	87,460
Net charge offs	(550,758)	(748,743)
Provision for loan losses	1,944,989	1,579,202
<b>Balance, end of year</b>	<b>\$ 4,796,102</b>	<b>\$ 3,401,871</b>

Foreclosed assets (included within other assets) of \$971,767 and \$880,041 as of December 31, 2010 and 2009, respectively, are presented net of a valuation allowance for losses. The following is a summary of the changes in the allowance for foreclosed asset losses during the years ended December 31:

	2010	2009
<b>Balance, beginning of year</b>	<b>\$ 11,325</b>	<b>\$ 72,326</b>
Charge offs	(11,325)	(201,843)
Provision for losses	-	140,842
<b>Balance, end of year</b>	<b>\$ 0</b>	<b>\$ 11,325</b>

# 2010 Notes to Consolidated Financial Statements

## 6. SERVICING

The Bank services loans for others which generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and taxing authorities, and processing foreclosures. Loans serviced as of December 31, 2010 and 2009, approximate \$236 million and \$218 million, respectively; such loans are not included on the accompanying consolidated balance sheets.

The fair values of mortgage servicing rights were approximately \$2,058,000 and \$1,964,000 at December 31, 2010 and 2009, respectively. The fair value of servicing rights was determined using discount rates ranging from 7.72% to 7.96%, and prepayment speeds ranging from 12.76% to 16.64%, depending upon the stratification of the specific right.

The following summarizes the carrying value and the changes therein of mortgage servicing rights for the years ended December 31:

	<u>2010</u>	<u>2009</u>
Balance at beginning of year	\$ 1,299,308	\$ 816,360
Mortgage servicing rights capitalized	554,185	1,022,574
Mortgage servicing rights amortized	<u>(482,973)</u>	<u>(539,626)</u>
<b>Balance at end of year</b>	<b><u>\$ 1,370,520</u></b>	<b><u>\$ 1,299,308</u></b>

## 7. PREMISES AND EQUIPMENT

Net premises and equipment consists of the following at December 31:

	<u>2010</u>	<u>2009</u>
Land and improvements	\$ 1,053,508	\$ 1,053,508
Buildings and improvements	4,954,641	4,923,206
Leasehold improvements	492,937	492,937
Furniture and equipment	<u>5,597,986</u>	<u>5,319,084</u>
Total	12,099,072	11,788,735
Less accumulated depreciation	<u>7,638,493</u>	<u>7,082,109</u>
<b>Premises and equipment, net</b>	<b><u>\$ 4,460,579</u></b>	<b><u>\$ 4,706,626</u></b>

Depreciation expense was \$556,385 and \$580,151 for 2010 and 2009, respectively.

## 8. DEPOSITS

Time deposits of \$100,000 or more were \$32,042,539 and \$21,567,057 as of December 31, 2010 and 2009, respectively. Interest expense for these deposits was \$540,130 in 2010 and \$675,257 in 2009.

Scheduled maturities of time deposits for each of the five years succeeding December 31, 2010 are summarized as follows:

<u>Year</u>	<u>Amount</u>
2011	\$ 42,082,637
2012	16,379,405
2013	7,130,476
2014	6,036,206
2015	<u>5,936,113</u>
<b>Total</b>	<b><u>\$ 77,564,837</u></b>

## 9. BORROWED FUNDS

### Federal Home Loan Bank Advances and Line of Credit

The Corporation's Federal Home Loan Bank ("FHLB") line of credit payable consists of outstanding draws on a \$10,000,000 revolving line of credit under the FHLB's Overdraft Line of Credit program, with interest charged at the FHLB short-term variable interest rate (effective rate of 0.50% at December 31, 2010). The expiration date of this agreement is June 15, 2011.

Outstanding FHLB borrowings are collateralized by a blanket lien on all qualified 1-to-4 family whole mortgage loans with carrying values totaling approximately \$28,645,000 and \$27,404,000 at December 31, 2010 and 2009, respectively.

FHLB borrowings and their contractual maturities are summarized as follows at December 31:

		<u>2010</u>	<u>2009</u>
FHLB advances			
Putable fixed rate advances:			
April 28, 2010	4.25%	\$ -	\$ 1,600,000
November 30, 2010	4.89%	-	5,000,000
May 16, 2011	3.36%	945,874	1,994,631
November 14, 2012	4.93%	2,300,000	2,300,000
June 15, 2015	4.55%	864,659	895,723
December 1, 2016	4.77%	<u>1,700,000</u>	<u>1,700,000</u>
Total FHLB advances		5,810,533	13,490,354
FHLB line of credit		<u>4,517,380</u>	<u>-</u>
		<b><u>\$ 10,327,913</u></b>	<b><u>\$13,490,354</u></b>

### Line of Credit Borrowings

The Corporation's line of credit note payable with a bank consists of outstanding draws on a \$2,000,000 revolving credit facility with interest on borrowings charged at the prime rate less 1% with a floor of 3.25% (effective rate of 3.25% at December 31, 2010). The agreement expires on September 30, 2011. Borrowings are collateralized by 100% of the Bank's outstanding common stock. The borrowing agreement contains restrictive covenants which require the Bank to maintain well-capitalized ratios as defined by Federal Reserve Bank guidelines, allowance for loan losses to total loans of at least 1.0%, to limit non-performing assets to 25% of equity, and minimum return on average assets of 0.75%.

## 10. FEDERAL INCOME TAXES

The provision for federal income taxes consists of the following components for the years ended December 31:

	<u>2010</u>	<u>2009</u>
Currently payable	\$ 1,576,000	\$ 1,284,600
Deferred benefit	<u>(392,000)</u>	<u>(33,000)</u>
<b>Total provision</b>	<b><u>\$ 1,184,000</u></b>	<b><u>\$ 1,251,600</u></b>

Federal income tax expense differs from the statutory federal income tax rate applied to pre-tax income primarily due to tax-exempt income for both 2010 and 2009.

The components of the net deferred income tax asset (liability) which was \$217,409 and \$(128,591) at December 31, 2010 and 2009, respectively, and included within other assets (liabilities) in the accompanying consolidated balance sheets, are primarily related to temporary basis differences in the allowance for loan losses, intangible assets, and mortgage servicing rights.

The Corporation has evaluated the provisions of ASC Topic 740, *Accounting for Uncertainty in Income Taxes*. The evaluation was performed for the years 2007 through 2010, the years which remain subject to examination by major tax jurisdictions as of December 31, 2010. The Corporation concluded that there are no significant uncertain tax positions requiring recognition in the Corporation's consolidated financial statements. The Corporation does not expect the total amount of unrecognized tax benefits ("UTB") (e.g. tax deductions, exclusions, or credits claimed or expected to be claimed) to significantly change in the next 12 months. The Corporation does not have any amounts accrued for interest and penalties related to UTBs at December 31, 2010 or 2009, and it is not aware of any claims for such amounts by federal or state income tax authorities.

## 11. RELATED PARTY TRANSACTIONS

### Loans

In the ordinary course of business, the Bank grants loans to certain directors, executive officers and their affiliates. Such loans aggregated approximately \$3,091,000 and \$1,798,000 as of December 31, 2010 and 2009, respectively.

### Deposits

Deposits of Corporation directors, executive officers and their affiliates were approximately \$833,000 and \$445,000 at December 31, 2010 and 2009, respectively.

## 12. OFF-BALANCE SHEET ACTIVITIES

The Bank is a party to credit related financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments may include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank follows the same credit policy in making such commitments, including requirements for collateral, as it does for on-balance sheet instruments; no significant losses are anticipated as a result of these commitments.

The following financial instruments were outstanding whose contract amounts represent credit risk at December 31:

	<u>Contract Amount</u>	
	<u>2010</u>	<u>2009</u>
Unfunded commitments under lines of credit	\$ 67,660,000	\$ 56,283,000
Commitments to grant loans	13,683,000	21,414,000
Standby letters of credit	5,846,000	939,000

Unfunded commitments under commercial lines-of-credit and revolving credit lines are commitments for possible future extensions of credit to existing customers. These lines-of-credit usually do contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed; a portion is uncollateralized.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed interest rates, fixed expiration dates or other termination clauses and may require payment of a fee. The commitments may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer. A portion of these commitments are uncollateralized.

Approximately 21% of the above commitments are at fixed rates of interest.

Standby letters of credit are conditional commitments issued by the Bank to guarantee a customer's performance to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially, all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments if deemed necessary and at December 31, 2010 and 2009 such collateral amounted to \$5,887,560 and \$1,494,633, respectively. Guarantees that are not derivative contracts have been recorded on the Corporation's consolidated balance sheets at their fair value at inception. The Corporation considers standby letters of credit to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is not significant, a liability related to such guarantees is not recorded at December 31, 2010.

Approximately \$499,000 of the total commitments were to related parties as of December 31, 2010.

## 13. DERIVATIVE FINANCIAL INSTRUMENTS

### *Forward Loan Sale Commitments*

To protect against the price risk inherent in derivative loan commitments and mortgage loans held for sale, the Corporation utilizes both "mandatory delivery" and "best efforts" forward loan sale commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments.

With a "mandatory delivery" contract, the Corporation commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. If the Corporation fails to deliver the amount of mortgages necessary to fulfill the commitment by the specified date, it is obligated to pay a "pair-off" fee, based on then-current market prices, to the investor to compensate the investor for the shortfall.

With a "best efforts" contract, the Corporation commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. Generally, the price the investor will pay the seller for an individual loan is specified prior to the loan being funded (e.g., on the same day the lender commits to lend funds to a potential borrower).

The Corporation expects that these forward loan sale commitments will experience changes in fair value opposite to the change in fair value of mortgage loans held for sale. The notional amount of fixed rate forward loan sale commitments was \$601,850 and \$194,350 at December 31, 2010 and 2009, respectively.

The fair value of the rate lock loan commitments related to the origination of mortgage loans that will be held for sale and the forward loan sale commitments are deemed insignificant by management and, accordingly, are not recorded in these consolidated financial statements.

### *Collateral Requirements*

To reduce credit risk related to the use of derivative instruments, the Corporation might deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on the Corporation's credit evaluation of the customer. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant and equipment and real estate. If the counterparty does not have the right and ability to redeem the collateral or the Corporation is permitted to sell or re-pledge the collateral on short notice, the Corporation records the collateral in its consolidated balance sheet at fair value with a corresponding obligation to return it.

# 2010 Notes to Consolidated Financial Statements

## 14. REGULATORY MATTERS

### Capital Requirements

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

Quantitative measurements established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and Tier 1 capital to average assets (as defined). Management believes as of December 31, 2010 and 2009, that the Corporation and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2010, the most recent notification from the OCC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the most recent notification that management believes have changed the Bank's category.

The Corporation's and the Bank's actual and required capital amounts and ratios are as follows (dollars in thousands):

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2010</b>						
Total capital to risk weighted assets						
Corporation	\$ 31,504	11.7%	\$ 21,510	8.0%	\$ N/A	N/A%
Bank	32,232	12.0	21,510	8.0	26,887	10.0
Tier 1 capital to risk weighted assets						
Corporation	28,052	10.4	10,755	4.0	N/A	N/A
Bank	28,780	10.7	10,755	4.0	16,132	6.0
Tier 1 capital to average assets						
Corporation	28,052	8.3	13,538	4.0	N/A	N/A
Bank	28,780	8.5	13,538	4.0	16,923	5.0
<b>As of December 31, 2009</b>						
Total capital to risk weighted assets						
Corporation	\$ 29,824	11.7%	\$ 20,330	8.0%	\$ N/A	N/A%
Bank	30,640	12.1	20,330	8.0	25,412	10.0
Tier 1 capital to risk weighted assets						
Corporation	26,645	10.5	10,165	4.0	N/A	N/A
Bank	27,461	10.8	10,165	4.0	15,247	6.0
Tier 1 capital to average assets						
Corporation	26,645	8.3	12,822	4.0	N/A	N/A
Bank	27,461	8.6	12,822	4.0	16,027	5.0

### Restrictions on Cash and Amounts Due from Banks

The Bank is required by regulatory agencies to maintain legal cash reserves based on the level of certain customer deposits. Required reserve balances were \$6,465,000 and \$5,640,000 at December 31, 2010 and 2009, respectively.

### Restrictions on Dividends, Loans, and Advances

Banking regulations place certain restrictions on dividends paid and loans or advances made by the Bank to the Corporation.

Prior approval of the Federal Reserve and OCC is required if the total dividends declared by the Bank in a calendar year exceed the sum of the retained net income of the Bank for the current year plus its retained net income for the two preceding years, less any required transfers from retained earnings to common stock (as defined). In addition, dividends paid by the Bank would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital standards. At January 1, 2011, the Bank's retained earnings available for the legal payment of dividends, without prior approval from the regulators, was approximately \$1,695,000.

Loans or advances made by the Bank to the Corporation are generally limited to 10 percent of the Bank's contributed capital (par value common stock and additional paid-in capital). Accordingly, at December 31, 2010, Bank funds available for loans or advances to the Corporation amounted to approximately \$1,079,000.

## 15. CONTINGENCIES

### Litigation

The Corporation may be party to litigation arising during the normal course of business. In the opinion of management, based on consultation with legal counsel, the resolution of such litigation is not expected to have a material effect on the consolidated financial statements.

### Environmental Issues

As a result of acquiring real estate in foreclosure proceedings, the Bank is subject to potential claims and possible legal proceedings involving environmental matters. No such claims have been asserted at December 31, 2010.

## 16. SHARE-BASED PAYMENTS

### Stock Compensation Plan

A ten-year Stock Compensation Plan was adopted by the Corporation in April 2007. Under the plan, the Corporation and its subsidiary may grant common stock purchase options, shares of restricted stock, and stock appreciation rights to its directors, officers, and key employees. The aggregate number of shares under option stock and restricted stock that may be issued and outstanding pursuant to the exercise of options, the granting of restricted stock awards or stock appreciation rights under this plan may not exceed 74,000 shares. During 2010 and 2009, no stock options were granted nor stock appreciation rights awarded under the plan.

The Corporation issued 7,480 and 5,360 shares of restricted common stock in 2010 and 2009, respectively. The fair value of restricted stock at the grant date was determined by the Corporation's Board of Directors based on the weighted-average selling price of the Corporation's common stock for the previous four quarters (\$19.81 and \$21.87 per share in 2010 and 2009, respectively). Under the provisions of the plan, the Corporation cannot be obligated to "cash-settle" any of the restricted stock awards through redemption. The shares become vested ratably over a four-year period on December 31 of each year if the designated performance criteria are met for that year. During the period the shares are not vested, the grantee may not sell, assign, transfer or pledge the shares but has all other rights of a shareholder, including the right to receive dividends and the right to vote such shares. Restricted stock is immediately forfeited when the employment of a grantee is terminated. Noninterest expense is recognized for the fair value of the vested shares as of the vesting date. During 2010, of the 7,480, 5,360, 4,920 and 7,620 shares of restricted stock issued in 2010, 2009, 2008 and 2007, respectively, grantees became fully vested in a total of 6,030 shares (\$19.91 per share). During 2009, of the 5,360, 4,920, and 7,620 shares of

restricted stock issued in 2009, 2008, and 2007, respectively, grantees became fully vested in a total of 4,230 shares (\$21.95 per share). Included within the Corporation's consolidated statements of income is compensation expense of \$99,650 and \$71,187 in 2010 and 2009, respectively, and directors' and advisory members' fees expense of \$20,408 and \$21,323 in 2010 and 2009, respectively, related to the vested shares under the plan. Basic and diluted earnings per share were impacted by approximately \$0.02 and \$0.01 in 2010 and 2009, respectively, related to the cumulative effect. As of December 31, 2010 and 2009, respectively, cumulative unrecognized compensation costs related to nonvested restricted stock awards had balances of \$226,628 and \$200,376 and are presented as a reduction of shareholders' equity. A corresponding increase to shareholders' equity for both 2010 and 2009 is presented within common stock, resulting in a \$ -0- impact on total shareholders' equity as of December 31, 2010 and 2009.

### **Incentive Stock Option Plan**

A ten-year Incentive Stock Option Plan was adopted in 1995 in which options may be granted to officers and other key employees to purchase up to 40,000 shares of common stock at fair value on the date of grant. Options are exercisable, in whole or in part, beginning two years and expiring ten years after the date of grant. Effective February 8, 2005, the Incentive Stock Option Plan was terminated in accordance with the Plan document. As such, there were no options available for grant as of December 31, 2010 or 2009.

A summary of activity in the Incentive Stock Option Plan during 2010 and 2009 is as follows:

	<b><u>Options Available for Grant</u></b>	<b><u>Options Outstanding</u></b>	<b><u>Weighted Average Exercise Price</u></b>
Outstanding, January 1, 2009	-	14,240	\$ 37.89
Exercised	-	-	-
Terminated (retirees did not exercise and expiration)	-	(4,640)	37.67
Outstanding, December 31, 2009	-	9,600	<u>\$ 38.00</u>
Exercised	-	-	-
Terminated (retirees did not exercise and expiration)	-	(1,600)	40.00
<b>Outstanding, December 31, 2010</b>	<u>-</u>	<u>8,000</u>	<u>\$ 37.60</u>

For stock options outstanding at December 31, 2010 and 2009, the range of exercise prices per share was between \$36.00 and \$40.00 for both years, and the weighted average remaining contractual terms were 0.2 and 1.2 years, respectively. At December 31, 2010 and 2009, 8,000 and 9,600 options were exercisable at weighted average exercise prices of \$37.60 and \$38.00 per share, respectively.

### **17. EMPLOYEE BENEFIT PLANS**

A noncontributory pension/profit sharing plan covers all salaried employees following the completion of 1 year of employment (1,000 hours in a 12 consecutive month period) and who are 21 years of age or older. Contributions to the plan are made quarterly to the employees' plan account. The amount of each contribution is determined by the Board of Directors.

The Bank also has a complimentary Safe Harbor 401(k) plan for eligible employees, following three consecutive months of service. The Bank makes a "Safe Harbor" match contribution in the amount of 100% of the employees' contribution. The percentage rate applies to only the first 5% of the employees' Plan Salary.

Contribution expense related to the noncontributory pension/profit sharing plan was approximately \$445,000 and \$463,000 in 2010 and 2009, respectively. Contributions to the Safe Harbor 401(k) plan were \$229,000 and \$227,000 in 2010 and 2009, respectively.

### **18. SUPPLEMENTAL CASH FLOWS INFORMATION**

#### **Non-Cash Investing Activities**

During 2010 and 2009, collateral was repossessed related to mortgage loans receivable of \$1,237,466 and \$1,399,389, respectively, which amounts were then transferred to foreclosed assets.

#### **Other Cash Flows Information**

Cash paid for interest and income taxes amounted to the following during the years ended December 31:

	<b><u>2010</u></b>	<b><u>2009</u></b>
Interest	<u>\$ 2,493,482</u>	<u>\$ 3,724,661</u>
Income taxes	<u>\$ 1,234,000</u>	<u>\$ 1,684,309</u>

# Totally Committed to the Community.

## 2010 Board of Directors

### Craig Connor

"Being a Director of CNB Community Bancorp, Inc. and County National Bank is a serious but enjoyable responsibility. Looking out for the interests of the shareholders, customers, employees and the communities we do business in helps all of the Directors do their best to assure we are operating a safe and sound bank."

### Claude Rowley

"After seeing the struggles and effects in banking over the last couple of years, I understand even more the importance of having a strong community bank. And as a CNB Director, I'm committed to seeing the bank remain strong and involved in our communities."

### Stephen Maddalena

"I have the honor of representing Jackson on the Board of Directors at CNB. With this responsibility comes my commitment to the bank to help CNB grow our presence in the Jackson market and help promote the bank in the Jackson community as a better alternative to the larger regional and national banks."

### John Barrett

"As a director of County National Bank, I am committed to making sound financial decisions that will help our bank prosper now and in the future."

### David Pope

"I am totally committed to community banking, just as I am totally committed to serving our shareholders, the well being of our staff and the success of our customers."

### Judy Gabriele

"I stand strong with County National Bank's commitment to sound business decisions, community involvement and superior customer satisfaction."

### John Lovinger

"As a Director, I am committed to maintaining County National Bank's tradition as a financially sound and reliable Community Bank and to ensuring that we continue to be the cornerstone of a successful and prosperous community."

### Steven Wells

"I will continue to help make our community bank a place where our employees enjoy working, our customers feel treated fairly, and our shareholders are pleased with the bank's performance."



Hillsdale County Fair Parade



Jackson Chamber of Commerce JAXPO



Ella Sharp Museum of Art and History's Norman Rockwell Lecture Reception



Big Brothers Big Sisters "Bowl for Kids' Sake"



# Totally Committed.

## 2010 Officers:

(Left to Right Read)

- Top Row First Photo:** Craig S. Connor, President & Chief Executive Officer; Spencer D. Swank, Executive Vice President & Chief Financial Officer
- Second Photo:** Cindy Dwyer, Vice President – Technology; Diane K. Clow, Vice President – Director of Human Resources; Mary P. Marshall, Vice President – Senior Trust Officer; Lois E. Howard, Vice President – Commercial Loans; Dorene M. Shaw, Vice President – Chief Auditor
- Third Photo:** Timothy P. Sullivan, Assistant Vice President – Trust Officer; Eric A. Potes, Commercial Loan Officer; Wendora K. Broesamle, Branch Officer – Hillsdale; Christine L. Walworth, Assistant Vice President – Trust Operations Officer; Jeffrey S. Jackson, Consumer Loan Officer
- Middle Row First Photo:** Ronald J. Haber, 2nd Vice President – Commercial Loans; Michelle R. Graber, 2nd Vice President – Compliance Officer; Luann J. Crowley, 2nd Vice President – Mortgage Loans; Phyllis J. Brooks, 2nd Vice President – Consumer Loans; Scott E. Evans, Vice President – Senior Mortgage Officer
- Second Photo:** David J. Kreger, Assistant Vice President – Commercial Loan Officer – Jackson; Gwenda J. Ripley, Branch Officer – Cortland Office; John R. Waldron, Vice President – Senior Loan Officer; William C. Jors, Assistant Vice President – Commercial Loan Officer – Jackson
- Third Photo:** Donald W. Germann, Branch Officer – Jonesville; Michelle L. Caldwell, Branch Officer – Litchfield; Robin G. Pelham, Branch Officer – Somerset Center; Craig R. Burlingame, Branch Officer – Homer
- Last Row First Photo:** Ryan R. Ambs, Branch Officer – Wisner Office; Craig D. Talbert, Mortgage Officer – Cortland Office; Suzanne L. Nye, Mortgage Officer – Jackson; Robert J. Wrozek, Branch Officer – Horton Road Office; Kelly D. Jensen, Assistant Vice President & Branch Officer – Spring Arbor
- Second Photo:** Debra K. Storer, Underwriter Operations Officer; Debra S. Smith, 2nd Vice President – Accounting; Sandra K. Grimm, Assistant Vice President – Data Processing; L. Michelle Heminger, 2nd Vice President – Administration; Rae A. Organ, Assistant Vice President – Bank Secrecy & Security Officer
- Third Photo:** Brenda L. Carpenter, Mortgage Officer – Jackson; Sharon L. Burns, 2nd Vice President – Controller



Totally Committed.

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