

**UNIVERSITY BANCORP, INC.  
AND SUBSIDIARIES**

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2015 and 2014

# UNIVERSITY BANCORP, INC. AND SUBSIDIARIES

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## INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying consolidated financial statements of University Bancorp, Inc. and Subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of operations and comprehensive income, equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Financial Statements**

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

### **Auditor's Responsibility**

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

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

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

To the Board of Directors and Stockholders  
University Bancorp, Inc. and Subsidiaries  
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**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, 2015 and 2014, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*UHY LLP*

Farmington Hills, Michigan  
March 25, 2016

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

	December 31,	
	<u>2015</u>	<u>2014</u>
<b>ASSETS</b>		
Cash and due from banks	\$ 59,738,893	\$ 2,364,321
Restricted cash	1,002,307	1,000,553
Certificates of deposit	-	6,250,000
Investment securities available-for-sale, at fair value	2,438,803	1,254,164
Federal Home Loan Bank stock, at cost	637,000	872,300
Loans and financings held for sale or assignment, at fair value	42,666,107	40,078,919
Loans and financings, net	55,686,036	50,672,477
Premises and equipment, net	4,854,364	4,340,368
Mortgage and financing servicing rights, at fair value	9,379,862	7,900,842
Real estate owned, net	301,840	355,107
Accounts receivable	1,257,584	649,014
Accrued interest and financing income receivable	177,401	168,229
Prepaid expenses	983,009	683,492
Derivatives, at fair value	959,862	1,065,770
Goodwill	356,310	356,310
Customer relationships, net	284,571	355,714
Investor remittances receivable	546,644	470,474
Refundable federal income taxes	-	333,691
Deferred income taxes	1,158,111	1,752,521
Other assets	30,208	52,513
	<u>                    </u>	<u>                    </u>
Total assets	<u><u>\$ 182,458,912</u></u>	<u><u>\$ 120,976,779</u></u>

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS (Continued)**

	December 31,	
	2015	2014
<b>LIABILITIES AND EQUITY</b>		
<b>LIABILITIES</b>		
Deposits:		
Demand - non-interest bearing	\$ 131,835,236	\$ 72,232,864
Demand - interest bearing and profit sharing	16,566,706	18,362,490
Savings	436,324	305,205
Time	3,417,774	3,672,550
Total deposits	<b>152,256,040</b>	94,573,109
Derivatives, at fair value	58,111	172,008
Accounts payable	807,958	992,130
Accrued interest and profit sharing payable	7,318	4,694
Allowance for loan and financing recourse	217,553	431,394
Escrow, mortgage and financing insurance liabilities	257,002	360,111
Liability to fund closed but undisbursed loans and financings	1,600,925	1,498,022
Investor remittances payable	1,330,595	1,397,269
Contingent earn-out liability, at fair value	-	74,129
Earn-out liability	430,012	-
Contingent legal liability	977,840	848,000
Federal income tax payable	17,808	-
Deferred income taxes	4,670,948	3,965,749
Accrued expenses and other liabilities	2,497,529	1,391,096
Preferred stock subject to mandatory redemption	-	350,000
Total liabilities	<b>165,129,639</b>	106,057,711
<b>EQUITY</b>		
University Bancorp, Inc. stockholders' equity:		
Common stock, \$.01 par value per share; 6,000,000 and 5,000,000 shares authorized, 5,100,899 and 4,782,782 shares issued as of December 31, 2015 and 2014, respectively	51,009	47,828
Additional paid-in capital	7,548,685	6,313,650
Treasury stock, at cost; -0- and 31,522 shares held as of December 31, 2015 and 2014, respectively	-	(93,192)
Retained earnings	7,204,249	4,065,032
Accumulated other comprehensive income	17,475	23,111
Equity attributable to stockholders of University Bancorp, Inc.	<b>14,821,418</b>	10,356,429
Noncontrolling interest	2,507,855	4,562,639
Total equity	<b>17,329,273</b>	14,919,068
Total liabilities and equity	<b>\$ 182,458,912</b>	\$ 120,976,779

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND**  
**COMPREHENSIVE INCOME**

	<b>Years ended December 31,</b>	
	<b>2015</b>	<b>2014</b>
Interest and financing income:		
Interest and fees on loans and financing income	<b>\$ 4,583,564</b>	\$ 4,100,004
Interest on securities:		
U.S. Government agencies	<b>50,743</b>	65,235
Other securities	<b>30,915</b>	45,617
Interest on federal funds and other	<b>147,823</b>	196,346
Total interest and financing income	<b>4,813,045</b>	4,407,202
Interest and profit sharing expense:		
Interest and profit sharing on deposits:		
Demand deposits	<b>21,955</b>	39,815
Savings deposits	<b>349</b>	295
Time deposits	<b>59,001</b>	73,525
Other	<b>5,395</b>	65,209
Total interest and profit sharing expense	<b>86,700</b>	178,844
Net interest and financing income	<b>4,726,345</b>	4,228,358
Provision for loan and financing losses	<b>(314,131)</b>	(308,443)
Net interest and financing income after provision for loan and financing losses	<b>5,040,476</b>	4,536,801
Other income (loss):		
Loan and financing servicing and sub-servicing fees	<b>9,930,774</b>	8,584,385
Origination and other fees	<b>7,017,767</b>	5,898,005
Gain on sale of mortgage loans, net, and fee income for assignment of financings	<b>20,703,586</b>	16,409,483
Insurance & investment agency fee income	<b>735,790</b>	639,148
Deposit service charges and fees	<b>10,876</b>	8,493
Change in fair value of mortgage and financing servicing rights due to:		
Pay-offs and pay-downs	<b>(1,146,491)</b>	(878,649)
Changes in estimates	<b>(563,480)</b>	(643,943)
Change in fair value of loans and financings held for sale or assignment, interest and financing rate locks, and forward commitments	<b>1,988,921</b>	1,938,093
Other income	<b>153,637</b>	235,835
Total other income, net	<b>38,831,380</b>	32,190,850

See notes to consolidated financial statements.

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND**  
**COMPREHENSIVE INCOME (Continued)**

	<b>Years ended December 31,</b>	
	<b>2015</b>	<b>2014</b>
Other expenses:		
Compensation and benefits	\$ 27,646,858	\$ 23,667,458
Occupancy	1,665,021	1,610,261
Data processing and equipment expense	2,088,268	2,027,340
Legal and audit	1,401,142	2,267,769
Consulting fees	547,582	666,217
Mortgage banking	1,477,937	1,162,616
Advertising	831,233	730,223
Membership and training	343,020	269,142
Travel and entertainment	678,943	359,496
Supplies and postage	1,092,580	1,244,534
Insurance	415,793	353,698
Real estate expense	41,531	37,718
Director related expenses	191,588	164,547
FDIC assessments	60,702	52,837
Contingent legal expense	129,840	848,000
Amortization of customer relationships	71,143	71,143
Other operating expenses	227,920	207,895
	<u>38,911,101</u>	<u>35,740,894</u>
Income before income taxes	4,960,755	986,757
Income tax expense	1,711,575	360,837
<b>Net income</b>	<u>\$ 3,249,180</u>	<u>\$ 625,920</u>
<b>COMPREHENSIVE INCOME</b>		
Net income	\$ 3,249,180	\$ 625,920
Net unrealized loss on securities available-for-sale	<u>(5,636)</u>	<u>(57,477)</u>
<b>COMPREHENSIVE INCOME</b>	<u>\$ 3,243,544</u>	<u>\$ 568,443</u>
Net income (loss) and comprehensive income (loss) attributable to the noncontrolling interests	<u>\$ 109,963</u>	<u>\$ (129,261)</u>
<b>Net income attributable to common stockholders of University Bancorp, Inc.</b>	<u>\$ 3,139,217</u>	<u>\$ 755,181</u>
<b>Comprehensive income attributable to common stockholders of University Bancorp, Inc.</b>	<u>\$ 3,133,581</u>	<u>\$ 697,704</u>



**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF EQUITY**

	University Bancorp, Inc. Stockholders'								
	Common Stock \$.01 Par value		Additional Paid-in Capital	Treasury Stock		Retained Earnings	Accumulated Other Compre- hensive Income	Non- controlling Interest	Total
	Number of Shares	Par Value		Number of Shares	Cost				
<b>Balance at January 1, 2014</b>	4,782,782	\$ 47,828	\$ 6,267,158	(89,954)	\$ (265,940)	\$ 3,309,851	\$ 80,588	\$ 4,691,900	\$ 14,131,385
Exercise of stock options	-	-	(67,570)	58,432	172,748	-	-	-	105,178
Excess tax benefit from exercise of stock options	-	-	106,000	-	-	-	-	-	106,000
Share-based compensation	-	-	8,062	-	-	-	-	-	8,062
Net unrealized loss on securities available-for-sale	-	-	-	-	-	-	(57,477)	-	(57,477)
Net income (loss)	-	-	-	-	-	755,181	-	(129,261)	625,920
<b>Balance at December 31, 2014</b>	4,782,782	47,828	6,313,650	(31,522)	(93,192)	4,065,032	23,111	4,562,639	14,919,068
Exercise of stock options	17,041	170	76,609	31,522	93,192	-	-	-	169,971
Excess tax benefit from exercise of stock options	-	-	53,000	-	-	-	-	-	53,000
Issuance of common stock to ESOP	9,215	92	-	-	-	-	-	-	92
Issuance of common stock to acquire noncontrolling interest	309,361	3,094	1,210,251	-	-	-	-	(2,164,747)	(951,402)
Repurchase and cancellation of common stock	(17,500)	(175)	(104,825)	-	-	-	-	-	(105,000)
Net unrealized loss on securities available-for-sale	-	-	-	-	-	-	(5,636)	-	(5,636)
Net income	-	-	-	-	-	3,139,217	-	109,963	3,249,180
<b>Balance at December 31, 2015</b>	5,100,899	\$ 51,009	\$ 7,548,685	-	\$ -	\$ 7,204,249	\$ 17,475	\$ 2,507,855	\$ 17,329,273

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

	<b>Years ended December 31,</b>	
	<b>2015</b>	<b>2014</b>
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 3,249,180	\$ 625,920
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	994,446	947,902
Change in fair value of mortgage and financing servicing rights	1,709,971	1,522,592
Change in fair value of loans and financings held for sale or assignment, interest and financing rate locks, and forward commitments	(1,988,921)	(1,938,093)
Deferred income tax expense	1,352,609	351,941
Provision for loan and financing losses	(314,131)	(308,443)
Net gain on sale of mortgage loans and fee income for assignment of financings	(20,703,586)	(16,409,483)
Net gain on sale of other real estate owned	(100,155)	(172,052)
Net amortization (accretion) on investment securities	855	(30,063)
Write down of real estate owned	-	4,700
Originations of mortgage loans and financings	(669,483,879)	(532,064,911)
Proceeds from mortgage loan sales and assignment of financings	686,281,280	535,423,425
Share-based compensation	-	8,062
Preferred dividends recorded as interest expense	5,273	65,209
Net change in:		
Various other assets	(639,187)	1,116,056
Various other liabilities	923,618	(242,046)
Net cash provided by (used in) operating activities	<u>1,287,373</u>	<u>(11,099,284)</u>
<b>INVESTING ACTIVITIES</b>		
Purchase of securities available-for-sale	(1,237,773)	-
Proceeds from maturities of securities available-for-sale	46,643	422,098
Proceeds from redemption of Federal Home Loan Bank stock	235,300	200,000
Proceeds from sale of real estate owned	455,262	243,798
Loans and financings (granted) and repayments, net	(5,001,268)	(1,867,568)
Purchases of premises and equipment	(1,437,299)	(637,677)
Payment of contingent earn-out liability	(74,129)	(79,181)
Redemptions of certificates of deposit, net	6,250,000	750,000
Net cash used in investing activities	<u>(763,264)</u>	<u>(968,530)</u>

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS** (Continued)

	<b>Years ended December 31,</b>	
	<b>2015</b>	<b>2014</b>
<b>FINANCING ACTIVITIES</b>		
Net change in deposits	\$ 57,682,931	\$ 9,040,250
Exercise of stock options	169,971	105,178
Repurchase of common stock	(105,000)	-
Redemption of preferred stock	(350,000)	(681,450)
Payment of preferred dividends	(26,049)	(184,315)
Acquisition of noncontrolling interest	(521,390)	-
	<u>56,850,463</u>	<u>8,279,663</u>
	<b>57,374,572</b>	<b>(3,788,151)</b>
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>2,364,321</u>	<u>6,152,472</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$ 59,738,893</u>	<u>\$ 2,364,321</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid during the year for interest	<u>\$ 78,803</u>	<u>\$ 115,709</u>
Net cash paid (refunded) during the year for income taxes	<u>\$ -</u>	<u>\$ (148,302)</u>
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTIONS:</b>		
Mortgage loans and financings converted to real estate owned	<u>\$ 301,840</u>	<u>\$ -</u>
Reduction in accrued compensation through issuance of common stock to ESOP	<u>\$ 92</u>	<u>\$ -</u>
Issuance of common stock to acquire noncontrolling interest	<u>\$ 2,611,007</u>	<u>\$ -</u>
Earn-out liability to acquire noncontrolling interest	<u>\$ 430,012</u>	<u>\$ -</u>

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2015 and 2014**

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

**Nature of Operations and Principles of Consolidation**

The consolidated financial statements of University Bancorp, Inc. (the “Parent”) include the operations of its wholly-owned subsidiary, University Bank (the “Bank”), the Bank’s wholly owned subsidiaries, Ann Arbor Insurance Centre, Inc. (“AAIC”), Hoover, LLC (“Hoover”), University Lending Group, LLC (“ULG”) and Midwest Loan Services, Inc. (“Midwest”), and the Bank’s 80% owned subsidiary, University Islamic Financial Corporation (“UIF”). Midwest was 80% owned as of December 31, 2014, but during 2015 the Bank purchased the remaining 20% of Midwest’s stock and Midwest became a wholly-owned subsidiary of the Bank. These consolidated financial statements also include the operations of Hoover’s wholly owned subsidiary, Tuomy, LLC, as well as the operations of AAIC’s wholly owned subsidiary, 2621 Carpenter Road, 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. University Bancorp, Inc. and Subsidiaries are herein referred to as the “Company”.

The Parent is a bank holding company. The 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 sales, life insurance, property casualty insurance and foreign currency exchange. The Bank’s customer base is primarily located in the Ann Arbor, Michigan metropolitan statistical area.

The 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.

AAIC is engaged in the sale of insurance products including life, health, property and casualty, and investment products such as annuities. AAIC is located in the building owned by 2621 Carpenter Road, LLC in Ann Arbor, MI.

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

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2015 and 2014**

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

**Nature of Operations and Principles of Consolidation (Continued)**

ULG commenced operations in April 2008 and is headquartered in Clinton Township, Michigan. ULG operates in fourteen retail branches throughout Michigan, Indiana, Florida, and Alabama. ULG is engaged in the business of marketing, originating, processing, closing and selling retail mortgage loans. ULG is also engaged in the business of servicing mortgage loans as servicing rights are retained on selective loans that are sold.

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 is also engaged in the business of marketing, originating, processing, closing and selling retail mortgage loans.

UIF is a faith-based banking firm and was formed in December 2005. UIF is based in Southfield, Michigan. Its current products, which comply with federal and state law, as well as Islamic religious precepts, are deposits (as agent for the Bank) that are insured by the Federal Deposit Insurance Corporation (the "FDIC"), home financings (as agent for the Bank and Federal Home Loan Mortgage Corporation ("Freddie Mac")), and home financings and commercial real estate financings (as principal for its own account). These products are offered to service the large number of Muslim, Hindu, Jewish, and Christian customers who have an ethical aversion to paying or receiving interest.

There are two distinct financing products offered using redeemable lease and installment sale contracts.

Under the redeemable lease method, a single-asset trust or an LLC is established by or on behalf of the originator (Bank/UIF), as settlor, naming a special purpose entity as the trustee or manager. The trust or LLC 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 program. The funds necessary to acquire the real property are deposited into the trust or LLC by the originator, as settlor, and used to fund the purchase of the property. The trust or LLC then enters into a combination lease/contract-for-deed agreement with the lessee/purchaser. The settlor is the initial beneficiary of the trust or LLC, but the beneficial interest in the payment stream arising from the trust or LLC is assignable to third parties. The power to remove and appoint trustees or managers is granted to the beneficiary and the beneficiary has the power to direct the trustee or manager 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.

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2015 and 2014**

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

**Nature of Operations and Principles of Consolidation (Continued)**

The redeemable lease arrangement is treated as financing rather than leasing in accordance with U.S. 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
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 redeemable lease transactions, the Company uses the balance sheet account title “Loans and financings” instead of a typical title of “Loans”. In the consolidated statements of operations and comprehensive income, “Interest and fees on loans” is modified to state “Interest and fees on loans and financing income”.

The second form of home financing uses the installment sale method. As agent for the Bank, UIF buys a property selected by a customer and then resells it to the customer, at a selling price higher than the purchase price. The difference between UIF’s purchase price and the selling price is the profit that the ultimate holder of the installment contract will accrete into income over the life of the contract. After the contract is executed by UIF and the customer, the contract is assigned to the Bank, and then assigned to the Freddie Mac. Freddie Mac then reimburses the Bank for the outlay of cash to purchase the property and pays the Bank a fee for origination. The cash, origination fees, and servicing rights are retained by UIF under an installment sale agreement between UIF and the Bank. The customer pays Freddie Mac for the property that was purchased on an installment basis, per an agreed repayment schedule.

The Company records these contracts at fair value for the short period of time that they are held before assignment to Freddie Mac. The installment contracts are assigned 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 assignment of the underlying installment contract. See Note 22 for additional discussion of the determination of fair value.

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2015 and 2014**

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

**Nature of Operations and Principles of Consolidation (Continued)**

On the liability side of the balance sheet, UIF (as agent for the Bank) also offers FDIC-insured deposits that use a method of profit sharing. These deposits are specifically invested in investments that do not involve interest such as, but not limited to, transactions structured using the redeemable lease and installment sale methods. Savings, money markets, and certificates of deposits pay out earnings that are derived specifically from the revenues from these 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 to as low as zero percent with the net earnings of the redeemable lease portfolio and other investments compliant.

The earnings paid to the depositors by the Bank are accounted for as an expense. This expense is analogous to interest expense paid on deposits in conventional financing. To reflect the legal substance of the profit sharing 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 consolidated statements of operations and comprehensive income, “Interest on deposits” is modified to state “Interest and profit sharing on deposits”.

**Use of Estimates**

The preparation of 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 and financing servicing rights, the allowance for loan and financing losses, the identification and valuation of impaired loans and financings, the valuation of real estate owned, impairment analysis of goodwill and other intangible assets, the valuation allowance for deferred tax assets, the fair value of loans and financings held for sale or assignment, and the fair value of derivative instruments such as mortgage interest and financing rate locks and forward commitments, recourse liabilities related to loans sold and financings assigned and loans and financings held for sale or assignment, the valuation of stock options and related stock based-compensation, the fair value of the contingent earn-out liability, the amount of contingent liabilities, and the determination and the fair value of other financial instruments.

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2015 and 2014**

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

**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 loans and financings, deposit transactions, and interest bearing deposits with other banks.

**Securities**

Securities are classified as 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. 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.

**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 the FHLB stock are subject to economic events, regulatory actions, and other factors.

**Loans and Financings**

Loans and financings are reported at the principal balance outstanding, net of unearned interest or financing income, deferred loan or financing fees and costs, and an allowance for loan and financing losses. Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Financing income is calculated monthly and includes amortization of net deferred financing fees and costs over the term of the financing. Interest or financing 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 and financings are reported as principal reductions, unless all interest or financing income and principal payments in arrears are paid in full.



**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Allowance for Loan and Financing Losses**

The allowance for loan and financing losses is a valuation allowance for probable credit losses, increased by the provision for loan and financing losses and recoveries and decreased by charge-offs. Management estimates the balance required based on past 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 or financing terms is not expected. Impairment is evaluated in total for smaller-balance loans and financings of similar nature such as residential, consumer, and credit card, 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. When collection becomes remote, loans or financings are charged off.

**Premises and Equipment**

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization is computed primarily on the straight-line method over the assets' estimated useful lives which range from three to thirty-nine years. In the case of a leasehold improvement, the life will be the lesser of the term of the lease and the estimated useful life.

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Mortgage Banking Activities**

The Company's mortgage banking activities consist of retail and servicing operations. Loans and financings held for sale are sold or assigned with selective loans or financings having their servicing or financing rights retained, and others are sold or assigned on a servicing released basis. The Company elected to record loans and financings held for sale at fair value. Loans and financings are sold or assigned without recourse, except in certain events as defined in the related documents.

An allowance was booked for potential recourse liabilities related to loans and financings sold or assigned, and loans and financings held for sale or assignment, in the amount of \$217,553 and \$431,394 as of December 31, 2015 and 2014, respectively.

Mortgage and financing servicing rights ("MSRs") represent both purchased rights and the allocated value of servicing rights retained on loans or financings originated and sold or assigned. Loan and financing servicing and sub-servicing fees are contractually based and are recognized monthly as earned over the life of the loans or financings.

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

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

**Derivative Instruments**

The Company enters into interest and financing rate lock commitments (“IRLCs”) in connection with its mortgage banking activities to fund residential mortgage loans and financings at specified times in the future. IRLCs that relate to the origination of mortgage loans and financings that will be held for sale or assignment are considered derivative instruments under the ASC. As such, these IRLCs are recorded at fair value (see Note 22) with changes in fair value recorded in earnings.

Outstanding IRLCs expose the Company to the risk that the price of the loans or financings underlying the commitments might decline from inception of the rate lock to the funding of the loan or financing. To protect against this risk, the Company utilizes forward loan and financing sales commitments to economically hedge the risk of potential changes in the value of the loans and financings that would result from the commitments. These forward commitments are valued at fair value (see Note 22) 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.

**Goodwill**

Goodwill is the excess costs of acquired businesses over the fair value amounts assigned to identifiable assets acquired and liabilities assumed. The Company has elected not to amortize goodwill, but rather, review goodwill for impairment annually or whenever events and circumstances have occurred that indicate a potential impairment.

When performing an impairment test, entities are provided with the option of first performing a qualitative assessment on none, some or all of its reporting units to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If after completing a qualitative analysis, it is determined that it is more likely than not that the fair value of a reporting unit is less than its carrying value, a quantitative analysis is required.

Under a quantitative analysis, management first compares the fair value of a reporting unit to the carrying value of the reporting unit's net assets at the measurement date. If the carrying value of the reporting unit exceeds the fair value, the second step of the quantitative analysis must be performed. The second step of the quantitative analysis requires an allocation of the estimated fair value of the reporting unit to all assets and liabilities as if the reporting unit had been acquired at the measurement date. The carrying value of goodwill is then compared to the implied value of goodwill and any excess of carrying value over implied value is recognized as goodwill impairment.

The Company's evaluations of goodwill completed during 2015 and 2014 resulted in no impairment losses.

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Long-Lived Assets**

Management periodically reviews the potential impairment of long-lived assets to assess recoverability. If a long-lived asset is deemed to be impaired, the write-down is recorded as a periodic expense. There was no impairment recorded during 2015 or 2014.

**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 is more likely than not to be realized.

The ASC standards regarding accounting for uncertainty in income taxes 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, 2015 and 2014, there was no accrual for uncertain tax positions.

The Company's major state tax expense is in the state of Michigan. Under Michigan tax law, the Company is subject to a franchise tax. It is management's policy to include the franchise tax in other operating expenses. The Michigan statute calls for 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 Parent and the Bank have 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.

**Subsequent Events**

The Company has performed a review of events subsequent to December 31, 2015 through March 25, 2016 the date the consolidated financial statements were available to be issued. See Note 24 for a summary of subsequent events.

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2015 and 2014

**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, 2015 and 2014, this reserve requirement amounted to \$4,003,000 and \$2,120,000, respectively.

In accordance with a seller and servicer agreement with Freddie Mac, UIF is required to maintain a pledged collateral deposit of \$1,000,000. The balance maintained in the restricted account totaled \$1,002,307 and \$1,000,553 at December 31, 2015 and 2014, respectively. This cash balance is shown as restricted cash in the consolidated balance sheets.

**NOTE 3 – INVESTMENT SECURITIES - AVAILABLE-FOR-SALE**

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

Securities available-for-sale at December 31, 2015 consists of the following:

	<u>Amortized Cost</u>	<u>Unrealized Gain</u>	<u>Fair Value</u>
U.S. agency mortgage-backed securities	<u>\$ 2,421,328</u>	<u>\$ 17,475</u>	<u>\$ 2,438,803</u>

Securities available-for-sale at December 31, 2014 consists of the following:

	<u>Amortized Cost</u>	<u>Unrealized Gain</u>	<u>Fair Value</u>
U.S. agency mortgage-backed securities	<u>\$ 1,231,053</u>	<u>\$ 23,111</u>	<u>\$ 1,254,164</u>

At December 31, 2015 and 2014, the fair value of available-for-sale securities pledged to secure certain borrowings was \$2,438,803 and \$1,254,164, respectively. The balance of these borrowings at both December 31, 2015 and 2014 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 \$46,643 and \$422,098 for the years ended December 31, 2015 and 2014, respectively.

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2015 and 2014

**NOTE 4 – LOANS AND FINANCINGS, NET**

Major classifications of loans and financings are as follows:

	December 31,	
	2015	2014
Commercial	\$ 1,837,939	\$ 1,808,629
Commercial real estate	33,482,901	30,797,443
Residential real estate	20,492,242	18,404,463
Installment	139,385	168,763
Credit cards	138,246	158,259
	<u>56,090,713</u>	<u>51,337,557</u>
Gross loans and financings		
Allowance for loan and financing losses	(404,677)	(665,080)
	<u>\$ 55,686,036</u>	<u>\$ 50,672,477</u>
Net loans and financings		

Changes in the allowance for loan and financing losses were as follows:

	December 31,	
	2015	2014
Balance, beginning of year	\$ 665,080	\$ 968,244
Provision charged to operations	(314,131)	(308,443)
Recoveries	53,728	7,065
Charge-offs	-	(1,786)
	<u>\$ 404,677</u>	<u>\$ 665,080</u>
Balance, end of year		

Information regarding impaired loans and financings is as follows:

	December 31,	
	2015	2014
Impaired loans and financings:		
Loans and financings with no allowance allocated	\$ 458,222	\$ -
Loans and financings with allowance allocated	\$ 5,127	\$ 1,828,915
Amount of allowance for loan and financing losses allocated	\$ 4,080	\$ 17,971
Impaired loans and financings:		
Average balance during the year	\$ 579,828	\$ 1,856,224
Interest and financing income recognized thereon	\$ 33,251	\$ 169,292
Cash basis interest and financing income recognized	\$ 30,077	\$ 123,873

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 4 – LOANS AND FINANCINGS, NET (Continued)**

The following tables present informative data by class of loan and financing regarding their age and interest or financing income accrual status at December 31, 2015 and 2014 (in thousands):

December 31, 2015	Current	Past Due			Total Past Due	Total Loans and Financings
		30-59 Days	60-89 Days	≥ 90 Days		
Commercial	\$ 1,838	\$ -	\$ -	\$ -	\$ -	\$ 1,838
Commercial real estate	33,483	-	-	-	-	33,483
Consumer	139	-	-	-	-	139
Credit card	138	-	-	-	-	138
Residential real estate	20,035	156	-	302	458	20,493
Total	\$ 55,633	\$ 156	\$ -	\$ 302	\$ 458	\$ 56,091

December 31, 2014	Current	Past Due			Total Past Due	Total Loans and Financings
		30-59 Days	60-89 Days	≥ 90 Days		
Commercial	\$ 1,810	\$ -	\$ -	\$ -	\$ -	\$ 1,810
Commercial real estate	30,530	-	-	267	267	30,797
Consumer	169	-	-	-	-	169
Credit card	158	-	-	-	-	158
Residential real estate	17,931	302	160	11	473	18,404
Total	\$ 50,598	\$ 302	\$ 160	\$ 278	\$ 740	\$ 51,338

December 31, 2015	Accrual Status	
	Total Loans and Financings on Nonaccrual Status	Loans and Financings Past Due ≥ 90 Days and Still Accruing
Commercial	\$ -	\$ -
Commercial real estate	-	-
Consumer	-	-
Credit card	-	-
Residential real estate	302	-
Total	\$ 302	\$ -

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 4 – LOANS AND FINANCINGS, NET (Continued)**

	Accrual Status	
	Total Loans and Financings on Nonaccrual Status	Loans and Financings Past Due ≥ 90 Days and Still Accruing
December 31, 2014		
Commercial	\$ -	\$ -
Commercial real estate	267	-
Consumer	-	-
Credit card	-	-
Residential real estate	11	-
Total	\$ 278	\$ -

**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 \$17.0 billion and \$14.9 billion as of December 31, 2015 and 2014, respectively. The value of these mortgage servicing rights are not included in the accompanying consolidated financial statements.

University Bank, Midwest, UIF and ULG sell residential mortgage loans and financings to the secondary market with servicing rights retained for selective loans and financings. These loans and financings are owned by other institutions and are not included in the Company's consolidated balance sheets, but the MSR's are included in the accompanying consolidated financial statements. Such mortgage loans and financings have been sold or assigned predominately without recourse or with limited recourse. The unpaid principal balance of these loans and financings was \$1.015 billion and \$797 million at December 31, 2015 and 2014, respectively.

Custodial escrow balances maintained in connection with these loans and financings were \$167 million and \$223 million, of which \$62 million and \$152 million were held at other banks and were not included in the accompanying consolidated financial statements at December 31, 2015 and 2014, respectively.



**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
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**NOTE 5 – MORTGAGE BANKING ACTIVITIES (Continued)**

The following summarizes the activity relating to MSR's:

	December 31,	
	2015	2014
Balance, January 1	\$ 7,900,842	\$ 7,170,318
Amount capitalized	3,188,991	2,253,116
Change in fair value due to:		
Pay-offs and pay-downs	(1,146,491)	(878,649)
Changes in estimates	(563,480)	(643,943)
Balance, December 31	<u>\$ 9,379,862</u>	<u>\$ 7,900,842</u>

The Company enters into IRLCs in connection with its mortgage banking activities to fund residential mortgage loans and financings at specified times in the future. As of December 31, 2015 and 2014, IRLCs amounted to \$40.0 million and \$38.7 million, respectively, of which management estimated \$34.4 million and \$31.8 million, respectively, to eventually close and be funded. These IRLCs were recorded in assets in the consolidated balance sheets at a fair value of \$959,862 and \$1,065,770 as of December 31, 2015 and 2014, respectively.

The Company also utilizes forward loan and financing sales commitments in order to economically hedge the risk of potential changes in the value of the loans and financings that would result from the IRLCs. Forward sales commitments to fund loans and financings at specified rates amounted to \$55.9 million and \$37.4 million as of December 31, 2015 and 2014, respectively, which were recorded in liabilities in the consolidated balance sheets at a fair value of \$58,111 and \$172,008 as of December 31, 2015 and 2014, respectively.

The net change in fair value of the IRLCs and the related forward loan and financing sales commitments held at December 31, 2015 and 2014 resulted in gains of \$7,989 and \$416,070, respectively, which has been recognized in the other income section in the consolidated statements of operations. These gains and losses are due principally to the inclusion of day one gains associated with the adoption of fair value accounting as discussed in Note 22. 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 or assignment of the related loans and financings.

Market interest rate conditions can quickly affect the fair value of MSRs, IRLCs, and forward loan and financing sales commitments in a positive or negative fashion, as long-term interest rates rise and fall. See Note 22 for further discussion of management's assumptions used in determination of fair value of these assets and liabilities.

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
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**NOTE 6 – PREMISES AND EQUIPMENT, NET**

Premises and equipment consist of the following:

	December 31,	
	2015	2014
Land	\$ 562,500	\$ 562,500
Buildings and improvements	3,325,815	3,069,818
Furniture, fixtures, equipment and software	4,908,446	5,608,289
Construction in process	59,071	51,262
	<u>8,855,832</u>	<u>9,291,869</u>
Less accumulated depreciation and amortization	<u>(4,001,468)</u>	<u>(4,951,501)</u>
Premises and equipment, net	<u>\$ 4,854,364</u>	<u>\$ 4,340,368</u>

Depreciation and amortization expense related to premises and equipment amounted to \$923,303 and \$876,759 for the years ended December 31, 2015 and 2014, respectively.

Midwest, UIF, and ULG each lease office space for their respective operations. ULG and UIF also lease office space for their retail branches. All of the retail branch lease agreements are short-term in nature, with some being month-to-month, and some allowing the Company to break the lease with both a termination notice ranging from thirty days to six months, and a fee. The Company leases various other facilities and office equipment at varying rates on a month-to-month basis. Total rent expense for all operating leases was approximately \$902,000 and \$820,000 in 2015 and 2014, respectively.

The following table summarizes the future minimum payments under the contractual obligations of the Company as of December 31, 2015:

Years ending December 31,	Amount
2016	\$ 627,867
2017	584,319
2018	503,057
2019	447,461
2020	401,158

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 7 – GOODWILL**

The following table summarizes goodwill by reporting unit:

	December 31,	
	2015	2014
Midwest	\$ 103,914	\$ 103,914
AAIC	252,396	252,396
	<u>\$ 356,310</u>	<u>\$ 356,310</u>

**NOTE 8 – CUSTOMER RELATIONSHIPS, NET**

During 2012, the Company acquired customer relationships of \$498,000 as part of the acquisition of AAIC and 2621 Carpenter Road, LLC. These customer relationships are being amortized on a straight-line basis over their estimated economic lives, which were determined to be seven years. Amortization expense amounted to \$71,143 for each of the years ended December 31, 2015 and 2014. Amortization expense related to these customer relationships is expected to be approximately \$71,143 in each of the next four years.

**NOTE 9 – TIME DEPOSITS**

Time deposit liabilities issued in denominations of \$100,000 or more were \$2,108,380 and \$2,060,630 at December 31, 2015 and 2014, respectively.

At December 31, 2015, stated maturities of time deposits were:

Years ending December 31,	Amount
2016	\$ 1,324,920
2017	1,160,587
2018	139,566
2019	352,154
2020 and thereafter	<u>440,547</u>
	<u>\$ 3,417,774</u>

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 10 – DEFERRED COMPENSATION**

ULG has a deferred compensation agreement (the “Agreement”) with one of its key employees that provides this employee with a phantom interest in the net income of ULG based on years of service. The deemed value of the phantom interest at any point in time is the net income of ULG since September 1, 2011, less 34%, multiplied by 12.4975%, less \$250,000. This phantom interest vests over three years, but is fully vested upon a change in control, death or disability of the employee, or the dissolution or liquidation of ULG, as defined in the Agreement. Since December 31, 2014, the phantom interest has been fully vested.

In addition, the employee is entitled to earn \$250,000 vested over time with 50% vesting after 5 years, and 10% vesting in each of the 5 years thereafter. Any accrued benefit to the employee is to be distributed upon retirement, death, or disability of the employee, or upon termination of the employee without cause. During each of the years ended December 31, 2014 and 2013, a special distribution event occurred in which the employee was paid \$165,000 and \$65,000 of the accrued liability, respectively. No amounts were paid during the year ended December 31, 2015. In relation to the Agreement, the Company recognized compensation expense of \$279,469 and \$206,029 during the years ended December 31, 2015 and 2014, respectively, and recorded accrued deferred compensation of \$410,442 and \$130,973 as of December 31, 2015 and 2014, respectively. Accrued deferred compensation is included in “Accrued expenses and other liabilities” in the consolidated balance sheets.

**NOTE 11 – INCOME TAXES**

Income tax expense is summarized as follows:

	December 31,	
	2015	2014
Current	\$ 358,966	\$ 8,896
Deferred	1,352,609	351,941
Income tax expense	<u>\$ 1,711,575</u>	<u>\$ 360,837</u>

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.

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
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**NOTE 11 – INCOME TAXES (Continued)**

Significant components of the Company's deferred income tax assets and liabilities consist of the following:

	December 31,	
	2015	2014
Deferred income tax assets:		
Allowance for loan and financing losses and recourse liabilities	\$ -	\$ 202,689
Tax credit carry-forward	815,411	1,072,176
Contingent legal liability	288,320	288,320
Net operating loss carryforward	-	76,504
Other	54,380	112,832
Deferred tax asset	<u>1,158,111</u>	<u>1,752,521</u>
Deferred income tax liabilities:		
Mortgage servicing rights	3,189,153	2,686,287
Derivatives and LHFS	980,112	821,367
Premises and equipment	400,495	337,153
Customer relationships	96,754	120,942
Allowance for loan and financing losses and recourse liabilities	4,434	-
Deferred tax liability	<u>4,670,948</u>	<u>3,965,749</u>
Net deferred tax asset (liability)	<u>\$ (3,512,837)</u>	<u>\$ (2,213,228)</u>
Unused Credits:		
	Amount	Date of expiration
Low income housing credits	\$ 713,829	Starting 2020
Minimum tax credits	\$ 101,582	N/A

**NOTE 12 – PREFERRED STOCK SUBJECT TO MANDATORY REDEMPTION**

As of December 31, 2015 and 2014, the Company had 500,000 shares of preferred stock authorized with a \$.001 par value per share. As of December 31, 2015 and 2014 there were 0- and 35,000 preferred shares issued and outstanding, respectively. During the years ended December 31, 2015 and 2014, the Company redeemed 35,000 and 68,145 preferred shares for \$350,000 and \$681,450, respectively. The shares have a \$10 per share liquidation value and accrue dividends at an annual rate of 9%. Additional shares of preferred stock are typically issued semi-annually for unpaid accrued dividends. However, the Board did not approve any paid-in-kind dividends during 2014 or 2015.

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
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**NOTE 12 – PREFERRED STOCK SUBJECT TO MANDATORY REDEMPTION**

(Continued)

During 2015 and 2014, the Company declared preferred dividends of \$5,273 and \$65,209, respectively. Generally accepted accounting principles require these dividends to be reflected as interest expense. As a result, they have been included in other interest in the consolidated statements of operations and comprehensive income. As of December 31, 2015 and 2014, the Company had unpaid preferred dividends of \$-0- and \$20,776, respectively, which are included in accrued expenses and other liabilities in the consolidated balance sheets.

**NOTE 13 – 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 to directors of the Company in lieu of board fees paid in cash, outside of the 1995 Stock Plan.

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
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**NOTE 13 – STOCK OPTIONS** (Continued)

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, 2014	206,995	\$ 2.20
Granted	7,000	7.49
Exercised	(58,432)	1.80
Expired or forfeited	-	-
Outstanding at December 31, 2014	155,563	2.59
Granted	-	-
Exercised	(48,563)	3.50
Expired or forfeited	-	-
Outstanding at December 31, 2015	<u>107,000</u>	<u>\$ 2.17</u>

At December 31, 2015:

Number of options immediately exercisable	107,000
Weighted average exercise price of immediately exercisable options	\$2.17
Range of exercise price of options outstanding	\$1.80 - \$7.49
Weighted average remaining life of options outstanding	1.2 years

During 2015 and 2014, the Company received cash of \$169,971 and \$105,178, respectively, related to the exercise of options. As of the exercise date, the intrinsic value of the exercised options was approximately \$189,000 and \$330,000 for the years ended December 31, 2015 and 2014, respectively.

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. The fair value of the Company's 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. The options that were granted in 2014 were fully vested at the grant date. The Company recognized share-based compensation expense of \$-0- and \$8,062 during the years ended December 31, 2015 and 2014, respectively. The weighted-average grant-date fair value of stock options granted during 2014 was \$1.15 per option. As of December 31, 2015 and 2014, all outstanding options were fully vested.

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**NOTE 13 – STOCK OPTIONS** (Continued)

The Black-Scholes option pricing model values options based on the stock price at the grant date, expected term of the option, expected volatility of the stock, expected dividend payments and risk-free interest rate over the expected term of the option. The assumptions used in the Black-Scholes model were as follows for the options granted in 2014:

Risk-free interest rate	1.0%
Expected volatility	23%
Expected term	2 years
Expected dividend yield	0%

The Black-Scholes option valuation model was developed for estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Because option valuation models require the use of subjective assumptions, changes in these assumptions can materially affect the fair value of the options. As the Company's options do not have the characteristics of traded options, the option valuation models do not necessarily provide a reliable measure of the fair value of its options.

**NOTE 14 – EMPLOYEE STOCK OWNERSHIP PLAN (“ESOP”)**

The Company has a noncontributory ESOP covering all full-time employees after one year of service, after at least 1,000 hours of service, and upon reaching the age of twenty-one (“participants”). The participants' share in the Company's contribution is based on their current compensation as a percentage of the total employee compensation. Upon retirement from the Company, participants can receive distributions of their allocated shares of the Company's stock. The Company contributed 9,215 and -0- common shares to the ESOP during the years ended December 31, 2015 and 2014, respectively. Compensation expense related to the shares contributed in 2015 was accrued and expensed in years prior to 2014 when the ESOP contributions were declared.

The annual contribution to the ESOP is at the discretion of the Board of Directors. Assets of the ESOP are comprised entirely of 98,054 and 88,839 shares of the Company's stock at December 31, 2015 and 2014, respectively, all of which were fully allocated. The assets of the ESOP are held in trust and were valued at \$635,390 and \$599,663 at December 31, 2015 and 2014, respectively.



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**NOTE 15 – NONCONTROLLING INTEREST**

As of December 31, 2014, the Bank owned an 80% interest in the common stock of Midwest, with the remaining 20% owned by the former CEO of Midwest. In February 2015, the Company acquired the 20% noncontrolling interest in MLS for consideration of \$3,562,409 consisting of cash of \$521,390, 309,361 shares of University Bancorp, Inc. common stock with a fair value of \$2,611,007, and an earn-out of \$430,012. The earn-out is to be paid monthly and determined by multiplying the federal funds interest rate minus 0.5%, by the monthly average MLS escrow deposits held at University Bank and the FHLB, divided by 12. At December 31, 2015, the balance of the earn-out was \$430,012 as no amounts were required to be paid for the earn-out during 2015. In conjunction with this agreement to acquire the MLS noncontrolling interest, in January 2015, the Company amended its articles of incorporation which increased the number of authorized common shares from 5,000,000 to 6,000,000.

At December 31, 2015 and 2014, total equity of Midwest was \$12,421,448 and \$10,823,745, respectively, resulting in a \$-0- and \$2,164,748 noncontrolling interest reflected in the Company's consolidated balance sheets, respectively.

Also, included in the consolidated financial statements are the results for UIF. The Bank owns 80% of the common stock of UIF. An outside investor owns the remaining 20%. At December 31, 2015 and 2014, total equity of UIF was \$12,539,278 and \$11,989,461, respectively. The noncontrolling interest at December 31, 2015 and 2014 was \$2,507,855 and \$2,397,891, respectively.

**NOTE 16 – EMPLOYEE RETIREMENT PLAN**

The Bank has a 401(K) plan (the "Plan") that allows employees of the Bank and the Bank's subsidiaries to contribute a portion of their salary pre-tax, to the allowable limit prescribed by the Internal Revenue Service. Management has discretion to make matching contributions to the Plan. The Company did not make any matching contributions to the Plan during the years ended December 31, 2015 and 2014.

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**NOTE 17 – 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:

	<u>December 31,</u>	
	<u>2015</u>	<u>2014</u>
Unused lines of credit	\$ 1,388,046	\$ 1,101,559
Unused credit card limits	1,438,914	794,690
Unused commitments for residential construction	<u>3,542,452</u>	<u>734,205</u>
	<u>\$ 6,369,412</u>	<u>\$ 2,630,454</u>

**Contingencies**

The Company has been party to various legal claims that have arisen from time to time in the normal course of business. Any impact of these legal claims has been reflected in the Company's consolidated financial statements.

At December 31, 2015 and 2014, the Company recorded a contingent liability totaling \$977,840 and \$848,000, respectively, related to a lawsuit against the Company stemming from trade secrets claims made by a competitor of UIF. In March 2015, the jury returned a verdict against UIF and awarded the competitor \$848,000. As of the date of this report, the competitor has filed a motion for an award of additional damages and attorneys' fees, and UIF has filed a motion for an award of attorneys' fees related to twenty-one counts that were dismissed by summary judgment. The court has not yet rendered a decision on these motions. UIF is considering an appeal of the jury verdict. Depending upon the court's decision on the pending motions, those rulings may also be appealed.

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**NOTE 18 – RELATED PARTY TRANSACTIONS**

Available lines of credit to directors, officers and their affiliates at both December 31, 2015 and 2014 amounted to \$70,000, of which \$41,177 and \$42,952 had been borrowed against, respectively. The Company has closed and sold related party loans during the normal course of business. These loans were performing pursuant to terms at December 31, 2015 and 2014.

The Bank had demand deposits of \$244,904 and \$495,533 from directors, officers and their affiliates as of December 31, 2015 and 2014, respectively. The Bank also holds demand deposits from various employees in the normal course of business.

**NOTE 19 – LINES OF CREDIT**

The Bank has a line of credit available from the FHLB. The limit on this line was \$1,250,000 and \$2,050,000 as of December 31, 2015 and 2014, respectively. There were no advances on this line of credit as of December 31, 2015 and 2014. Borrowings are secured by the pledge of specific mortgage loans held for investment along with FHLB stock and available-for-sale securities. As of December 31, 2015 and 2014, the Bank had unutilized and available credit under the line of credit of \$1,250,000 and \$2,050,000, respectively.

In June 2014, the Company entered into a \$1,000,000 revolving warehouse line of credit with a bank so that UIF could meet a state licensing requirement. The Company does not intend to draw on this line. Interest on this line is at the greater of the prime rate or 5%. This line is secured by financings, and matures on June 30, 2016. At both December 31, 2015 and 2014, there was no outstanding balance on this line of credit.

**NOTE 20 – 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 paid dividends to University Bancorp, Inc. totaling \$973,390 and \$483,000 during the years ended December 31, 2015 and 2014, respectively. University Bancorp, Inc. did not pay any dividends to common shareholders during the years ended December 31, 2015 and 2014.

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**NOTE 20 – REGULATORY MATTERS (Continued)**

**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.

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, 2015 and 2014, 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 are as follows:

	Actual		To Be Adequately Capitalized		To Be Well Capitalized	
	Amount	Ratios	Amount	Ratios	Amount	Ratios
As of December 31, 2015:						
Total capital						
(to risk-weighted assets)	\$ 12,497,000	16.71%	\$ 5,982,000	8.00%	\$ 7,478,000	10.00%
Tier 1 capital						
(to risk-weighted assets)	12,092,000	16.17%	2,991,000	4.00%	4,487,000	6.00%
Tier 1 capital						
(to average assets)	12,092,000	8.93%	5,415,000	4.00%	6,768,000	5.00%
As of December 31, 2014:						
Total capital						
(to risk-weighted assets)	\$ 14,036,000	16.48%	\$ 6,816,000	8.00%	\$ 8,520,000	10.00%
Tier 1 capital						
(to risk-weighted assets)	13,371,000	15.69%	3,408,000	4.00%	5,112,000	6.00%
Tier 1 capital						
(to average assets)	13,371,000	12.75%	4,195,000	4.00%	5,244,000	5.00%

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**NOTE 21 – OTHER CAPITAL REQUIREMENTS**

The Bank, Midwest, ULG, and UIF are subject to certain capital requirements in connection with seller/servicer agreements that these entities have entered into with secondary market investors. Failure to maintain minimum capital requirements could result in these entities' 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.

The Bank's, Midwest's, ULG's, and UIF's actual capital amounts and the minimum amounts required for capital adequacy purposes, by investor, are as follows:

	Actual Capital	Minimum Capital
	<hr/>	<hr/>
As of December 31, 2015:		
Bank		
HUD	\$ 13,551,671	\$ 1,000,000
FHLMC	13,551,671	3,000,482
FNMA	13,551,671	2,826,050
Midwest		
HUD	\$ 12,343,608	\$ 2,080,108
FHLMC	12,343,608	2,506,179
FNMA	12,343,608	2,863,693
GNMA	12,343,608	2,796,945
ULG		
HUD	\$ 10,645,178	\$ 1,863,307
UIF		
FHLMC	\$ 12,180,974	\$ 3,636,147
	Actual Capital	Minimum Capital
	<hr/>	<hr/>
As of December 31, 2014:		
Bank		
HUD	\$ 14,039,165	\$ 1,000,000
FHLMC	14,039,165	3,603,511
FNMA	14,039,165	2,886,733
Midwest		
HUD	\$ 10,677,031	\$ 1,762,950
FHLMC	10,677,031	2,557,687
FNMA	10,677,031	2,885,132
GNMA	10,677,031	2,558,220
ULG		
HUD	\$ 8,104,690	\$ 1,651,376
UIF		
FHLMC	\$ 11,884,028	\$ 2,500,000

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**NOTE 21 – OTHER CAPITAL REQUIREMENTS (Continued)**

As of December 31, 2015 and 2014, the Bank, Midwest, ULG and UIF were also each required to have a minimum amount of liquid assets under certain liquidity requirements and were in compliance with these requirements.

**NOTE 22 - FAIR VALUE MEASUREMENTS**

The ASC 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 standards also emphasize 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 standards, 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.

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.

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**NOTE 22 - FAIR VALUE MEASUREMENTS (Continued)**

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.

*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.

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**NOTE 22 - FAIR VALUE MEASUREMENTS (Continued)**

*Loans and Financings Held for Sale or Assignment*

The Company elected to account for its loans and financings held for sale or assignment 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 and financings held for sale or assignment 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 financings and adjusted to reflect the inherent credit risk. In most situations, these loans and financings are locked into buckets to be sold under forward loan and financing sales commitments (as discussed below), in which case the fair value of these loans and financings held for sale or assignment are approximated by the value to be received soon thereafter under the forward sales commitments. Loans and financings held for sale or assignment are considered to be Level 2 assets in the valuation hierarchy. Net changes in the fair value of the Company's loans and financings held for sale or assignment are included in earnings. The net gain on change in fair value of loans and financings held for sale or assignment at December 31, 2015 and 2014 was \$1,980,932 and \$1,522,023, respectively, which is included in the other income section in the consolidated statements of operations.

*MSRs*

The Company accounts for MSR's at fair value in accordance with the ASC standards for servicing rights as discussed in Note 1. The fair value of MSR's represents the amount that the Company would receive upon the sale of the MSR's. The Company receives an independent valuation of its MSR's on a quarterly basis. The fair value of MSR's is determined by projecting cash flows which are then discounted to estimate an expected fair value. The fair value of MSR's 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's are considered to be Level 3 assets in the valuation hierarchy. Net changes in fair value of MSR's are included in earnings.



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**NOTE 22 - FAIR VALUE MEASUREMENTS (Continued)**

*Derivatives – IRLCs and Forward Commitments*

The Company enters into IRLCs in connection with its mortgage banking activities to fund mortgage loans and financings at specified times in the future. IRLCs that relate to the origination of mortgage loans and financings that will be held for sale or assignment 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 or financing commitment based on an expectation that it will be exercised and the loan or financing 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 or financings. 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 or financing.

Also, the fair value of these commitments is derived from the fair value of the related mortgage loans or financings, 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 or financing servicing are excluded from the valuation of IRLCs.

Outstanding IRLCs expose the Company to the risk that the price of the loans or financings underlying the commitments might decline from inception of the rate lock to the funding of the loan or financing. To protect against this risk, the Company utilizes forward loan or financing sales commitments to economically hedge the risk of potential changes in the value of the loans or financings 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.

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**NOTE 22 - FAIR VALUE MEASUREMENTS (Continued)**

*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. 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.

*Contingent Earn-Out*

In 2012, the Company acquired 100% of the stock of AAIC and 100% of the membership interest of 2621 Carpenter Road, LLC. The contingent earn-out arrangement requires the Company to pay the seller an earn-out amount based on AAIC's retention rate of customers since acquisition. The fair value of this contingent earn-out arrangement was estimated based on actual retention of customers. As of December 31, 2015 and 2014, the fair value of the contingent earn-out liability was \$-0- and \$74,129 as the retention rate of customers was met for the full payout. The Company recognized no income or expense related to the change in the fair value of this contingent earn-out arrangement for the years ended December 31, 2015 and 2014. The Company made the last remaining payment of \$74,129 during 2015 under this earn-out arrangement.

The following tables summarize assets and liabilities measured at fair value on a recurring basis as of December 31, 2015 and 2014, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Level 1	Level 2	Level 3
December 31, 2015			
Assets:			
Available-for-sale securities	\$ -	\$ 2,438,803	\$ -
Loans and financings held for sale or assignment	\$ -	\$ 42,666,107	\$ -
Mortgage and financing servicing rights	\$ -	\$ -	\$ 9,379,862
Interest and financing rate lock commitments	\$ -	\$ -	\$ 959,862
Liabilities:			
Forward sales commitments	\$ -	\$ -	\$ 58,111

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**NOTE 22 - FAIR VALUE MEASUREMENTS (Continued)**

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
December 31, 2014			
Assets:			
Available-for-sale securities	\$ -	\$ 1,254,154	\$ -
Loans and financings held for sale or assignment	\$ -	\$ 40,078,919	\$ -
Mortgage and financing servicing rights	\$ -	\$ -	\$ 7,900,842
Interest and financing rate lock commitments	\$ -	\$ -	\$ 1,065,770
Liabilities:			
Forward sales commitments	\$ -	\$ -	\$ 172,008
Contingent earn-out liability	\$ -	\$ -	\$ 74,129

The table below includes a roll forward of the fair value of assets and liabilities that are classified by the Company within Level 3 of the valuation hierarchy:

	<u>MSRs</u>	<u>IRLCs</u>	<u>Forward Sales Commitments</u>	<u>Contingent Earn-out Liability</u>
Fair value at January 1, 2014	\$ 7,170,318	\$ 396,855	\$ 80,837	\$ (153,310)
Purchases, sales, issuances, settlements, net	2,253,116	(396,855)	(80,837)	79,181
Net gains (losses)	<u>(1,522,592)</u>	<u>1,065,770</u>	<u>(172,008)</u>	<u>-</u>
Fair value December 31, 2014	7,900,842	1,065,770	(172,008)	(74,129)
Purchases, sales, issuances, settlements, net	3,188,991	(1,065,770)	172,008	74,129
Net gains (losses)	<u>(1,709,971)</u>	<u>959,862</u>	<u>(58,111)</u>	<u>-</u>
Fair value December 31, 2015	<u>\$ 9,379,862</u>	<u>\$ 959,862</u>	<u>\$ (58,111)</u>	<u>\$ -</u>

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**NOTE 22 - FAIR VALUE MEASUREMENTS (Continued)**

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

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Year ended December 31, 2015			
Real estate owned	\$ -	\$ 301,840	\$ -

There were no assets or liabilities measured at fair value on a nonrecurring basis during the year ended December 31, 2014.

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 due from banks, certificates of deposit, and Federal Home Loan Bank stock. The methodologies for other financial assets and financial liabilities are discussed below.

*Loans and Financings, Net*

The fair value of fixed-rate loans and financings is estimated by discounting the future cash flows for each loan and financing category using the current rates at which similar loans or financings would be made to borrowers with similar credit ratings and for the same remaining maturities. These loans and financings are considered to be Level 2 assets in the valuation hierarchy. The fair value of adjustable-rate loans is 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. These time deposits are considered to be Level 2 liabilities in the valuation hierarchy.

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**NOTE 22 - FAIR VALUE MEASUREMENTS (Continued)**

The estimated fair values of financial instruments are as follows (in thousands):

	December 31,			
	2015		2014	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Significant financial assets:				
Cash and due from banks	\$ 59,739	\$ 59,739	\$ 2,364	\$ 2,364
Restricted cash	1,002	1,002	1,001	1,001
Certificates of deposit	-	-	6,250	6,250
Securities available-for-sale	2,439	2,439	1,254	1,254
Federal Home Loan Bank stock	637	637	872	872
Loans and financings held for sale or assignment	42,666	42,666	40,079	40,079
Loans and financings, net	55,686	55,833	50,672	52,226
Mortgage and financing servicing rights	9,380	9,380	7,901	7,901
Derivatives	960	960	1,066	1,066
Significant financial liabilities:				
Deposits:				
Demand - non-interest bearing	\$ 131,835	\$ 131,835	\$ 72,233	\$ 72,233
Demand - interest bearing and profit sharing	16,567	16,567	18,362	18,362
Savings	436	436	305	305
Time	3,418	3,579	3,673	3,854
Derivatives	58	58	172	172

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2015 and 2014

**NOTE 23 – PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION**

**CONDENSED BALANCE SHEETS**

	<u>December 31,</u>	
	<u>2015</u>	<u>2014</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 63,389	\$ 423,494
Investment in University Bank	14,192,552	10,188,550
Accounts receivable - University Bank	505,000	-
Other assets	<u>61,575</u>	<u>121,161</u>
Total assets	<u>\$ 14,822,516</u>	<u>\$ 10,733,205</u>
<b>LIABILITIES AND EQUITY</b>		
Accounts payable and other liabilities	\$ 1,098	\$ 26,776
Preferred stock subject to mandatory redemption	<u>-</u>	<u>350,000</u>
Total liabilities	1,098	376,776
Total equity	<u>14,821,418</u>	<u>10,356,429</u>
Total liabilities and equity	<u>\$ 14,822,516</u>	<u>\$ 10,733,205</u>

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2015 and 2014

**NOTE 23 – PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION**  
(Continued)

**CONDENSED STATEMENTS OF OPERATIONS**

	<u>December 31,</u>	
	<u>2015</u>	<u>2014</u>
<b>OTHER INCOME</b>		
Interest and dividend income	\$ 391	\$ 770
<b>EXPENSES</b>		
Compensation and benefits	133,429	-
Professional fees and public listing	27,255	31,806
Other miscellaneous	15,157	13,555
Share-based compensation	-	8,062
Interest expense	<u>5,273</u>	<u>65,209</u>
Total expenses	<u>181,114</u>	<u>118,632</u>
Net loss before income taxes and net income of subsidiary	(180,723)	(117,862)
Income tax expense (benefit)	<u>(72,572)</u>	<u>5,751</u>
Net loss before net income of subsidiary	(108,151)	(123,613)
Net income of subsidiary	<u>3,247,368</u>	<u>878,794</u>
Net income	<u>\$ 3,139,217</u>	<u>\$ 755,181</u>

**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2015 and 2014

**NOTE 23 – PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION**  
(Continued)

**CONDENSED STATEMENTS OF CASH FLOWS**

	<b>December 31,</b>	
	<b>2015</b>	<b>2014</b>
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 3,139,217	\$ 755,181
Adjustments to reconcile net income to net cash flows from operating activities:		
Share-based compensation	-	8,062
Preferred dividends recorded as interest expense	5,273	65,209
Net change in:		
Accounts receivable and other assets	(914,729)	682,115
Accounts payable and other liabilities	(4,810)	6,000
Net income of subsidiary	<u>(3,247,368)</u>	<u>(878,794)</u>
Net cash provided by (used in) operating activities	<u>(1,022,417)</u>	<u>637,773</u>
<b>INVESTING ACTIVITIES</b>		
Dividends received from University Bank	<u>973,390</u>	<u>483,000</u>
<b>FINANCING ACTIVITIES</b>		
Redemption of preferred stock	(350,000)	(681,450)
Repurchase of common stock	(105,000)	-
Payment of preferred dividends	(26,049)	(184,315)
Exercise of stock options	<u>169,971</u>	<u>105,178</u>
Net cash used in financing activities	<u>(311,078)</u>	<u>(760,587)</u>
<b>NET CHANGE IN CASH</b>	(360,105)	360,186
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>423,494</u>	<u>63,308</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$ 63,389</u>	<u>\$ 423,494</u>



**UNIVERSITY BANCORP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2015 and 2014**

**NOTE 24 – SUBSEQUENT EVENTS**

In early 2016, University Bancorp, Inc. paid a dividend totaling approximately \$546,000 to its common shareholders.