

**UNIVERSITY BANCORP, INC.
AND SUBSIDIARIES**

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2010 and 2009

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES

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INDEPENDENT AUDITOR'S REPORT

Board of Directors and Stockholders
University Bancorp, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of University Bancorp, Inc. and Subsidiaries (the "Company") as of December 31, 2010 and 2009, and the related consolidated statements of operations, equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

As of and for the year ended December 31, 2010, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in Governmental Auditing Standards issued by the Comptroller General of the United States. As of and for the year ended December 31, 2009, we conducted our audit in accordance with auditing standards generally accepted in the United States of America. Both these standards require that we plan and perform the audits 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 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 financial position of University Bancorp, Inc. and Subsidiaries as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated April 27, 2011, on our consideration of University Bank's internal control over financial reporting. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and not to provide an opinion on the internal control over financial reporting. In accordance with Government Auditing Standards, we have also issued a report dated April 27, 2011, on University Bank's compliance with certain provisions of laws, regulations, contracts, grants, agreements and other matters that could have a direct and material effect on a major HUD-assisted program. Those reports are an integral part of an audit performed in accordance with Government Auditing Standards, and should be read in conjunction with this report in considering the results of our audits.

Board of Directors and Stockholders
University Bancorp, Inc. and Subsidiaries
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Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The accompanying supplemental information (shown on pages 42-47) is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements of University Bancorp, Inc. and Subsidiaries. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

UHY LLP

Southfield, Michigan
April 27, 2011

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2010	2009
ASSETS		
Cash and due from banks	\$ 13,595,247	\$ 40,689,831
Certificates of deposit	6,250,000	-
Trading securities, at fair value	964,893	1,513,047
Investment securities available-for-sale, at fair value	2,934,369	557,096
Federal Home Loan Bank Stock, at cost	1,197,400	1,325,000
Loans and financings held for sale, at lower of cost or market	3,645,675	3,110,100
Loans and financings held for sale, at fair value	18,811,794	19,360,521
Loans and financings, net	57,603,267	58,355,345
Premises and equipment, net	2,979,735	2,811,030
Mortgage servicing rights, at fair value	2,929,514	2,465,243
Other real estate owned, net	1,425,821	679,403
Accounts receivable	966,055	727,000
Accrued interest and financing income receivable	195,277	213,713
Prepaid expenses	996,889	828,887
Derivatives, at fair value	107,012	115,442
Goodwill	103,914	103,914
Other assets	2,558,699	1,559,469
	\$ 117,265,561	\$ 134,415,041

	December 31,	
	2010	2009
LIABILITIES AND EQUITY		
LIABILITIES		
Deposits:		
Demand - non-interest bearing	\$ 74,570,044	\$ 80,765,969
Demand - interest bearing and profit sharing	11,432,451	23,214,716
Savings	275,307	308,984
Time	13,335,788	13,744,890
Total deposits	<u>99,613,590</u>	<u>118,034,559</u>
Derivatives, at fair value	-	14,905
Accounts payable	412,817	561,731
Accrued interest and profit sharing payable	44,274	50,617
Other liabilities	5,986,100	4,001,903
Preferred stock subject to mandatory redemption	880,140	806,120
Total liabilities	<u>106,936,921</u>	<u>123,469,835</u>
EQUITY		
University Bancorp, Inc. stockholders' equity:		
Common stock, \$.01 par value per share; 5,000,000 shares authorized; 4,391,062 shares issued as of both December 31, 2010 and 2009	43,911	43,911
Additional paid-in capital	6,154,967	6,154,967
Additional paid-in capital, stock options	49,234	49,234
Treasury stock, at cost, 115,184 shares held	(340,530)	(340,530)
Retained earnings (accumulated deficit)	(51,632)	266,943
Accumulated other comprehensive income	67,759	2,872
Equity attributable to stockholders of University Bancorp, Inc.	<u>5,923,709</u>	<u>6,177,397</u>
Noncontrolling interest	<u>4,404,931</u>	<u>4,767,809</u>
Total equity	<u>10,328,640</u>	<u>10,945,206</u>
Total liabilities and equity	<u>\$ 117,265,561</u>	<u>\$ 134,415,041</u>

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	Years ended December 31,	
	2010	2009
Interest and financing income:		
Interest and fees on loans and financing income	\$ 4,464,094	\$ 4,877,510
Interest on securities:		
U.S. Government agencies	10,703	209,622
Other securities	14,928	37,766
Interest on Federal funds and other	182,506	62,168
	<u>4,672,231</u>	<u>5,187,066</u>
Total interest and financing income		
Interest and profit sharing expense:		
Interest and profit sharing on deposits:		
Demand deposits	418,812	368,962
Savings deposits	651	1,237
Time deposits	327,422	609,972
Short-term borrowings	-	4,400
	<u>746,885</u>	<u>984,571</u>
Total interest and profit sharing expense		
Net interest and financing income	3,925,346	4,202,495
Provision for loan losses	891,094	1,293,546
	<u>891,094</u>	<u>1,293,546</u>
Net interest and financing income after provision for loan losses	3,034,252	2,908,949
	<u>3,034,252</u>	<u>2,908,949</u>
Other income:		
Loan servicing and sub-servicing fees	4,775,784	3,611,402
Initial loan set-up and other fees	4,998,388	4,839,320
Gain on sale of mortgage loans, net	5,571,048	7,511,571
Insurance & investment fee income	191,215	235,584
Deposit service charges and fees	13,987	23,341
Net realized gain (loss) on trading securities	(8,338)	160,156
Net realized gain (loss) on securities available-for-sale	-	6,299
Change in fair value of mortgage servicing rights	(145,152)	87,447
Change in fair value of loans held for sale, interest rate locks and forward commitments	126,464	76,345
Other income	242,097	76,208
	<u>15,765,493</u>	<u>16,627,673</u>
Total other income		

	Years ended December 31,	
	2010	2009
Other expenses:		
Salaries and benefits	\$ 10,803,594	\$ 9,444,190
Occupancy	762,114	721,920
Data processing and equipment expense	937,908	872,518
Legal and audit	907,726	662,897
Consulting fees	408,175	1,071,810
Mortgage banking	1,955,364	1,471,764
Advertising	142,272	157,930
Membership and training	242,608	224,054
Travel and entertainment	309,941	310,608
Supplies and postage	527,031	542,879
Insurance	243,185	211,023
Other operating expenses	1,252,318	1,413,352
	18,492,236	17,104,945
Income before income taxes	307,509	2,431,677
Income tax expense (benefit)	138,150	(186,595)
Net income	169,359	2,618,272
Net income attributable to the noncontrolling interests	410,564	1,924,755
Net income (loss) attributable to common stockholders of University Bancorp, Inc.	\$ (241,205)	\$ 693,517

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EQUITY

	<u>University Bancorp, Inc. Stockholders'</u>			
	<u>Common Stock</u>		<u>Additional</u>	<u>Additional</u>
	<u>\$.01 Par value</u>			
	<u>Number</u>	<u>Par</u>	<u>Paid-in</u>	<u>Capital</u>
	<u>of Shares</u>	<u>Value</u>	<u>Capital</u>	<u>Stock</u>
				<u>Options</u>
Balance at January 1, 2009	4,391,062	\$ 43,911	\$ 6,154,967	\$ 49,234
Comprehensive income (loss):				
Net income				
Other comprehensive income (loss)				
Change in unrealized gain				
on securities available-for-sale				
Total comprehensive income				
Preferred stock dividend				
Balance at December 31, 2009	4,391,062	43,911	6,154,967	49,234
Comprehensive income (loss):				
Net income (loss)				
Other comprehensive income (loss)				
Change in unrealized gain				
on securities available-for-sale				
Total comprehensive income (loss)				
Dividends to noncontrolling interest				
Preferred stock dividend				
Balance at December 31, 2010	<u>4,391,062</u>	<u>\$ 43,911</u>	<u>\$ 6,154,967</u>	<u>\$ 49,234</u>

University Bancorp, Inc. Stockholders'					
Treasury Stock		Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Non-controlling Interest	Total
Number of Shares	Cost				
(115,184)	\$ (340,530)	\$ (360,046)	\$ (34,300)	\$ 2,843,054	\$ 8,356,290
		693,517		1,924,755	2,618,272
			37,172		37,172
		693,517	37,172	1,924,755	2,655,444
		(66,528)			(66,528)
(115,184)	(340,530)	266,943	2,872	4,767,809	10,945,206
		(241,205)		410,564	169,359
			64,887		64,887
		(241,205)	64,887	410,564	234,246
		(77,370)		(773,442)	(773,442)
				(77,370)	(77,370)
<u>(115,184)</u>	<u>\$ (340,530)</u>	<u>\$ (51,632)</u>	<u>\$ 67,759</u>	<u>\$ 4,404,931</u>	<u>\$ 10,328,640</u>

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended December 31,	
	2010	2009
OPERATING ACTIVITIES		
Net income	\$ 169,359	\$ 2,618,272
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	471,765	435,113
Change in fair value of mortgage servicing rights	145,152	(87,447)
Change in fair value of loans held for sale, interest rate locks and forward commitments	(126,464)	(76,345)
Deferred income tax benefit	138,150	(186,595)
Provision for loan losses	891,094	1,293,546
Net gain on sale of mortgages	(5,571,048)	(7,511,571)
Net realized (gain) loss on trading securities	8,338	(160,156)
Net gain on securities available-for-sale	-	(6,299)
Proceeds from maturities of trading securities	539,818	1,068,170
Proceeds from sales of trading securities	-	2,502,582
Net loss on sale of mortgage servicing rights	25,516	-
Net loss on the sale of other real estate owned	4,949	14,078
Net amortization (accretion) on investment securities	(9,658)	4,638
Write down of other real estate owned	29,132	259,420
Loss on disposal of premises and equipment	-	21,338
Originations of mortgage loans and financings	(381,380,905)	(549,701,692)
Proceeds from mortgage loan and financing sales	387,085,094	565,872,611
Net change in:		
Various other assets	(1,526,001)	(66,514)
Various other liabilities	1,902,960	288,838
Net cash provided by operating activities	2,797,251	16,581,987
INVESTING ACTIVITIES		
Purchase of certificates of deposit	(6,250,000)	-
Purchase of securities available-for-sale	(2,333,844)	-
Proceeds from sale of securities available-for-sale	-	19,623,469
Proceeds from maturities of securities available-for-sale	31,114	504,621
Net proceeds from sale of Federal Home Loan Bank stock	127,600	-
Proceeds from sale of mortgage servicing rights	99,953	-
Proceeds from sale of other real estate owned	433,375	931,713
Payments for improvements of other real estate owned	(8,594)	-
Loans granted, net of repayments	(1,344,296)	(2,091,126)
Increase in mortgage servicing rights	(734,892)	(1,136,412)
Purchases of premises and equipment	(640,470)	(484,755)
Net cash provided by (used in) investing activities	(10,620,054)	17,347,510

	Years ended December 31,	
	2010	2009
FINANCING ACTIVITIES		
Net change in deposits	(18,420,969)	14,040,109
Dividends on preferred stock	(77,370)	(66,528)
Net repayments to Federal Home Loan Bank	-	(12,011,678)
Dividends to noncontrolling interest	(773,442)	-
Issuance of preferred stock	-	200,000
	(19,271,781)	2,161,903
NET CHANGE IN CASH	(27,094,584)	36,091,400
Cash and Cash Equivalents, Beginning	40,689,831	4,598,431
Cash and Cash Equivalents, Ending	\$ 13,595,247	\$ 40,689,831
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest	\$ 753,228	\$ 990,055
Income taxes	\$ -	\$ -
SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTIONS:		
Mortgage loans converted to other real estate owned and other assets	\$ 1,205,280	\$ 850,293
Accrued dividends on preferred stock converted to additional shares of preferred stock	\$ 74,020	\$ 54,950

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Nature of Operations

The consolidated financial statements of University Bancorp, Inc. (the “Company”) include the operations of its wholly owned subsidiary, University Bank, Inc. (the “Bank”), the Bank’s wholly owned subsidiaries, University Insurance & Investment Services, Inc. (“Agency”) and Hoover, LLC (“Hoover”), the Bank’s two 80% owned subsidiaries, Midwest Loan Services, Inc. (“Midwest”) and University Islamic Financial Corporation (“UIFC”), and the Bank’s 50.01% owned subsidiary University Lending Group, LLC (“ULG”). These consolidated financial statements also include the operations of Hoover’s wholly owned subsidiary, Tuomy, LLC. The accounts are maintained on an accrual basis in accordance with generally accepted accounting principles and predominant practices within the banking and mortgage banking industries. All significant intercompany balances and transactions have been eliminated in preparing the consolidated financial statements.

The Company is a bank holding company. University Bank, which is located in Michigan, is a full service community bank, which offers all customary banking services, including the acceptance of checking, savings and time deposits. The Bank also makes commercial, real estate, personal, home improvement, automotive and other installment, credit card and consumer loans, and provides fee based services such as annuity and mutual fund sales, stock brokerage and money management, life insurance, property casualty insurance and foreign currency exchange. The Bank’s customer base is primarily located in the Ann Arbor, Michigan area.

University Bank’s loan portfolio is concentrated in Ann Arbor and Washtenaw County, Michigan. While the loan portfolio is diversified, the customers’ ability to honor their debts is partially dependent on the local economy. The Ann Arbor area is primarily dependent on the education, healthcare, services and manufacturing (automotive and other) industries. Most real estate loans are secured by residential or commercial real estate and business assets secure most business loans. Generally, installment loans are secured by various items of personal property.

The Agency is engaged in the sale of insurance products including life, health, property and casualty, and investment products including annuities, mutual funds, stock brokerage and money management. The Agency is located in the Bank’s Ann Arbor main office. The Agency also has a limited partnership investment in low-income housing tax credits through Michigan Capital Fund for Housing Limited Partnership I.

Hoover owns the Bank’s headquarters facility. Tuomy owns commercial land with a rental building.

Midwest is engaged in the business of servicing and sub-servicing residential mortgage loans. Midwest began operations in 1992 and was acquired by University Bank in December 1995. Midwest is based in Houghton, Michigan, and also originates mortgage loans for itself and other financial institutions, including the Bank (See Note 5).

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Principles of Consolidation and Nature of Operations (Continued)

ULG commenced operations in April 2008 and operates in Farmington Hills, Michigan. ULG also operates two loan processing offices, one in Michigan and one in Ohio. ULG is engaged in the business of marketing, processing, closing and selling secondary mortgage market loans. ULG is also engaged in the business of servicing mortgage loans as servicing rights are retained on selective loans that are sold.

UIFC is engaged in Islamic Banking and was formed on December 30, 2005. Its current products, which comply with Islamic (Sharia'a) law, are FDIC-insured deposits and home financings (as agent for the Bank), mutual funds (as agent for a third-party fund distribution company) and home financings (as principal for its own account). The Sharia'a compliant products are offered to service the large number of Muslim customers in general area of the Company.

There are two distinct home financing products offered, the Ijara and the Murabaha.

Under the Ijara method, a single-asset trust is established by or on behalf of the originator (Bank/UIFC), as settlor, naming a special purpose entity as the trustee. The trust is subject to the terms of the written indenture designed for this specific purpose which is used generically for all financings in the redeemable lease (Ijara) program. The funds necessary to acquire the real property are deposited into the trust by the originator, as settlor, and used to fund the purchase of the property. The trust then enters into a combination lease/contract-for-deed agreement with the lessee/purchaser. The settlor is the initial beneficiary of the trust, but the beneficial interest in the payment stream arising from the trust is assignable to third parties. The power to remove and appoint trustees is granted to the beneficiary and the beneficiary has the power to direct the trustee with respect to foreclosure of the property. These rights are assignable with the payment stream.

The terms of the lease and contract-for-deed agreements, in combination, result in a payment stream and cost of the real property that are functionally equivalent to secured real estate lending for both the lessee/purchaser and the Company. The lease payment under the lease agreement is similar to an interest payment under a conventional mortgage. The contract-for-deed payments resemble a principal payment under a conventional mortgage.

The redeemable lease arrangement is treated as financing rather than leasing in accordance with generally accepted accounting principles ("GAAP"). A lease that transfers substantially all of the benefits and risks incident to the ownership of property should be accounted for as the acquisition of an asset by the lessee and as a financing by the lessor. Under lease accounting standards of the Accounting Standards Codification ("ASC"), a lease would generally be accounted for as a financing if:

1. The underlying property is transferred to the lessee at the end of the lease, or

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Principles of Consolidation and Nature of Operations (Continued)

2. The lease contains a bargain purchase that is reasonably assured of being exercised, and
3. It is reasonably certain that the lease payments will be collected, and
4. No uncertainties surround the amount of un-reimbursable costs yet to be incurred by the lessor under the lease.

Accordingly, the Company's accounting for this product is essentially the same as a conventional mortgage product. To reflect the legal substance of the Ijara transactions, the Company uses the balance sheet account title "Loans and financings", instead of a typical title of "Loans". In the statement of operations, "Interest and fees on loans" is modified to state "Interest and fees on loans and financing income".

The second form of home financing is the Murabaha. This form of financing is similar to an installment sale contract. As agent for the Federal Home Loan Mortgage Corporation ("Freddie Mac"), the Bank buys a home selected by a customer and then resells it to the customer, at a selling price higher than the purchase price. The difference between the Bank's purchase price and the selling price is the profit that the ultimate holder (Freddie Mac) of the installment contract will accrete into income over the life of the contract. After the contract is executed by the Bank and the customer, Freddie Mac reimburses the Bank for its outlay of cash to purchase the home and pays the Bank a fee for originating the transaction. The customer pays Freddie Mac for the home that was purchased on an installment basis, per an agreed repayment schedule.

As of December 31, 2009, the installment contracts are recorded at the lower of cost or market on the Company's balance sheet for the short period of time that they are held before settlement with Freddie Mac. During 2010, the Company began to record these contracts at fair value. As of December 31, 2010, the installment contracts are recorded at fair value. The installment contracts are sold with servicing retained. Thus, the value of the installment contract and value of the servicing is determined to calculate the fair value and any gain or loss on the sale of the underlying installment contract. See Note 19 for additional discussion of the determination of fair value.

On the liability side of the balance sheet, the Bank offers FDIC-insured deposits that are compliant with Sharia'a. These deposits are specifically invested in Sharia'a compliant investments such as, but not limited to, the Ijara. Sharia'a compliant savings, money markets and certificates of deposit pay out earnings that are derived specifically from the revenues from the Sharia'a compliant investments net of certain expenses. In compliance with the FDIC definition of a deposit, balances in these accounts like all deposit accounts, are FDIC insured. The sharing of earnings paid out to the depositors holding these accounts can fluctuate with the net earnings of the Ijara portfolio and other Sharia'a compliant investments. The earnings paid to the depositors are accounted for as an expense.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Principles of Consolidation and Nature of Operations (Continued)

This expense is analogous to interest expense paid on deposits in conventional finance. To reflect the legal substance of the Sharia'a compliant deposits, the Company uses the balance sheet account title "Demand deposits – interest bearing and profit sharing" instead of the typical title of "Demand deposits – interest bearing". In the statement of operations, "Interest on deposits" is modified to state "Interest and profit sharing on deposits".

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions based upon available information. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

The significant estimates incorporated into these consolidated financial statements, which are more susceptible to change in the near term, include the value of mortgage servicing rights, the allowance for loan losses, the identification and valuation of impaired loans, the valuation of other real estate owned, impairment analysis of goodwill, the fair value of financial instruments, the valuation of deferred tax assets, and the fair value of certain loans held for sale and derivative instruments such as mortgage interest rate locks and forward commitments.

Cash Flow Reporting

For purposes of the consolidated statements of cash flows, cash and cash equivalents is defined to include the cash on hand, interest bearing deposits in other institutions, federal funds sold and other investments with an original maturity of three months or less. Net cash flows are reported for customer loan and deposit transactions and interest bearing deposits with other banks.

Securities

Securities are classified as trading securities or available-for-sale at the date of purchase. Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income or loss. Trading securities are carried at fair value with realized gains and losses recorded in earnings. Available-for-sale securities are written down to fair value through a charge to earnings when a decline in fair value is not temporary. Interest income includes amortization of purchase premium or discount. Other securities such as Federal Home Loan Bank stock are carried at cost.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Federal Home Loan Bank Stock

As a member of the Federal Home Loan Bank (“the FHLB”), the Bank is required to invest in FHLB stock, which is carried at cost since there is no readily available market value. When redeemed, the Bank receives an amount equal to the par value of the stock. Dividends paid on FHLB stock are subject to economic events, regulatory actions and other factors.

Loans and Financings

Loans are reported at the principal balance outstanding, net of unearned interest or profit sharing, deferred loan or financing fees and costs, and an allowance for loan losses. Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Profit sharing flows from lease income calculated monthly and includes amortization of net deferred financing fees and costs over the term of the financing. Interest or profit sharing income is not reported when full loan repayment is in doubt, typically when payments are past due over ninety days. Payments received on such loans are reported as principal reductions, unless all interest or profit sharing and principal payments in arrears are paid in full.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable credit losses, increased by the provision for loan losses and recoveries and decreased by charge-offs. Management estimates the balance required based on past loan loss experience, known and inherent risks in the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans or financings, but the entire allowance is available for any loan or financing that, in management’s judgment, should be charged-off.

Loan or financing impairment is reported when full payment under the loan terms is not expected. Impairment is evaluated in total for smaller-balance loans of similar nature such as residential mortgage, consumer, and credit card loans, and on an individual loan or financing basis for other loans or financings. If a loan or financing is impaired, a portion of the allowance is allocated so that the loan or financing is reported, net, at the present value of estimated future cash flows using the loan’s or financing’s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Loans or financings are evaluated for impairment when payments are delayed, typically ninety days or more, or when it is probable that all principal and interest or profit sharing amounts will not be collected according to the original terms of the loan or financing.

Premises and Equipment, Net

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed primarily on the straight-line method over the assets estimated useful lives.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Premises and Equipment, Net (Continued)

The Company used the following useful lives as of December 31, 2010 and 2009:

	<u>Years</u>
Building and building improvements	5-39
Leasehold improvements	Term of lease or 5-39 years
Equipment	3-10
Furniture and fixtures	3-7
Software	2-5

Mortgage Servicing Rights

Mortgage servicing rights (“MSRs”) represent both purchased rights and the allocated value of servicing rights retained on loans or financings originated and sold.

The Company accounts for its MSRs in accordance with the applicable standards under the ASC which requires that mortgage servicing rights be initially recognized at their fair value and by providing the option to either: (1) carry mortgage servicing rights at fair value with changes in fair value recognized in earnings; or (2) continue recognizing periodic amortization expense and assess the mortgage servicing rights for impairment. This option may be applied by class of servicing assets or liabilities. The Company has identified MSRs relating to mortgage loans as a class of servicing rights and has elected to apply fair value accounting to these assets.

Other Real Estate Owned

Real estate properties acquired in collection of a loan or financing are recorded at fair value upon foreclosure, establishing a new cost basis. Any reduction to fair value from the carrying value of the related loan or financing is accounted for as a loan loss. After foreclosure, management periodically performs valuations to ensure real estate is carried at the lower of cost or fair value, less estimated costs to sell. Expenses, gains and losses on disposition, and decreases in the fair value are reported in other expenses.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Mortgage Banking Activities

Mortgage banking activities include retail, wholesale and servicing operations. Mortgage loans are originated through various channels, including relationships with financial institutions, mortgage brokers and real estate brokerage firms. Mortgage loans held for sale are sold with selective loans having their servicing retained, and others on a servicing released basis. The Company elected to record ULG and UICF mortgage loans held for sale at fair value as discussed in Note 19. All other loans held for sale are valued at the lower of cost or market as determined by bid prices for loans in the secondary market. Mortgage loans are sold without recourse, except in certain events as defined in the loan purchase documents.

An allowance was booked for potential recourse liabilities related to loans sold and loans held for sale in the amount of \$298,586 and \$293,747 as of December 31, 2010 and 2009, respectively. This allowance is included in "Other liabilities" on the face of the consolidated balance sheets.

Loan servicing and sub-servicing fees are contractually based and are recognized monthly as earned over the life of the loans.

Derivative Instruments

ULG enters into interest rate lock commitments ("IRLCs") in connection with its mortgage banking activities to fund residential mortgage loans at specified times in the future. IRLCs that relate to the origination of mortgage loans that will be held for sale are considered derivative instruments under the ASC. As such, these IRLCs are recorded at fair value (see Note 19) with changes in fair value recorded in earnings.

Outstanding IRLCs expose ULG to the risk that the price of the loans underlying the commitments might decline from inception of the interest rate lock to the funding of the loan. To protect against this risk, ULG utilizes forward loan sales commitments to economically hedge the risk of potential changes in the value of the loans that would result from the commitments. These forward commitments are valued at fair value (see Note 19) with net changes in fair value recorded in earnings. The Company documents its risk management strategy and hedge effectiveness at the inception of and during the term of the IRLCs and forward sales commitments within the portfolio.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Goodwill

The Company evaluates the carrying value of goodwill during each quarter of each year and between quarterly evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. When evaluating whether goodwill is impaired, the Company compares the fair value of the reporting unit to which the goodwill is assigned, to the reporting unit's carrying amount, including goodwill. An impairment loss would be recognized when the carrying amount of goodwill exceeds its fair value. The Company's evaluations of goodwill completed during 2010 and 2009 resulted in no impairment losses.

Income Taxes

Deferred income tax assets and liabilities are recorded for estimated future tax consequences attributable to the differences between the financial carrying amounts of existing assets and liabilities and their respective tax bases. Deferred income taxes are to be computed on the liability method and deferred tax assets are recognized only when realization is certain. Deferred income tax assets and liabilities are measured using the tax rate in effect for the year in which those temporary differences are expected to turn around. If necessary, a valuation allowance is booked to reduce net deferred tax assets to a net amount that more likely than not to be realized.

The Company adopted ASC standards regarding accounting for uncertainty in income taxes. This guidance clarifies the accounting for income taxes by prescribing the minimum recognition threshold an income tax position is required to meet before being recognized in the financial statements and applies to all income tax positions. Each income tax position is assessed using a two step process. A determination is first made as to whether it is more likely than not that the income tax position will be sustained, based upon technical merits, upon examination by the taxing authorities. If the income tax position is expected to meet the more likely than not criteria, the benefit recorded in the financial statements equals the largest amount that is greater than 50% likely to be realized upon its ultimate settlement. At December 31, 2010 and 2009, there were no uncertain tax positions that require accrual.

The Company's 2007 federal tax return was subject to examination by the Internal Revenue Service ("IRS"). As of the date of this report, this examination was complete and there were no significant findings noted. ULG's 2008 federal tax return is currently under examination by the IRS. As of the date of this report, there were no findings noted. None of the Company's other federal or state income tax returns are currently under examination by the Internal Revenue Service ("IRS") or state authorities. However, fiscal years 2007 and later remain subject to examination by the IRS and its respective states.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes (Continued)

Michigan adopted a business tax which includes a tax on taxable income, a tax on adjusted gross receipts, and a franchise tax. Under the Michigan Business Tax law the Company is subject to the franchise tax. It is management's policy to include the franchise tax in other operating expenses.

The Michigan statute created a "joint and severally liable" unitary tax on entities which are commonly controlled and have inter-company "flow of value" transactions. Hence, the Company pays this tax on a consolidated basis just as it pays its federal tax on a consolidated basis.

The Company has a tax sharing agreement with some of its subsidiaries in which the subsidiaries record their share of federal and state taxes in accordance with the tax sharing agreements.

Retirement Plan

The Bank has a 401(K) Plan that allows employees of the Bank and the Bank's subsidiaries to contribute up to 15% of salary pre-tax, to the allowable limit prescribed by the Internal Revenue Service. Management has discretion to make matching contributions to the Plan. The Bank made no matching contributions for each of the years ended December 31, 2010 and 2009.

Employee Stock Ownership Plan ("ESOP")

The Company has a noncontributory ESOP covering all full-time employees who have met certain service requirements. The employees' share in the Company's contribution is based on their current compensation as a percentage of the total employee compensation. As shares are contributed to the plan they are allocated to employees and compensation expense is recorded at the shares' fair value. The Company made no contribution during either year ended December 31, 2010 or 2009.

Stock Options

In accordance with the ASC, the Company is required to recognize the compensation cost relating to share-based payment transactions in the consolidated financial statements. That cost is to be measured based on the fair value of the equity or liability instruments issued. For each of the years ended December 31, 2010 and 2009, the Company recorded no compensation expense related to stock options.

Comprehensive Income (Loss)

Comprehensive income (loss) includes both net income (loss) and the change in unrealized gains and losses on securities available-for-sale.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Segment Reporting

The Company's segments are determined by the products and services offered, primarily distinguished between banking and its two separate mortgage banking operations. Loans, investments, and deposits provide the revenues in the banking operation. Servicing fees, underwriting fees and loan sales provide the revenues in each of the mortgage banking operations. All operations are domestic.

Reclassifications

Certain amounts in the 2009 consolidated financial statements have been reclassified to conform to presentation adopted in 2010.

NOTE 2 – RESTRICTIONS ON CASH AND AMOUNTS DUE FROM BANKS

The Bank is required to maintain average balances on hand or with the Federal Reserve Bank. At December 31, 2010 and 2009 this reserve requirement amounted to \$7,611,000 and \$4,891,000, respectively.

NOTE 3 – INVESTMENT SECURITIES

Trading Securities

The Bank's trading securities portfolio had a net accumulated unrealized gain of \$31,658 and \$39,996 at December 31, 2010 and 2009, respectively.

Trading securities consist of the following:

	December 31,	
	2010	2009
U.S. agency mortgage-backed securities	\$ 964,893	\$ 1,513,047

Available-for-Sale Securities

The following is a summary of the amortized cost, gross unrealized gains, gross unrealized losses and fair value of securities available-for-sale.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 3 – INVESTMENT SECURITIES (Continued)

Available-for-Sale Securities (Continued)

Securities available-for-sale at December 31, 2010 consists of the following:

	<u>Amortized cost</u>	<u>Unrealized Gain</u>	<u>Fair Value</u>
U.S. agency mortgage- backed securities	<u>\$ 2,866,610</u>	<u>\$ 67,759</u>	<u>\$ 2,934,369</u>

Securities available-for-sale at December 31, 2009 consists of the following:

	<u>Amortized cost</u>	<u>Unrealized Gain</u>	<u>Fair Value</u>
U.S. agency mortgage- backed securities	<u>\$ 554,224</u>	<u>\$ 2,872</u>	<u>\$ 557,096</u>

At December 31, 2010 and 2009, the fair value of these securities pledged to secure certain borrowings were \$3,899,262 and \$2,070,143, respectively. The balance of these borrowings at both December 31, 2010 and 2009 was \$-0-.

Actual maturities may differ from contractual maturities because issuers and borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Proceeds from pay downs of mortgage-backed securities amounted to \$570,932 and \$1,572,791 for the years ended December 31, 2010 and 2009, respectively.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 4 – LOANS AND FINANCINGS, NET

Major classifications of loans are as follows:

	December 31,	
	2010	2009
Commercial	\$ 31,296,085	\$ 26,311,952
Residential real estate	26,883,830	32,315,990
Installment	194,656	360,718
Credit cards	578,534	276,041
Gross loans	58,953,105	59,264,701
Allowance for loan losses	(1,349,838)	(909,356)
Net loans	<u>\$ 57,603,267</u>	<u>\$ 58,355,345</u>

Changes in the allowance for loan losses were as follows:

	December 31,	
	2010	2009
Balance, beginning of year	\$ 909,356	\$ 925,940
Provision charged to operations	891,094	1,293,546
Recoveries	617,477	17,185
Charge-offs	(1,068,089)	(1,327,315)
Balance, end of year	<u>\$ 1,349,838</u>	<u>\$ 909,356</u>

Non-accrual loans are summarized as follows:

	December 31,	
	2010	2009
Residential real estate	\$ 943,347	\$ 1,171,334
Commercial loans	827,718	2,379,827
Total	<u>\$ 1,771,065</u>	<u>\$ 3,551,161</u>

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 4 – LOANS AND FINANCINGS, NET (Continued)

Information regarding impaired loans is as follows:

	December 31,	
	2010	2009
Impaired loans:		
Loans with allowance allocated	\$ 4,148,545	\$ 3,487,293
Amount of allowance for loan losses allocated	\$ 1,008,585	\$ 555,928
Impaired loans:		
Average balance during the year	\$ 3,120,665	\$ 2,412,101
Interest income recognized thereon	\$ 398,069	\$ 164,249
Cash basis interest income recognized	\$ 372,607	\$ 161,960

NOTE 5 – MORTGAGE BANKING ACTIVITIES

Midwest provides sub-servicing of real estate mortgage loans for several financial institutions. The unpaid principal balance of these loans was approximately \$9.0 billion and \$7.9 billion as of December 31, 2010 and 2009, respectively. The value of these mortgage servicing rights are not included in the accompanying consolidated financial statements.

University Bank, Midwest, UIFC and ULG sell residential mortgage loans to the secondary market with servicing rights retained for selective loans. These loans are owned by other institutions and are not included in the Company's consolidated balance sheets, but the mortgage servicing rights are included in the accompanying consolidated financial statements. Such mortgage loans have been sold predominately without recourse or with limited recourse. The unpaid principal balance of these loans was \$355.3 million and \$276.9 million at December 31, 2010 and 2009, respectively.

Custodial escrow balances maintained in connection with these loans were \$122.8 million and \$50.9 million, at December 31, 2010 and 2009, respectively, and were not included in the accompanying consolidated financial statements.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 5 – MORTGAGE BANKING ACTIVITIES (Continued)

The following summarizes the activity relating to mortgage servicing rights:

	December 31,	
	2010	2009
Balance, January 1	\$ 2,465,243	\$ 1,241,384
Amount capitalized	734,892	1,136,412
Sale of servicing rights	(125,469)	-
Change in fair value	(145,152)	87,447
Balance, December 31	<u>\$ 2,929,514</u>	<u>\$ 2,465,243</u>

ULG began operations in 2008. ULG enters into IRLCs in connection with its mortgage banking activities to fund residential mortgage loans at specified times in the future. As of December 31, 2010 and 2009, IRLCs amounted to \$21.4 million and \$12.1 million, respectively, of which management estimated \$15.1 million and \$9.8 million, respectively, to eventually close and be funded. These IRLCs were recorded in assets on the face of the consolidated balance sheet at a fair value of \$105,342 as of December 31, 2010 and in liabilities at a fair value of \$14,905 as of December 31, 2009.

ULG also utilizes forward loan sales commitments in order to economically hedge the risk of potential changes in the value of the loans that would result from the IRLCs. Forward sales commitments to fund loans at specified rates amounted to \$14.9 million and \$11.3 million as of December 31, 2010 and 2009, respectively, which were recorded in assets on the face of the consolidated balance sheet at a fair value of \$1,670 and \$115,442, respectively.

The net change in fair value of the IRLCs and the related forward loan sales commitments held at December 31, 2010 and 2009 resulted in a gain of \$107,012 and \$100,537, respectively, which has been recognized in "Other income" in the consolidated statement of operations. These gains are due principally to the inclusion of day one gains associated with the adoption of fair value accounting as discussed in Note 19. Prior to companies being permitted to adopt fair value accounting, the recognition of such day one gains was prohibited and these gains were not recognized until realized through the sale of the related loans.

Market interest rate conditions can quickly affect the fair value of mortgage servicing rights, IRLCs, and forward loan sales commitments in a positive or negative fashion, as long-term interest rates rise and fall. See Note 19 for further discussion of management's assumptions used in determination of fair value of these assets and liabilities.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 6 – PREMISES AND EQUIPMENT, NET

Premises and equipment consist of the following:

	December 31,	
	2010	2009
Land	\$ 375,000	\$ 365,000
Buildings and improvements	2,039,322	1,782,915
Furniture, fixtures, equipment and software	4,503,298	4,129,235
	<u>6,917,620</u>	<u>6,277,150</u>
Less accumulated depreciation and amortization	<u>(3,937,885)</u>	<u>(3,466,120)</u>
	<u>\$ 2,979,735</u>	<u>\$ 2,811,030</u>

Depreciation and amortization expense related to premises and equipment amounted to \$471,765 and \$435,113 for the years ended December 31, 2010 and 2009, respectively.

Midwest leases its office space for approximately \$44,167 per year in Houghton, Michigan. ULG leases office space for approximately \$130,000 per year in Farmington, Michigan. The Company leases various other facilities at varying rates on a month-to-month basis. Total rent expense for all operating leases was approximately \$214,000 and \$198,000 in 2010 and 2009, respectively. The following table summarizes the future minimum payments under the contractual obligations of the Company as of December 31, 2010:

Year ended December 31,	Amount
2011	\$ 156,155
2012	138,291
2013	138,341
2014	142,351
2015 and thereafter	<u>167,033</u>
	<u>\$ 742,171</u>

NOTE 7 – TIME DEPOSITS

Time deposit liabilities issued in denominations of \$100,000 or more were \$8,700,236 and \$9,052,531 at December 31, 2010 and 2009, respectively.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 7 – TIME DEPOSITS (Continued)

At December 31, 2010, stated maturities of time deposits were:

Year ended December 31,	Amount
2011	\$ 5,996,091
2012	2,178,602
2013	86,361
2014	144,025
2015 and thereafter	<u>4,930,709</u>
	<u>\$ 13,335,788</u>

NOTE 8 – OTHER LIABILITIES

Other liabilities consist of the following:

	December 31,	
	2010	2009
Liability to fund closed but undisbursed loans	\$ 1,941,992	\$ 2,654,479
Remittances	2,418,406	-
Escrow and mortgage insurance liability	230,607	180,357
Allowance for loan recourse	298,586	293,747
Other	<u>1,096,509</u>	<u>873,320</u>
	<u>\$ 5,986,100</u>	<u>\$ 4,001,903</u>

NOTE 9 – INCOME TAXES

Income tax expense (benefit) for the years ended December 31, 2010 and 2009 is summarized as follows:

	December 31,	
	2010	2009
Current	\$ -	\$ -
Deferred	<u>138,150</u>	<u>(186,595)</u>
	<u>\$ 138,150</u>	<u>\$ (186,595)</u>

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 9 – INCOME TAXES (Continued)

The effective tax rate differs from the statutory income tax rate as a result of permanent differences in accounting for certain income and expense items for financial and tax reporting purposes, primarily meals and entertainment expense. Based on management's estimates of future income, during 2009, management decreased the valuation allowance in order to increase the net deferred tax asset to an amount that is more likely than not to be realized.

Significant components of the Company's deferred income tax assets and liabilities as of December 31, 2010 and 2009 are as follows:

	December 31,	
	2010	2009
Deferred income tax assets:		
Allowance for loan losses	\$ 376,688	\$ 54,397
Net operating loss carry-forward	206,668	590,465
Tax credit carry-forward	1,241,866	1,241,866
Donation carry-forward	-	5,640
Depreciation	31,921	38,029
Other	27,283	86,134
	<u>1,884,426</u>	<u>2,016,531</u>
Deferred tax asset		
	1,884,426	2,016,531
Deferred income tax liabilities:		
Mortgage servicing rights	872,221	786,488
Other	113,155	192,843
	<u>985,376</u>	<u>979,331</u>
Deferred tax liability		
	985,376	979,331
Net deferred tax asset	899,050	1,037,200
Valuation allowance	-	-
	<u>-</u>	<u>-</u>
Net deferred tax asset	<u>\$ 899,050</u>	<u>\$ 1,037,200</u>

The net deferred tax asset is included in "Other assets" on the consolidated balance sheets.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 9 – INCOME TAXES (Continued)

The Company has the following unused net operating loss carry forwards and available credits as of December 31, 2010:

	<u>Amount</u>	<u>Date of expiration</u>
Federal net operating loss	\$ 608,000	Beginning 2028
Low income housing credits	1,140,284	Beginning 2012
Minimum tax credits	101,582	N/A

NOTE 10 – MANDATORILY REDEEMABLE PREFERRED STOCK

As of December 31, 2010 and 2009, the Company had 500,000 shares of preferred stock authorized with a \$.001 par value per share. There were 88,014 and 80,612 shares of this preferred stock issued and outstanding as of December 31, 2010 and 2009, respectively. The shares have a \$10 per share liquidation value and accrue dividends quarterly at an annual rate of 9%. Additional shares of preferred stock are issued semi-annually for unpaid accrued dividends. The preferred stock is mandatorily redeemable by the Company no later than April 30, 2012 but no earlier than April 30, 2010, at \$10 per share plus all accrued and unpaid dividends through the redemption date. As of December 31, 2010, none of the preferred stock had been redeemed.

Through private placement transactions, the Company raised \$200,000 through the sale of 20,000 shares of its preferred stock in 2009. During 2010 and 2009, the Company declared preferred dividends of \$77,370 and \$66,528, respectively. As of December 31, 2010 and 2009, the Company had unpaid preferred dividends of \$39,930 and \$36,573, respectively, which are included in "Other liabilities" on the consolidated balance sheets. The amount the Company would be required to pay to redeem the stock at December 31, 2010 is \$880,140 plus accrued dividends of \$39,930.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 11 – STOCK OPTIONS

In 1995, the Company adopted a stock option and stock award plan (“the 1995 Stock Plan”), which provides for the grant of incentive stock options, as defined in Section 422(b) of the Internal Revenue Code of 1986, as amended, as well as the grant of non-qualified stock options and other stock awards. The plan provides for the grant to officers, directors and key employees of the Company, and independent contractors providing services to the Company, of options to purchase common stock and other awards of common stock. The exercise price of options granted under the plan shall be determined by the Board of Directors, or a compensation committee thereof. Options shall expire on the date specified by the Board of Directors or such committee, but not more than 10 years from the date of grant (or five years from the date of grant for incentive stock options if the grantee owned 10% of the Company’s voting stock at the date of grant). The 1995 Stock Plan terminated on November 15, 2006; however, all outstanding options under the plan remain outstanding until expiration, exercise or forfeiture. Options continue to be granted outside of the 1995 Stock Plan.

The following tables summarize the activity relating to options to purchase the Company’s common stock:

	Number of Options	Weighted Average Exercise Price
Outstanding at January 1, 2009	328,026	\$ 1.83
Granted - 2009	-	-
Exercised - 2009	-	-
Forfeited - 2009	(36,000)	1.85
Outstanding at December 31, 2009	292,026	1.83
Granted - 2010	-	-
Exercised - 2010	-	-
Forfeited - 2010	(118,463)	2.00
Outstanding at December 31, 2010	<u>173,563</u>	<u>\$ 1.85</u>

At December 31, 2010:

Number of options immediately exercisable	173,563
Weighted average exercise price of immediately exercisable options	\$1.85
Range of exercise price of options outstanding	\$1.00 - \$3.00
* Exercise price of 48,563 options will change from \$3.00 to \$3.50 in 2012	
Weighted average remaining life of options outstanding	2.30 years

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 11 – STOCK OPTIONS (Continued)

The value of the options was determined pursuant to the Black Scholes model at the date of issuance. As the options vested, the Company recognized compensation expense in earnings. As of December 31, 2010 and 2009, all outstanding options were vested. The Company recognized no stock compensation expense during the years ended December 31, 2010 and 2009.

NOTE 12 – EMPLOYEE STOCK OWNERSHIP PLAN (“ESOP”)

The employees' allocation of ESOP assets is based on their current compensation, after one year of service and upon reaching the age of twenty-one. The annual contribution to the ESOP is at the discretion of the Board of Directors. Assets of the plan are comprised entirely of 62,349 shares of the Company's stock at December 31, 2010 and 2009, all of which were fully allocated at December 31, 2010. Upon retirement from the plan, participants can receive distributions of their allocated shares of the Company's stock. The assets of the ESOP are held in trust and were valued at approximately \$99,758, and \$62,972 at December 31, 2010 and 2009, respectively.

NOTE 13 – NONCONTROLLING INTEREST

The Bank owns an 80% interest in the common stock of Midwest, with the remaining 20% owned by the President of Midwest. At December 31, 2010 and 2009, total equity of Midwest was \$6,887,281 and \$5,655,663, respectively, resulting in a \$1,377,455 and \$1,131,133 noncontrolling interest reflected on the Company's consolidated balance sheets, respectively.

Also, included in the consolidated financial statements are the results for UIFC. The Bank owns 80% of the common stock of UIFC. An outside investor owns the remaining 20%. At December 31, 2010 and 2009, total equity of UIFC was \$42,649,207 and \$34,652,927, respectively, which includes \$10,000,000 in common stock and \$33,315,000 of preferred stock as of December 31, 2010. The noncontrolling interest at December 31, 2010 and 2009 was \$1,866,843 and \$1,826,979, respectively.

Also, included in the consolidated financial statements are the results for ULG. The Bank owns 50.01% of ULG, with the remaining 49.99% owned by the President, CEO, and COO of ULG. The noncontrolling interest was to incur the first \$200,000 of start up losses, but would be the first to recoup the losses once income was earned. At December 31, 2010 and 2009, total members' equity of ULG was \$2,320,913 and \$3,620,118, respectively. At December 31, 2010 and 2009, the noncontrolling interest was \$1,160,633 and \$1,809,697, respectively.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 13 – NONCONTROLLING INTEREST (Continued)

In accordance with ULG's operating agreement, ULG is to make annual distributions to its members to be used to pay the members' tax liability associated with the members' ownership in ULG. ULG made distributions to the noncontrolling interest of \$773,442 and \$-0- during the years ended December 31, 2010 and 2009, respectively.

The results of Midwest's, UIFC's, and ULG's operations for the years ended December 31, 2010 and 2009 are included in the Company's consolidated statements of operations.

NOTE 14 – COMMITMENTS AND CONTINGENCIES

Commitments

The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to fund lines of credit and credit card limits. The Bank's exposure to credit loss in the event of non-performance is equal to or less than the contractual amount of these instruments. The Bank follows the same credit policy to make such commitments as that followed by loans recorded in the consolidated financial statements.

The following is a summary of commitments:

	December 31,	
	2010	2009
Unused lines of credit	\$ 1,264,442	\$ 2,686,000
Unused credit card limits	827,124	1,113,000
	<u>\$ 2,091,566</u>	<u>\$ 3,799,000</u>

Legal Contingencies

Various legal claims may arise from time to time in the normal course of business, which, in the opinion of management, will not have a material effect on the Company's financial statements.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 15 – RELATED PARTY TRANSACTIONS

The Bank had loans outstanding of \$102,904 and \$94,862 to related officers and directors at December 31, 2010 and 2009, respectively. Available lines of credit to related parties at both December 31, 2010 and 2009, totaled \$161,000. Related party loans were made in the normal course of business and were performing pursuant to terms at December 31, 2010 and 2009.

The Bank had demand deposits of \$443,110 and \$663,359 from directors, officers and their affiliates as of December 31, 2010 and 2009, respectively.

NOTE 16 – FEDERAL HOME LOAN BANK ADVANCES

The Bank has a line of credit available from the FHLB in the amount of \$3,000,000 and \$4,000,000 as of December 31, 2010 and 2009, respectively. There were no advances on this line of credit as of December 31, 2010 and 2009. Borrowings are secured by the pledge of specific mortgage loans held for investment along with FHLB stock, trading securities, and available-for-sale securities. As of December 31, 2010 and 2009, the Bank had \$3,000,000 and \$4,000,000 of unutilized and available credit under the line of credit, respectively.

NOTE 17 – REGULATORY MATTERS

Dividend Restriction

Banking regulations require the maintenance of certain capital levels and limits the amount of dividends that may be paid by a bank to a holding company or by a holding company to shareholders. The Bank is currently required to get written consent prior to declaring or paying any dividend. The Bank paid \$50,000 and \$0- dividends to the holding company, University Bancorp, Inc., during 2010 and 2009, respectively. University Bancorp, Inc. did not pay any dividends to common shareholders during 2010 or 2009.

Regulatory Capital Requirements

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional, discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by regulators about components, risk weightings, and other factors.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 17 – REGULATORY MATTERS (Continued)

Regulatory Capital Requirements (Continued)

The Bank is also subject to prompt corrective action capital requirement regulations set forth by the FDIC. The FDIC requires the Bank to maintain a minimum of total capital and Tier 1 capital (as defined) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average total assets (as defined). As of December 31, 2010 and 2009, respectively, the Bank met all capital adequacy requirements to which it is subject.

The Bank's required and actual ratios and amounts of Tier 1 leverage, Tier 1 risk-weighted and total risk-weighted capital as of December 31 are as follows:

	Actual		To Be Adequately Capitalized Under Prompt Corrective Action Provisions		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratios	Amount	Ratios	Amount	Ratios
As of December 31, 2010:						
Total capital (to risk-weighted assets)	\$ 11,519,000	18.74%	\$ 7,989,000	13.00%	\$ 7,989,000	13.00%
Tier 1 capital (to risk-weighted assets)	10,785,000	17.55%	2,458,000	4.00%	3,687,000	6.00%
Tier 1 capital (to average assets)	10,785,000	9.27%	9,594,000	8.25%	9,594,000	8.25%
As of December 31, 2009:						
Total capital (to risk-weighted assets)	\$ 12,172,000	21.59%	\$ 7,329,000	13.00%	\$ 7,329,000	13.00%
Tier 1 capital (to risk-weighted assets)	11,503,000	20.10%	2,255,000	4.00%	3,383,000	6.00%
Tier 1 capital (to average assets)	11,503,000	9.21%	10,302,000	8.25%	10,302,000	8.25%

NOTE 18 – OTHER CAPITAL REQUIREMENTS

The Bank is subject to certain capital requirements in connection with seller/servicer agreements that the Bank has entered into with secondary market investors. Failure to maintain minimum capital requirements could result in the Bank's inability to originate and service loans for the respective investor and, therefore, could have a direct material effect on the Company's consolidated financial statements.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
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December 31, 2010 and 2009

NOTE 18 – OTHER CAPITAL REQUIREMENTS

The Bank's actual capital amounts and the minimum amounts required for capital adequacy purposes, by investor, are as follows as of December 31, 2010:

	<u>Actual Capital</u>	<u>Minimum Capital</u>
HUD	\$ 11,226,529	\$ 250,000
FHLMC and FNMA	\$ 11,226,529	\$ 250,000

NOTE 19 - FAIR VALUE MEASUREMENTS

The ASC standards regarding fair value enhance previous guidance for measuring assets and liabilities using fair value. The standards provide a single definition of fair value, together with a framework for measuring it, and require additional disclosure about the use of fair value to measure assets and liabilities. The standard also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under the standard, fair value measurements are disclosed by level within that hierarchy.

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

The fair value standards require the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 19 - FAIR VALUE MEASUREMENTS (Continued)

Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

In that regard, the standards establish a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. Determining which hierarchical level an asset or liability falls within requires significant judgment. The Company's management evaluates its hierarchy disclosures. Hierarchical levels, as defined by the standards and directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities are as follows:

Level 1: Quoted prices in active markets for identical assets or liabilities.

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

Level 3: Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities.

Because valuation methodologies require the use of subjective assumptions, changes in these assumptions can materially affect fair value. Furthermore, the reported fair value amounts have not been comprehensively revalued since the presentation dates, and therefore, estimates of fair value after the balance sheet date may differ significantly from the amounts presented herein. A description of the valuation methodologies used by the Company for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Financial assets and financial liabilities measured at fair value on a recurring basis include the following:

Trading and Available-for-Sale Securities

The fair value of the securities represents the amount the Company would realize upon sale of the mortgage backed securities currently in the portfolio. The Company receives current market values from The Federal Home Loan Bank on a monthly basis as part of its collateral positions. The securities are then marked to market every month based on these values. These securities are considered to be level 2 assets in the valuation hierarchy. Net unrealized gains and losses on available-for-sale securities are included in other comprehensive income. Net unrealized gains and losses on trading securities are included in earnings.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 19 - FAIR VALUE MEASUREMENTS (Continued)

Loans Held for Sale – ULG and UIFC

The Company elected to account for ULG's and UIFC's loans held for sale at fair value under the ASC standards that permit the Company to choose to measure eligible items at fair value at specified election dates. Unrealized gains and losses on items for which the fair value measurement option has been elected are reported in earnings at each subsequent reporting date. The fair value option (i) may be applied instrument by instrument, with certain exceptions, thus the Company may record identical financial assets and liabilities at fair value or by another measurement basis permitted under GAAP, (ii) is irrevocable (unless a new election date occurs) and (iii) is applied only to entire instruments and not to portions of instruments.

Loans held for sale are recorded at fair value based on quoted market prices, where available, or are determined by discounting cash flows using interest rates approximating the Company's current origination rates for similar loans and adjusted to reflect the inherent credit risk. In most situations, these loans are locked into buckets to be sold under forward loan sales commitments (as discussed below), in which case the fair value of these loans held for sale are approximated by the value to be received soon thereafter under the forward sales commitments. Loans held for sale are considered to be level 2 assets in the valuation hierarchy. Net changes in the fair value of the Company's loans held for sale are included in earnings. The net gain on change in fair value of loans held for sale at December 31, 2010 and 2009 was \$119,989 and \$186,674, respectively, which is included in "Other income" in the consolidated statements of operations.

Derivatives – Interest Rate Lock Commitments and Forward Commitments

ULG enters into IRLCs in connection with its mortgage banking activities to fund mortgage loans at specified times in the future. IRLCs that relate to the origination of mortgage loans that will be held for sale are considered derivative instruments as discussed in Note 1. As such, in accordance with ASC standards for derivative instruments, these IRLCs are recorded at fair value with changes in fair value recorded in earnings.

The Company estimates the fair value of an IRLC subsequent to inception of the commitment. In estimating the fair value of an IRLC, the Company assigns a probability to the loan commitment based on an expectation that it will be exercised and the loan will be funded. The fair value of IRLCs, while based on interest rates observable in the market, is highly dependent on the ultimate closing of the loans. These "pull-through" rates are based on ULG's historical data and reflect an estimate of the likelihood that a commitment will ultimately result in a closed loan.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 19 - FAIR VALUE MEASUREMENTS (Continued)

Derivatives – Interest Rate Lock Commitments and Forward Commitments (Continued)

Also, the fair value of these commitments is derived from the fair value of the related mortgage loans which is based on unobservable data. Because these inputs are not transparent in market trades, IRLCs are considered to be level 3 assets or liabilities in the valuation hierarchy. Changes in the fair value of the IRLCs are recognized based on interest rate changes, changes in the probability that the commitment will be exercised, and the passage of time. Changes from the expected future cash flows related to the customer relationship or loan servicing are excluded from the valuation of IRLCs.

Outstanding IRLCs expose ULG to the risk that the price of the loans underlying the commitments might decline from inception of the interest rate lock to the funding of the loan. To protect against this risk, ULG utilizes forward loan sales commitments to economically hedge the risk of potential changes in the value of the loans that would result from the commitments. These forward sales commitments are considered derivative instruments as discussed in Note 1, and hence are valued at fair value with changes in fair value recorded in earnings.

The fair value of forward sales commitments is based primarily on the fluctuation of interest rates between the date on which the particular forward sales commitment was entered into and year end. Forward commitments are considered to be level 3 assets or liabilities in the valuation hierarchy.

Mortgage Servicing Rights

The Company accounts for MSR at fair value in accordance with the ASC standards for servicing rights as discussed in Note 1. The fair value of MSR represents the amount that the Company would receive upon the sale of the MSR. The Company receives an independent valuation of its MSR on a quarterly basis. The fair value of MSR is determined by projecting cash flows which are then discounted to estimate an expected fair value. The fair value of MSR is impacted by a variety of factors, including prepayment assumptions, discount rates, delinquency rates, contractual specified servicing fees and underlying portfolio characteristics. Because these inputs are not transparent in market trades, MSR are considered to be level 3 assets in the valuation hierarchy. Net changes in fair value of MSR are included in earnings.

Other Real Estate Owned

Real estate properties acquired in collection of a loan are recorded at fair value upon foreclosure, establishing a new cost basis. After foreclosure, management periodically performs valuations to ensure real estate is carried at lower of cost or fair value, less estimated costs to sell. Fair value of the collateral is estimated by considering appraisals, which are updated on a periodic basis to reflect current housing market conditions.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 19 - FAIR VALUE MEASUREMENTS (Continued)

Other Real Estate Owned (Continued)

The following tables summarize financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2010 and 2009, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2010			
Assets:			
Trading and available-for-sale securities	\$ -	\$ 3,899,262	\$ -
Loans held for sale - ULG,UIFC	-	18,811,794	-
Mortgage servicing rights	-	-	2,929,514
Interest rate lock commitments	-	-	105,342
Forward sales commitments	-	-	1,670
Total assets at fair value	\$ -	\$ 22,711,056	\$ 3,036,526
	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2009			
Assets:			
Trading and available-for-sale securities	\$ -	\$ 2,070,143	\$ -
Loans held for sale - ULG	-	19,360,521	-
Mortgage servicing rights	-	-	2,465,243
Forward sales commitments	-	-	115,442
Total assets at fair value	\$ -	\$ 21,430,664	\$ 2,580,685
Liabilities:			
Interest rate lock commitments	\$ -	\$ -	\$ 14,905

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 19 - FAIR VALUE MEASUREMENTS (Continued)

The table below includes a roll forward of the fair value of financial instruments that are classified by the Company within level 3 of the valuation hierarchy:

	Mortgage Servicing Rights	Interest Rate Lock Commitments	Forward Sales Commitments
Fair value at January 1, 2009	\$ 1,241,384	\$ 768,582	\$ (557,716)
Purchases, sales, issuances, settlements, net	1,136,412	(768,582)	557,716
Net gains (losses)	<u>87,447</u>	<u>(14,905)</u>	<u>115,442</u>
Fair value December 31, 2009	2,465,243	(14,905)	115,442
Purchases, sales, issuances, settlements, net	609,423	14,905	(115,442)
Net gains (losses)	<u>(145,152)</u>	<u>105,342</u>	<u>1,670</u>
Fair value December 31, 2010	<u>\$ 2,929,514</u>	<u>\$ 105,342</u>	<u>\$ 1,670</u>

The following table summarizes financial assets and liabilities measured at fair value on a nonrecurring basis:

	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Year ended December 31, 2010			
Other real estate owned	<u>\$ -</u>	<u>\$ 1,205,280</u>	<u>\$ -</u>
Year ended December 31, 2009			
Other real estate owned	<u>\$ -</u>	<u>\$ 850,293</u>	<u>\$ -</u>

Other ASC standards require disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or non-recurring basis are discussed above. The estimated fair value approximates carrying value for cash and cash equivalents, certificates of deposit, and Federal Home Loan Bank stock. The methodologies for other financial assets and financial liabilities are discussed below.

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 19 - FAIR VALUE MEASUREMENTS (Continued)

Loans and Financings Held for Sale, At Lower of Cost or Market and Loans and Financings, Net

The fair value of fixed-rate loans is estimated by discounting the future cash flows for each loan category using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. The fair value of adjustable-rate loans are assumed to approximate their carrying amount.

Deposits

The fair value of demand deposits and savings accounts is the amount payable on demand at the reporting date. The fair value of time deposits is estimated by discounting the future cash flows using the market rates offered for similar deposits with the same remaining maturities.

The estimated fair values of financial instruments as of December 31, 2010 and 2009 are as follows (in thousands):

	December 31,			
	2010		2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Significant financial assets:				
Cash and due from banks	\$ 13,595	\$ 13,595	\$ 40,690	\$ 40,690
Certificates of deposit	6,250	6,250	-	-
Trading securities	965	965	1,513	1,513
Securities available-for-sale	2,934	2,934	557	557
Federal Home Loan Bank stock	1,197	1,197	1,325	1,325
Loans and financings, held for sale, at lower of cost or market	3,646	3,696	3,110	3,160
Loans and financings, held for sale, at fair value	18,812	18,812	19,361	19,361
Loans and financings, net	57,603	58,025	58,355	59,738
Mortgage servicing rights	2,930	2,930	2,465	2,465
Derivatives	107	107	115	115
Significant financial liabilities:				
Deposits:				
Demand - non-interest bearing	\$ 74,570	\$ 74,570	\$ 80,766	\$ 80,766
Demand - interest bearing and profit sharing	11,432	11,432	23,215	23,215
Savings	275	275	309	309
Time	13,336	13,508	13,745	14,244
Derivatives	-	-	15	15

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 20 – SEGMENT REPORTING

The Company's operations include four primary segments: retail banking (the Bank), retail mortgage banking (Midwest), mortgage banking (ULG), and the holding company, as discussed in Note 1. The Company's four reportable segments are strategic business units that are separately managed as they offer different products and services and have different marketing strategies. In addition, the Bank, Midwest and ULG each service a different customer base.

The segment financial information provided below has been derived from the internal profitability reporting system used by management to monitor and manage the financial performance of the Company. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates segment performance based on profit or loss before income taxes, not including nonrecurring gains and losses. Certain indirect expenses have been allocated based on actual volume measurements and other criteria, as appropriate. The Company accounts for transactions between segments at current market prices. Information about reportable segments as of and for the years ended December 31, 2010 and 2009 is as follows (in thousands):

2010

	The Bank	Midwest	ULG	Holding Company	Consolidating Entries	Total
Interest and financing income	\$ 4,325	\$ 120	\$ 665	\$ -	\$ (438)	\$ 4,672
Net gain on sale of mortgage loans	883	1,045	3,643	-	-	5,571
Other non-interest income	2,879	7,919	1,645	-	(2,249)	10,194
Interest and profit sharing expense	739	23	423	-	(438)	747
Provision for loan losses	877	-	14	-	-	891
Salaries and benefits	3,356	3,902	3,546	-	-	10,804
Occupancy	366	204	192	-	-	762
Other operating expenses	2,803	3,068	1,530	9	(484)	6,926
Income (loss) before tax expense	(54)	1,887	248	(9)	(1,765)	307
Income tax expense (benefit)	138	656	-	-	(656)	138
Net income (loss)	(192)	1,231	248	(9)	(1,109)	169
Net income (loss) attributable to noncontrolling interests	-	-	-	-	410	410
Segment profit (loss)	\$ (192)	\$ 1,231	\$ 248	\$ (9)	\$ (1,519)	\$ (241)
Segment assets	\$ 121,942	\$ 13,334	\$ 19,595	\$ 7,077	\$ (44,682)	\$ 117,266
Capital expenditures	382	186	72	-	-	640
Depreciation and amortization	277	141	54	-	-	472

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 20 – SEGMENT REPORTING (Continued)

2009	The Bank	Midwest	ULG	Holding Company	Consolidating Entries	Total
Interest and financing income	\$ 4,644	\$ 102	\$ 1,032	\$ -	\$ (591)	\$ 5,187
Net gain on sale of mortgage loans	974	373	6,165	-	-	7,512
Other non-interest income	4,242	6,559	1,682	17	(3,384)	9,116
Interest and profit sharing expense	977	11	587	-	(590)	985
Provision for loan losses	1,024	270	-	-	-	1,294
Salaries and benefits	3,113	3,088	3,243	-	-	9,444
Occupancy	394	186	142	-	-	722
Other operating expenses	3,845	1,941	1,648	16	(512)	6,938
Income (loss) before tax expense	507	1,538	3,259	1	(2,873)	2,432
Income tax expense (benefit)	(187)	541	-	-	(541)	(187)
Net income (loss)	694	997	3,259	1	(2,332)	2,619
Net income (loss) attributable to noncontrolling interests	-	-	-	-	1,925	1,925
Segment profit (loss)	\$ 694	\$ 997	\$ 3,259	\$ 1	\$ (4,257)	\$ 694
Segment assets	\$ 135,417	\$ 7,858	\$ 22,706	\$ 7,093	\$ (38,659)	\$ 134,415
Capital expenditures	165	266	54	-	-	485
Depreciation and amortization	262	127	46	-	-	435

NOTE 21 – PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION

CONDENSED BALANCE SHEETS

	December 31,	
	2010	2009
ASSETS		
Cash and cash equivalents	\$ 37,482	\$ 578
Investment in University Bank	6,821,598	7,039,329
Other assets	699	699
Total assets	<u>\$ 6,859,779</u>	<u>\$ 7,040,606</u>
LIABILITIES AND EQUITY		
Accounts payable and other liabilities	\$ 55,930	\$ 57,089
Preferred stock subject to mandatory redemption	880,140	806,120
Total liabilities	936,070	863,209
Total equity	<u>5,923,709</u>	<u>6,177,397</u>
Total liabilities and equity	<u>\$ 6,859,779</u>	<u>\$ 7,040,606</u>

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 21 – PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION
(Continued)

CONDENSED STATEMENTS OF OPERATIONS

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
OTHER INCOME		
Interest and dividend income	\$ 9	\$ 14
Other	-	17,396
Total other income	<u>9</u>	<u>17,410</u>
EXPENSES		
Public listing	899	8,798
Professional fees	4,176	6,998
Other miscellaneous	3,521	-
Total expenses	<u>8,596</u>	<u>15,796</u>
Net income (loss) before income taxes and net income of subsidiary	(8,587)	1,614
Income tax expense	-	-
Net income (loss) before net income of subsidiary	(8,587)	1,614
Net income (loss) of subsidiary	<u>(232,618)</u>	<u>691,903</u>
Net income (loss)	<u>\$ (241,205)</u>	<u>\$ 693,517</u>

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 21 – PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION
(Continued)

CONDENSED STATEMENTS OF CASH FLOWS

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
OPERATING ACTIVITIES		
Net income (loss)	\$ (241,205)	\$ 693,517
Adjustments to reconcile net income (loss) to net cash flows from operating activities:		
Net change in:		
Other assets	-	4,891
Other liabilities	72,861	53,693
Investment in subsidiary	232,618	(691,903)
	<u>64,274</u>	<u>60,198</u>
Net cash provided by operating activities		
	<u>64,274</u>	<u>60,198</u>
INVESTING ACTIVITIES		
Dividend from University Bank	50,000	-
Additional investment in University Bank	-	(200,000)
	<u>50,000</u>	<u>(200,000)</u>
Net cash provided by (used in) investing activities		
	<u>50,000</u>	<u>(200,000)</u>
FINANCING ACTIVITIES		
Dividends on preferred stock	(77,370)	(66,528)
Issuance of preferred stock	-	200,000
	<u>(77,370)</u>	<u>133,472</u>
Net cash provided by (used in) financing activities		
	<u>(77,370)</u>	<u>133,472</u>
NET CHANGE IN CASH	36,904	(6,330)
Cash and Cash Equivalents, Beginning	<u>578</u>	<u>6,908</u>
Cash and Cash Equivalents, Ending	<u>\$ 37,482</u>	<u>\$ 578</u>
SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTIONS:		
Accrued dividends on preferred stock converted to additional shares of preferred stock	\$ 74,020	\$ 54,950

UNIVERSITY BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 22 – SUBSEQUENT EVENTS

The Company has performed a review of events subsequent to the balance sheet date through April 27, 2011, the date the consolidated financial statements were available to be issued.

Business Combination

On March 9 2011, ULG purchased 100% of the assets of a mortgage company (the “Seller”) for \$150,000. As part of the Asset Purchase Agreement, ULG assumed all assets, all contracts, real estate leases for three Indiana locations and one Michigan location, and the mortgage pipeline of the Seller. This acquisition brings ULG four loan processing branches that are expected to increase the ULG’s ability to expand its customer base.

During 2011, this transaction will be accounted for as a business combination under the ASC. Management has not yet completed its valuation of assets acquired and liabilities assumed as of the date of this report.

Minimum future rental payments under non-cancellable operating leases assumed by ULG in this business combination are as follows:

<u>Year ended December 31,</u>	<u>Amount</u>
2011	\$ 29,320
2012	35,877
2013	36,644
2014	<u>3,059</u>
	<u>\$ 104,900</u>

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

Board of Directors and Stockholders
University Bancorp, Inc. and Subsidiaries
University Bank

We have audited the consolidated financial statements of University Bancorp, Inc. and Subsidiaries, as of and for the year ended December 31, 2010 and have issued our report thereon dated April 27, 2011. We have also audited University Bank's compliance with specific requirements that could have a direct and material effect on each of its major U.S. Department of Housing and Urban Development HUD-assisted programs for the year ended December 31, 2010 and have issued our reports thereon dated April 27, 2011.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the *Consolidated Audit Guide for Audits of HUD Programs* (the "Guide") issued by the HUD Office of the Inspector General. Those standards and the Guide require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and whether University Bank complied with compliance requirements referred to above that could have a direct and material effect on a major HUD-assisted program.

The management of the University Bank is responsible for establishing and maintaining effective internal control over financial reporting and internal control over compliance with the compliance requirements referred to above. In planning and performing our audits of the consolidated financial statements and compliance, we considered University Bank's internal control over financial reporting and its internal control over compliance with the specific program requirements that could have a direct and material effect on a major HUD-assisted program to determine the auditing procedures for the purpose of expressing our opinions on the consolidated financial statements and compliance but not for the purpose of expressing an opinion on the effectiveness of University Bank's internal control over financial reporting and internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of University Bank's internal control over financial reporting and internal control over compliance.

Board of Directors and Stockholders
University Bancorp, Inc. and Subsidiaries
University Bank
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A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct (1) misstatements of the entity's consolidated financial statements or (2) noncompliance with applicable requirements of a HUD-assisted program on a timely basis. A material weakness is a deficiency or combination of deficiencies in internal control such that there is a reasonable possibility that (1) a material misstatement of the entity's consolidated financial statements or (2) material noncompliance with applicable requirements of a HUD-assisted program will not be prevented or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting and internal control over compliance was for the limited purpose described in the third paragraph of this report and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses as defined above.

This report is intended solely for the information and use of the Board of Directors, Stockholders and management of University Bancorp, Inc. and Subsidiaries and University Bank, and the Department of Housing and Urban Development and is not intended to be and should not be used by anyone other than these specified parties.

UHY LLP

Southfield, Michigan
April 27, 2011

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH SPECIFIC PROGRAM REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR HUD-ASSISTED PROGRAM

Board of Directors and Stockholders
University Bancorp, Inc. and Subsidiaries
University Bank

We have audited the compliance of University Bank (the "Company") with specific program requirements governing the quality control, loan origination, loan settlement, eligible fees and charges, kickbacks, mortgagee approval requirements, adjusted net worth and liquidity requirements that could have a direct and material effect on each of the Company's major HUD-assisted programs, for the year ended December 31, 2010. Compliance with those requirements is the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the *Consolidated Audit Guide for Audits of HUD Programs* (the "Guide") issued by the U.S. Department of Housing and Urban Development, Office of the Inspector General. Those standards and the Guide require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the requirements referred to above that could have a direct and material effect on a major HUD-assisted program occurred. An audit includes examining, on a test basis, evidence about the Company's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Company's compliance with those requirements.

In our opinion, University Bank complied, in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major HUD-assisted programs for the year ended December 31, 2010.

This report is intended solely for the information and use of the Board of Directors, Stockholders and management of University Bancorp, Inc. and Subsidiaries and University Bank, and the Department of Housing and Urban Development and is not intended to be and should not be used by anyone other than these specified parties.

UHY LLP

Southfield, Michigan
April 27, 2011

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH SPECIFIC
REQUIREMENTS APPLICABLE TO NONMAJOR HUD-ASSISTED PROGRAMS**

Board of Directors and Stockholders
University Bancorp, Inc. and Subsidiaries
University Bank

We have audited the consolidated financial statements of University Bancorp, Inc. and Subsidiaries as of and for the year ended December 31, 2010, and have issued our report thereon dated April 27, 2011.

In connection with that audit and our consideration of the University Bank's internal control used to administer HUD programs, as required by the *Consolidated Audit Guide for Audits of HUD Programs* (the "Guide"), issued by the U.S. Department of Housing and Urban Development, Office of the Inspector General, we selected certain transactions applicable to certain nonmajor HUD-assisted programs for the year ended December 31, 2010.

As required by the Guide, we performed auditing procedures to test compliance with the requirements governing escrow accounts, eligible fees and charges, and mortgagee approval requirements that are applicable to those transactions. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on University Bank's compliance with these requirements. Accordingly, we do not express such an opinion.

In our opinion, University Bank complied, in all material respects, with the requirements referred to above that could have a direct and material effect on each of its non-major HUD-assisted programs for the year ended December 31, 2010.

This report is intended solely for the information of the Board of Directors, Stockholders and management of University Bancorp, Inc. and Subsidiaries and University Bank, and the Department of Housing and Urban Development and is not intended to be and should not be used by anyone other than these specified parties.

UHY LLP

Southfield, Michigan
April 27, 2011

UNIVERSITY BANK
COMPUTATION OF ADJUSTED NET WORTH TO DETERMINE
COMPLIANCE WITH HUD NET WORTH REQUIREMENTS
December 31, 2010

1. Servicing portfolio for HUD loans at December 31, 2010		\$	191,478
2. Add:			
Origination of HUD loans during 2010	\$	154,624,372	
HUD loans purchased from loan correspondents during 2010		<u>7,580,514</u>	
Subtotal			162,204,886
3. Less:			
HUD loans originated during 2010 with servicing retained		132,826	
HUD loans purchased from correspondents during 2010 with servicing retained		<u>-</u>	
Subtotal			<u>132,826</u>
4. Total			<u>162,263,538</u>
5. 1% of line 4		\$	<u>1,622,635</u>
6. Minimum net worth required (greater of \$250,000 or line 5)		\$	<u>1,622,635</u>
7. Net worth required (lesser of \$1,000,000 or line 6)		\$	<u>1,000,000</u>
8. Stockholders' equity (net worth) per balance sheet	\$	11,226,529	
9. Less unacceptable assets		<u>-</u>	
10. Adjusted net worth for HUD requirement purposes			<u>\$ 11,226,529</u>
11. Adjusted net worth above amount required			<u>\$ 10,226,529</u>
12. Adjusted net worth below amount required			<u>\$ -</u>

UNIVERSITY BANK
COMPUTATION OF LIQUIDITY TO DETERMINE
COMPLIANCE WITH HUD LIQUIDITY REQUIREMENTS
December 31, 2010

1. Cash and cash equivalents	\$ 19,845,247
2. Securities available for sale	2,934,369
3. Trading account securities	<u>964,893</u>
4. Total liquid assets	<u>\$ 23,744,509</u>
5. Adjusted net worth	<u>\$ 11,226,529</u>
6. Liquidity required (20% of adjusted net worth, maximum \$100,000)	<u>\$ 100,000</u>
7. Liquidity above the program requirement	<u>\$ 23,644,509</u>