# UNIVERSITY BANCORP, INC.
# AND SUBSIDIARIES

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2013 and 2012

# 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, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, 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 entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

To the Board of Directors and Stockholders
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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, 2013 and 2012, 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 31, 2014

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

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| **ASSETS** | | |
| Cash and due from banks | **$ 6,152,472** | $ 9,152,534 |
| Restricted cash | **1,000,000** | - |
| Certificates of deposit | **7,000,000** | 7,250,000 |
| Trading securities, at fair value | **-** | 662,058 |
| Investment securities available-for-sale, at fair value | **1,703,676** | 1,627,780 |
| Federal Home Loan Bank stock, at cost | **1,072,300** | 1,072,300 |
| Loans and financings held for sale, at fair value | **27,407,166** | 43,645,515 |
| Loans and financings, net | **48,496,466** | 53,744,139 |
| Premises and equipment, net | **4,579,450** | 4,436,122 |
| Mortgage servicing rights, at fair value | **7,170,318** | 3,963,470 |
| Real estate owned, net | **431,553** | 851,633 |
| Accounts receivable | **666,282** | 972,226 |
| Accrued interest and financing income receivable | **179,714** | 222,454 |
| Prepaid expenses | **659,085** | 702,803 |
| Derivatives, at fair value | **477,692** | 830,813 |
| Goodwill | **356,310** | 356,310 |
| Customer relationships, net | **426,857** | 498,000 |
| Investor remittances receivable | **1,371,062** | 343,566 |
| Refundable federal income taxes | **503,856** | - |
| Deferred income taxes, net | **1,464,102** | 1,630,079 |
| Other assets | **94,023** | 212,841 |
| Total assets | **$ 111,212,384** | $ 132,174,643 |

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

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| **LIABILITIES AND EQUITY** | | |
| **LIABILITIES** | | |
| Deposits: | | |
| Demand - non-interest bearing | **$ 59,184,454** | $ 77,499,390 |
| Demand - interest bearing and profit sharing | **20,692,435** | 21,754,187 |
| Savings | **277,899** | 270,836 |
| Time | **5,378,071** | 8,644,469 |
| Total deposits | **85,532,859** | 108,168,882 |
| Derivatives, at fair value | **-** | 43,367 |
| Accounts payable | **549,000** | 690,887 |
| Accrued interest and profit sharing payable | **6,768** | 7,248 |
| Allowance for loan recourse | **338,026** | 623,943 |
| Escrow and mortgage insurance liabilities | **332,877** | 388,758 |
| Liability to fund closed but undisbursed loans | **1,239,513** | 3,806,795 |
| Investor remittances payable | **2,237,748** | 878,238 |
| Contingent earn-out liability, at fair value | **153,310** | 153,310 |
| Accrued federal income taxes | **-** | 253,454 |
| Deferred income taxes | **3,431,389** | 2,342,954 |
| Accrued expenses and other liabilities | **2,228,059** | 2,146,891 |
| Preferred stock subject to mandatory redemption | **1,031,450** | 1,031,450 |
| Total liabilities | **97,080,999** | 120,536,177 |
| **EQUITY** | | |
| University Bancorp, Inc. stockholders' equity: | | |
| Common stock, $.01 par value per share; 5,000,000 shares authorized; 4,782,782 shares issued as of December 31, 2013 and 2012 | **47,828** | 47,828 |
| Additional paid-in capital | **6,267,158** | 6,296,334 |
| Treasury stock, at cost; 89,954 and 115,184 shares held as of December 31, 2013 and 2012, respectively | **(265,940)** | (340,530) |
| Retained earnings | **3,309,851** | 1,483,843 |
| Accumulated other comprehensive income | **80,588** | 65,646 |
| Equity attributable to stockholders of University Bancorp, Inc. | **9,439,485** | 7,553,121 |
| Noncontrolling interest | **4,691,900** | 4,085,345 |
| Total equity | **14,131,385** | 11,638,466 |
| Total liabilities and equity | **$ 111,212,384** | $ 132,174,643 |

*See notes to consolidated financial statements.*

## UNIVERSITY BANCORP, INC. AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

| | Years ended December 31, 2013 | 2012 |
|---|---|---|
| Interest and financing income: | | |
| Interest and fees on loans and financing income | **$ 4,170,010** | $ 4,539,798 |
| Interest on securities: | | |
| U.S. Government agencies | **52,081** | 54,383 |
| Other securities | **40,675** | 35,539 |
| Interest on federal funds and other | **199,786** | 205,752 |
| Total interest and financing income | **4,462,552** | 4,835,472 |
| Interest and profit sharing expense: | | |
| Interest and profit sharing on deposits: | | |
| Demand deposits | **29,426** | 285,385 |
| Savings deposits | **278** | 365 |
| Time deposits | **101,268** | 96,625 |
| Other | **93,085** | 95,519 |
| Total interest and profit sharing expense | **224,057** | 477,894 |
| Net interest and financing income | **4,238,495** | 4,357,578 |
| Provision for loan losses | **100,153** | 1,395,063 |
| Net interest and financing income after provision for loan losses | **4,138,342** | 2,962,515 |
| Other income (loss): | | |
| Loan servicing and sub-servicing fees | **7,636,457** | 6,477,725 |
| Initial loan set-up and other fees | **6,032,716** | 6,559,971 |
| Gain on sale of mortgage loans, net | **18,178,860** | 19,986,094 |
| Insurance & investment fee income | **674,663** | 265,664 |
| Deposit service charges and fees | **9,346** | 6,443 |
| Net gain (loss) on trading securities | **(34,116)** | 782 |
| Change in fair value of mortgage servicing rights | **1,151,405** | (101,908) |
| Change in fair value of loans held for sale, interest rate locks and forward commitments | **591,520** | 1,819,732 |
| Other income | **153,170** | 141,150 |
| Total other income, net | **34,394,021** | 35,155,653 |

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

| | Years ended December 31, | |
|---|---|---|
| | **2013** | **2012** |
| Other expenses: | | |
| Compensation and benefits | **$ 24,138,898** | $ 21,472,124 |
| Occupancy | **1,555,150** | 1,364,047 |
| Data processing and equipment expense | **1,712,441** | 1,542,236 |
| Legal and audit | **1,271,917** | 681,888 |
| Consulting fees | **560,717** | 827,185 |
| Mortgage banking | **2,037,228** | 3,842,515 |
| Advertising | **620,274** | 716,210 |
| Membership and training | **392,550** | 342,621 |
| Travel and entertainment | **403,877** | 392,158 |
| Supplies and postage | **815,096** | 758,385 |
| Insurance | **271,210** | 277,380 |
| Other real estate expense, net | **115,399** | 663,628 |
| Director related expenses | **172,984** | 211,066 |
| FDIC assessments | **132,202** | 156,752 |
| Noncontrolling interest tax sharing fee | **447,385** | 52,615 |
| Amortization of customer relationships | **71,143** | - |
| Other operating expenses | **134,999** | 138,695 |
| Total other expenses | **34,853,470** | 33,439,505 |
| Income before income taxes | **3,678,893** | 4,678,663 |
| Income tax expense | **1,246,330** | 1,955,885 |
| **Net income** | **$ 2,432,563** | $ 2,722,778 |
| **COMPREHENSIVE INCOME** | | |
| Net income | **$ 2,432,563** | $ 2,722,778 |
| Net unrealized gain (loss) on securities available-for-sale | **14,942** | (22,381) |
| **COMPREHENSIVE INCOME** | **$ 2,447,505** | $ 2,700,397 |
| Net income and comprehensive income attributable to the noncontrolling interests | **$ 606,555** | $ 806,919 |
| **Net income attributable to common stockholders of University Bancorp, Inc.** | **$ 1,826,008** | $ 1,915,859 |
| **Comprehensive income attributable to common stockholders of University Bancorp, Inc.** | **$ 1,840,950** | $ 1,893,478 |

*See notes to consolidated financial statements.*

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

| | University Bancorp, Inc. Stockholders' | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Common Stock $.01 Par value | | Additional | Treasury Stock | | Retained Earnings | Accumulated Other Compre- | Non- | |
| | Number of Shares | Par Value | Paid-in Capital | Number of Shares | Cost | (Accumulated Deficit) | hensive Income | controlling Interest | Total |
| **Balance at January 1, 2012** | 4,757,782 | $ 47,578 | $ 6,524,099 | (115,184) | $ (340,530) | $ (432,016) | $ 88,027 | $ 3,496,116 | $ 9,383,274 |
| Exercise of stock options | 25,000 | 250 | 24,750 | - | - | - | - | - | 25,000 |
| Share-based compensation | - | - | 94,000 | - | - | - | - | - | 94,000 |
| Net unrealized loss on securities available-for-sale | - | - | - | - | - | - | (22,381) | - | (22,381) |
| Acquisition of noncontrolling interest | - | - | (346,515) | - | - | - | - | (217,690) | (564,205) |
| Net income | - | - | - | - | - | 1,915,859 | - | 806,919 | 2,722,778 |
| **Balance at December 31, 2012** | 4,782,782 | 47,828 | 6,296,334 | (115,184) | (340,530) | 1,483,843 | 65,646 | 4,085,345 | 11,638,466 |
| Net unrealized gain on securities available-for-sale | - | - | - | - | - | - | 14,942 | - | 14,942 |
| Exercise of stock options | - | - | (29,176) | 25,230 | 74,590 | - | - | - | 45,414 |
| Net income | - | - | - | - | - | 1,826,008 | - | 606,555 | 2,432,563 |
| **Balance at December 31, 2013** | 4,782,782 | $ 47,828 | $ 6,267,158 | (89,954) | $ (265,940) | $ 3,309,851 | $ 80,588 | $ 4,691,900 | $ 14,131,385 |

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

| | Years ended December 31, 2013 | 2012 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Net income | **$ 2,432,563** | $ 2,722,778 |
| Adjustments to reconcile net income to net cash flows from operating activities: | | |
| Depreciation and amortization | **925,994** | 691,691 |
| Change in fair value of mortgage servicing rights | **(1,151,405)** | 101,908 |
| Change in fair value of loans held for sale, interest rate locks and forward commitments | **(591,520)** | (1,819,732) |
| Deferred income tax expense | **1,254,412** | 1,560,300 |
| Provision for loan losses | **100,153** | 1,395,063 |
| Net gain on sale of mortgages | **(18,178,860)** | (19,986,094) |
| Net (gain) loss on trading securities | **34,116** | (782) |
| Proceeds from maturities of trading securities | **139,847** | 123,936 |
| Net gain on sale of other real estate owned | **(35,852)** | (5,347) |
| Net amortization on investment securities | **1,722** | 2,354 |
| Write down of other real estate owned | **-** | 327,231 |
| Originations of mortgage loans and financings | **(565,088,069)** | (588,680,377) |
| Proceeds from mortgage loan and financing sales | **598,065,192** | 597,784,229 |
| Share-based compensation | **-** | 94,000 |
| Preferred dividends recorded as interest expense | **93,085** | 93,938 |
| Deposit of restricted cash | **(1,000,000)** | - |
| Net change in: | | |
| Various other assets | **(1,020,132)** | (37,252) |
| Various other liabilities | **(1,671,391)** | 3,008,237 |
| Net cash provided by (used in) operating activities | **14,309,855** | (2,623,919) |
| **INVESTING ACTIVITIES** | | |
| Proceeds from maturities of securities available-for-sale | **425,419** | 952,203 |
| Proceeds from sale of real estate owned | **644,938** | 710,331 |
| Loans granted and repayments, net | **4,958,514** | 750,199 |
| Purchases of premises and equipment | **(998,179)** | (858,300) |
| Acquisition of business | **-** | (986,603) |
| Redemptions (purchases) of certificates of deposit, net | **250,000** | (1,000,000) |
| Purchase of securities available-for-sale | **-** | (23,458) |
| Net cash provided by (used in) investing activities | **5,280,692** | (455,628) |

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

| | Years ended December 31, 2013 | 2012 |
|---|---|---|
| **FINANCING ACTIVITIES** | | |
| Net change in deposits | **$ (22,636,023)** | $ 3,672,241 |
| Acquisition on noncontrolling interest | **-** | (500,000) |
| Exercise of stock options | **45,414** | 25,000 |
| Redemption of preferred stock | **-** | (17,820) |
| Net cash provided by (used in) financing activities | **(22,590,609)** | 3,179,421 |
| **NET CHANGE IN CASH AND CASH EQUIVALENTS** | **(3,000,062)** | 99,874 |
| **Cash and Cash Equivalents, Beginning of Year** | **9,152,534** | 9,052,660 |
| **Cash and Cash Equivalents, End of Year** | **$ 6,152,472** | $ 9,152,534 |
| **SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:** | | |
| Cash paid during the year for: | | |
| Interest | **$ 131,452** | $ 182,710 |
| Income taxes | **$ 759,237** | $ 103,672 |
| **SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTIONS:** | | |
| Mortgage loans converted to real estate owned and other assets | **$ 189,006** | $ 769,393 |
| Dividends payable on preferred stock converted to additional shares of preferred stock | **$ -** | $ 89,220 |

*See notes to consolidated financial statements.*

## 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, Inc. (the "Bank"), the Bank's wholly owned subsidiaries, Ann Arbor Insurance Centre, Inc. ("AAIC"), Hoover, LLC ("Hoover"), and University Lending Group, LLC ("ULG"); and the Bank's two 80% owned subsidiaries, Midwest Loan Services, Inc. ("Midwest") and University Islamic Financial Corporation ("UIF"). 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. AAIC and 2621 Carpenter Road LLC were acquired on December 27, 2012. 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 and mutual fund sales, life insurance, property casualty insurance and foreign currency exchange. The Bank's customer base is primarily located in the Ann Arbor, Michigan 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.

## 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 and Florida. 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 engaged in Islamic Banking and was formed on December 30, 2005. UIF is based in Farmington Hills, Michigan. Its current products, which comply with federal, state and Islamic (Sharia'a) law, are deposits that are insured by the Federal Deposit Insurance Corporation (the "FDIC"), home financings (as agent for the Bank), and home financings and commercial real estate financings (as principal for its own account). The Sharia'a compliant products are offered to service the large number of Muslim customers in the general area of the Company.

There are two distinct home financing products offered using Ijara and Murabaha contracts.

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

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

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

The Company records these contracts at fair value for the short period of time that they are held before settlement with Freddie Mac. The installment contracts are sold with servicing retained. Thus, the value of the installment contract and value of the servicing is determined to calculate the fair value and any gain or loss on the sale of the underlying installment contract. See Note 22 for additional discussion of the determination of fair value.

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

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

On the liability side of the balance sheet, the Bank also offers FDIC–insured deposits that use the Murabaha method of profit sharing. These deposits are specifically invested in Sharia'a compliant investments such as, but not limited to, transactions structured using the Ijara and Murabaha methods. Sharia'a compliant savings, money markets and certificates of deposit pay out earnings that are derived specifically from the revenues from the Sharia'a compliant investments net of certain expenses. In compliance with the FDIC definition of a deposit, balances in these accounts, like all deposit accounts, are FDIC insured. The sharing of earnings paid out to the depositors holding these accounts can fluctuate to as low as zero percent with the net earnings of the Ijara portfolio and or other Sharia'a compliant investments. The earnings paid to the depositors 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 Sharia'a compliant deposits, the Company uses the balance sheet account title "Demand deposits – interest bearing and profit sharing" instead of the typical title of "Demand deposits – interest bearing". In the 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 servicing rights, the allowance for loan losses, the identification and valuation of impaired loans, the valuation of other real estate owned, impairment analysis of goodwill and other intangible assets, the valuation allowance for deferred tax assets, the fair value of certain loans held for sale and derivative instruments such as mortgage interest rate locks and forward commitments, recourse liabilities related to loans sold and loans held for sale, liabilities to investors for penalties related to loss mitigation for loans subserviced, the valuation of stock options and related stock based-compensation, the fair value of assets acquired in the business combination, the fair value of the contingent earn-out liability, and the determination and the fair value of other financial instruments.

## 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 loan and deposit transactions and interest bearing deposits with other banks.

### Securities

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

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

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

### Allowance for Loan Losses

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

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

The Company used the following useful lives as of December 31, 2013 and 2012:

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

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

### Mortgage Banking Activities

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

An allowance was booked for potential recourse liabilities related to loans sold and loans held for sale in the amount of $338,026 and $623,943 as of December 31, 2013 and 2012, respectively.

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

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

### Real Estate Owned

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

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

**Derivative Instruments**

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

Outstanding IRLCs expose the Company to the risk that the price of the loans underlying the commitments might decline from inception of the interest rate lock to the funding of the loan. To protect against this risk, the Company utilizes forward loan sales commitments to economically hedge the risk of potential changes in the value of the loans that would result from the commitments. These forward commitments are valued at fair value (see Note 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 2013 and 2012 resulted in no impairment losses.

## 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 2013 or 2012.

### 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, 2013 and 2012, there was no accrual for uncertain tax positions.

None of the Company's federal or state income tax returns are currently under examination by the Internal Revenue Service ("IRS") or state authorities. However, fiscal years 2010 and later remain subject to examination by the IRS and its respective states.

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.

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

### Reclassifications

Certain amounts in the 2012 consolidated financial statements have been reclassified to conform to presentation adopted in 2013.

### Subsequent Events

The Company has performed a review of events subsequent to the balance sheet date through March 31, 2014, the date the consolidated financial statements were available to be issued.

## 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, 2013 and 2012, this reserve requirement amounted to $1,579,000 and $2,140,000, 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. This amount is shown as restricted cash in the consolidated balance sheets.

## NOTE 3 – INVESTMENT SECURITIES

### Trading Securities

The Bank's trading securities portfolio had a net accumulated unrealized gain of $-0- and $34,116 at December 31, 2013 and 2012, respectively.

Trading securities consist of the following:

| | December 31, | |
|---|---|---|
| | 2013 | 2012 |
| U.S. agency mortgage-backed securities | $ - | $ 662,058 |

During 2013, the Company transferred its trading securities into the available-for-sale category. Unrealized gains and losses at the date of the transfer between categories were not significant.

## NOTE 3 – INVESTMENT SECURITIES (Continued)

### Available-for-Sale Securities

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

Securities available-for-sale at December 31, 2013 consists of the following:

| | Amortized Cost | Unrealized Gain | Fair Value |
|---|---|---|---|
| U.S. agency mortgage-backed securities | $ 1,623,088 | $ 80,588 | $ 1,703,676 |

Securities available-for-sale at December 31, 2012 consists of the following:

| | Amortized Cost | Unrealized Gain | Fair Value |
|---|---|---|---|
| U.S. agency mortgage-backed securities | $ 1,562,134 | $ 65,646 | $ 1,627,780 |

At December 31, 2013 and 2012, the fair value of trading and available-for-sale securities pledged to secure certain borrowings were $1,703,676 and $2,289,838, respectively. The balance of these borrowings at both December 31, 2013 and 2012 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 $565,266 and $1,076,139 for the years ended December 31, 2013 and 2012, respectively.

## NOTE 4 – LOANS AND FINANCINGS, NET

Major classifications of loans are as follows:

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Commercial | $ 29,362,492 | $ 32,095,307 |
| Residential real estate | 19,863,213 | 22,521,766 |
| Installment | 59,140 | 123,392 |
| Credit cards | 179,865 | 161,856 |
| Gross loans | 49,464,710 | 54,902,321 |
| Allowance for loan losses | (968,244) | (1,158,182) |
| Net loans | $ 48,496,466 | $ 53,744,139 |

Changes in the allowance for loan losses were as follows:

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Balance, beginning of year | $ 1,158,182 | $ 1,072,317 |
| Provision charged to operations | 100,153 | 1,395,063 |
| Recoveries | 12,079 | 12,819 |
| Charge-offs | (302,170) | (1,322,017) |
| Balance, end of year | $ 968,244 | $ 1,158,182 |

Information regarding impaired loans is as follows:

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Impaired loans: | | |
| Loans with allowance allocated | $ 1,956,778 | $ 1,281,325 |
| Amount of allowance for loan losses allocated | $ 325,160 | $ 325,160 |
| Impaired loans: | | |
| Average balance during the year | $ 2,090,131 | $ 813,684 |
| Interest income recognized thereon | $ 167,262 | $ 91,219 |
| Cash basis interest income recognized | $ 155,903 | $ 84,743 |

**NOTE 4 – LOANS AND FINANCINGS, NET** (Continued)

The following tables present informative data by class of loan and financings regarding their age and interest or financing income accrual status at December 31, 2013 and 2012 (in thousands):

| December 31, 2013 | Current | Past Due 30-59 Days | Past Due 60-89 Days | Past Due ≥ 90 Days | Total Past Due | Total Loans and Financings |
|---|---|---|---|---|---|---|
| Commercial | $ 1,281 | $ - | $ - | $ - | $ - | $ 1,281 |
| Commercial real estate | 28,082 | - | - | - | - | 28,082 |
| Consumer | 59 | - | - | - | - | 59 |
| Credit card | 180 | - | - | - | - | 180 |
| Residential mortgage loans | 19,082 | 781 | - | - | 781 | 19,863 |
| Total | $ 48,684 | $ 781 | $ - | $ - | $ 781 | $ 49,465 |

| December 31, 2012 | Current | Past Due 30-59 Days | Past Due 60-89 Days | Past Due ≥ 90 Days | Total Past Due | Total Loans and Financings |
|---|---|---|---|---|---|---|
| Commercial | $ 2,181 | $ - | $ - | $ - | $ - | $ 2,181 |
| Commercial real estate | 29,914 | - | - | - | - | 29,914 |
| Consumer | 123 | - | - | - | - | 123 |
| Credit card | 162 | - | - | - | - | 162 |
| Residential mortgage loans | 22,306 | 104 | 60 | 52 | 216 | 22,522 |
| Total | $ 54,686 | $ 104 | $ 60 | $ 52 | $ 216 | $ 54,902 |

| December 31, 2013 | Accrual Status: Total Loans and Financings on Nonaccrual Status | Accrual Status: Loans and Financings Past Due ≥ 90 Days and Still Accruing |
|---|---|---|
| Commercial | $ - | $ - |
| Commercial real estate | - | - |
| Consumer | - | - |
| Credit card | - | - |
| Residential mortgage loans | 11 | - |
| Total | $ 11 | $ - |

**NOTE 4 – LOANS AND FINANCINGS, NET** (Continued)

| | Accrual Status | |
|---|---|---|
| December 31, 2012 | 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 mortgage loans | 40 | 52 |
| Total | $ 40 | $ 52 |

## 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 $14.5 billion and $12.2 billion as of December 31, 2013 and 2012, 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 to the secondary market with servicing rights retained for selective loans. These loans are owned by other institutions and are not included in the Company's consolidated balance sheets, but the mortgage servicing rights are included in the accompanying consolidated financial statements. Such mortgage loans have been sold predominately without recourse or with limited recourse. The unpaid principal balance of these loans was $665.8 million and $539.7 million at December 31, 2013 and 2012, respectively.

Custodial escrow balances maintained in connection with these loans were $136.7 million and $145.7 million, at December 31, 2013 and 2012, respectively, and were not included in the accompanying consolidated financial statements.

**NOTE 5 – MORTGAGE BANKING ACTIVITIES** (Continued)

The following summarizes the activity relating to mortgage servicing rights:

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Balance, January 1 | $ 3,963,470 | $ 2,452,156 |
| Amount capitalized | 2,055,443 | 1,613,222 |
| Change in fair value | 1,151,405 | (101,908) |
| Balance, December 31 | $ 7,170,318 | $ 3,963,470 |

The Company enters into IRLCs in connection with its mortgage banking activities to fund residential mortgage loans at specified times in the future. As of December 31, 2013 and 2012, IRLCs amounted to $19.2 million and $42.5 million, respectively, of which management estimated $16.6 million and $34.6 million, respectively, to eventually close and be funded. These IRLCs were recorded in assets in the consolidated balance sheets at a fair value of $396,855 and $830,813 as of December 31, 2013 and 2012, respectively.

The Company also utilizes forward loan sales commitments in order to economically hedge the risk of potential changes in the value of the loans that would result from the IRLCs. Forward sales commitments to fund loans at specified rates amounted to $24.5 million and $27.4 million as of December 31, 2013 and 2012, respectively, which were respectively recorded in assets and liabilities in the consolidated balance sheets at a fair value of $80,837 and ($43,367) as of December 31, 2013 and 2012, respectively.

The net change in fair value of the IRLCs and the related forward loan sales commitments held at December 31, 2013 and 2012 resulted in a loss of $309,754 and a gain of $226,465, respectively, which has been recognized in the other income section in the consolidated statements of operations. These gains are due principally to the inclusion of day one gains associated with the adoption of fair value accounting as discussed in Note 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 of the related loans.

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

## NOTE 6 – PREMISES AND EQUIPMENT, NET

Premises and equipment consist of the following:

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Land | $ 562,500 | $ 562,500 |
| Buildings and improvements | 2,997,982 | 2,787,699 |
| Furniture, fixtures, equipment and software | 6,964,298 | 6,211,494 |
| | 10,524,780 | 9,561,693 |
| Less accumulated depreciation and amortization | (5,945,330) | (5,125,571) |
| Premises and equipment, net | $ 4,579,450 | $ 4,436,122 |

Depreciation and amortization expense related to premises and equipment amounted to $854,851 and $691,691 for the years ended December 31, 2013 and 2012, respectively.

Midwest, UIF, and ULG each lease office space for their respective operations. ULG and UIF also lease office space for its 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 notice ranging from thirty to ninety days, and a fee. The Company leases various other facilities at varying rates on a month-to-month basis. Total rent expense for all operating leases was approximately $774,000 and $664,000 in 2013 and 2012, respectively.

The following table summarizes the future minimum payments under the contractual obligations of the Company as of December 31, 2013:

| Year ended December 31, | Amount |
|---|---|
| 2014 | $ 482,249 |
| 2015 | 202,350 |
| 2016 | 29,071 |
| | $ 713,670 |

## NOTE 7 – GOODWILL

The following table summarizes goodwill by subsidiary:

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Midwest | $ 103,914 | $ 103,914 |
| AAIC | 252,396 | 252,396 |
| | $ 356,310 | $ 356,310 |

As discussed in Note 23, during 2012, the Company recorded goodwill related to its acquisition of AAIC and 2621 Carpenter Road, LLC.

## 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 discussed in Note 23. These customer relationships will be amortized on a straight-line basis over their estimated economic lives, which were determined to be seven years. As the acquisition occurred at the end of 2012, amortization expense amounted to $71,143 and $-0- for the years ended December 31, 2013 and 2012, respectively. Amortization expense related to these customer relationships is expected to be approximately $71,143 in each of the next six years.

## NOTE 9 – TIME DEPOSITS

Time deposit liabilities issued in denominations of $100,000 or more were $2,047,363 and $5,687,282 at December 31, 2013 and 2012, respectively.

At December 31, 2013, stated maturities of time deposits were:

| Year ended December 31, | Amount |
|---|---|
| 2014 | $ 3,258,427 |
| 2015 | 283,207 |
| 2016 | 530,080 |
| 2017 | 622,120 |
| 2018 and thereafter | 684,237 |
| | $ 5,378,071 |

## 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.

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 2013, a special distribution event occurred in which the employee was paid $65,000 which represented a portion of the accrued liability. In relation to the Agreement, the Company recognized compensation expense of $99,719 and $55,225 during the years ended December 31, 2013 and 2012, respectively, and recorded accrued deferred compensation of $89,944 and $55,225 as of December 31, 2013 and 2012, respectively. Accrued deferred compensation is included in “Accrued expenses and other liabilities” in the consolidated balance sheets.

## NOTE 11 – INCOME TAXES

Income tax expense for the years ended December 31, 2013 and 2012 is summarized as follows:

| | December 31, | |
|---|---|---|
| | 2013 | 2012 |
| Current | $ (8,082) | $ 395,585 |
| Deferred | 1,254,412 | 1,651,300 |
| Decrease in valuation allowance | - | (91,000) |
| Income tax expense | $ 1,246,330 | $ 1,955,885 |

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 and the change in the valuation allowance. Based on management’s estimates of future income, during 2012, management decreased the valuation allowance in order to increase the related deferred tax assets to an amount that is more likely than not to be realized.

Significant components of the Company’s deferred income tax assets and liabilities as of December 31, 2013 and 2012 are as follows:

**NOTE 11 – INCOME TAXES** (Continued)

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Deferred income tax assets: | | |
| Allowance for loan losses and recourse liabilities | $ 244,244 | $ 423,747 |
| Tax credit carry-forward | 1,095,591 | 1,046,197 |
| Real estate owned | 42,330 | 66,896 |
| Premises and equipment | - | 15,488 |
| Other | 81,937 | 77,751 |
| Deferred tax asset | 1,464,102 | 1,630,079 |
| Deferred income tax liabilities: | | |
| Mortgage servicing rights | 2,437,909 | 1,347,580 |
| Derivatives and LHFS | 468,848 | 812,636 |
| Premises and equipment | 379,008 | - |
| Customer relationships | 145,131 | 169,320 |
| Other | 493 | 13,418 |
| Deferred tax liability | 3,431,389 | 2,342,954 |
| | (1,967,287) | (712,875) |
| Valuation allowance | - | - |
| Net deferred tax asset (liability) | $ (1,967,287) | $ (712,875) |

| | | |
|---|---|---|
| Unused Credits: | | |
| Low income housing credits | $ 994,009 | Beginning 2018 |
| Minimum tax credits | $ 101,582 | N/A |

## NOTE 12 – PREFERRED STOCK SUBJECT TO MANDATORY REDEMPTION

As of December 31, 2013 and 2012, the Company had 500,000 shares of preferred stock authorized with a $.001 par value per share. There were 103,145 shares of this preferred stock issued and outstanding as of both December 31, 2013 and 2012, 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 2013. During 2012, dividends of $89,220 were paid-in-kind with 8,922 shares of preferred stock. The preferred stock was mandatorily redeemable by the Company no later than April 30, 2012, at $10 per share plus all accrued and unpaid dividends through the redemption date. During 2012, all of the preferred shareholders agreed to extend the mandatory redemption date to April 30, 2014, except for one shareholder, whose 1,782 preferred shares were redeemed in 2012 for $17,820.

During 2013 and 2012, the Company declared preferred dividends of $93,085 and $93,938, 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, 2013 and 2012, the Company had unpaid preferred dividends of $139,882 and $46,797, respectively, which are included in accrued expenses and other liabilities in the consolidated balance sheets. The amount the Company would be required to pay to redeem the stock at December 31, 2013 is $1,031,450 plus accrued dividends of $139,882.

## 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.

**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, 2012 | 173,563 | $ 1.85 |
| Granted | 183,662 | 1.80 |
| Exercised | (25,000) | 1.00 |
| Expired or forfeited | (75,000) | 1.33 |
| Outstanding at December 31, 2012 | 257,225 | 2.14 |
| Granted | - | - |
| Exercised | (25,230) | 1.80 |
| Expired or forfeited | (25,000) | 2.00 |
| Outstanding at December 31, 2013 | 206,995 | $ 2.20 |

| | |
|---|---|
| At December 31, 2013: | |
| Number of options immediately exercisable | 206,995 |
| Weighted average exercise price of immediately exercisable options | $2.20 |
| Range of exercise price of options outstanding | $1.80 - $3.50 |
| Weighted average remaining life of options outstanding | 2.3 years |

During 2013 and 2012, the Company received cash of $45,414 and $25,000, respectively, related to the exercise of options. As of the exercise date, the intrinsic value of the options exercised was approximately $24,000 and $5,000 for the years ended December 31, 2013 and 2012, 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 2012 were fully vested at the grant date. The Company recognized share-based compensation expense of $-0- and $94,000 during the years ended December 31, 2013 and 2012, respectively. The weighted-average grant-date fair value of stock options granted during 2012 was $0.51 per option. As of December 31, 2013 and 2012, all outstanding options were fully vested.

**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 2012:

| | |
|---|---|
| Risk-free interest rate | 0.3% - 0.9% |
| Expected volatility | 53% |
| Expected term | 2 - 5 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 and upon reaching the age of twenty-one. The employees' share in the Company's contribution is based on their current compensation as a percentage of the total employee compensation. Upon retirement from the ESOP, participants can receive distributions of their allocated shares of the Company's stock. The Company incurred expense related to contributions to the ESOP of $68,943 and $-0- for the years ended December 31, 2013 and 2012, respectively. Of these contributions, all $68,943 related to 2012, but were not approved by the Board until the middle of 2013. Additional contributions related to 2013 may be made out of the approved profit sharing pool discussed in Note 16.

The annual contribution to the ESOP is at the discretion of the Board of Directors. Assets of the ESOP are comprised entirely of 90,148 and 62,349 shares of the Company's stock at December 31, 2013 and 2012, respectively, all of which were fully allocated. The assets of the ESOP are held in trust and were valued at $324,533 and $148,391 at December 31, 2013 and 2012, respectively.

## NOTE 15 – NONCONTROLLING INTEREST

The Bank owns an 80% interest in the common stock of Midwest, with the remaining 20% owned by the President of Midwest. At December 31, 2013 and 2012, total equity of Midwest was $10,406,522 and $9,320,688, respectively, resulting in a $2,081,304 and $1,864,141 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, 2013 and 2012, total equity of UIF was $26,680,980 and $44,420,635, respectively, which includes $10,000,000 in common stock as of both December 31, 2013 and 2012, and $13,628,000 and $33,315,000 of preferred stock as of December 31, 2013 and 2012, respectively. The noncontrolling interest at December 31, 2013 and 2012 was $2,610,596 and $2,221,204, respectively.

UIF has an agreement that calls for UIF to pay a fee to the noncontrolling interest, based on UIF standalone taxable income. These fees are included in "Noncontrolling interest tax sharing fee" in the consolidated statements of operations and comprehensive income, and amounted to $447,385 and $52,615 for the years ended December 31, 2013 and 2012, respectively. UIF is only required to pay a cumulative amount of $500,000 to the noncontrolling interest under this agreement. As of December 31, 2013, UIF had incurred all expense related to this agreement.

Also, included in the consolidated financial statements are the results for ULG. As of December 31, 2011 the Bank owned 87.5% of ULG, with the remaining amounts owned by an executive of ULG. During 2012, the Company acquired the remaining 12.5% for $500,000. As a result, as of December 31, 2012, the Company owned 100% of ULG.

In accordance with ULG's operating agreement that in effect while there was a noncontrolling interest, ULG was to make annual distributions to its members to be used to pay the members' tax liability associated with the members' ownership in ULG. ULG made no distributions to the noncontrolling interest during the year ended December 31, 2012.

## 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 incurred expense related to matching contributions of $758,428 and $-0- for the years ended December 31, 2013 and 2012, respectively. Of these matching contributions, $358,750 related to 2012, but was not approved by the Board until the middle of 2013. The additional $399,678 is a profit sharing pool that relates to 2013 and was approved by the Board, some of which may end up being allocated to the ESOP plan discussed in Note 14.

## 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:

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Unused lines of credit | $ 1,090,407 | $ 747,483 |
| Unused credit card limits | 795,917 | 686,646 |
| | $ 1,886,324 | $ 1,434,129 |

### Contingencies

On September 26, 2012, the Bank entered into a consent agreement with the FDIC and the OFIR to cease and desist from certain unsafe and unsound banking practices and violations as defined in the order. The order required that management of the Bank coordinate the performance of certain assessments, along with the implementation of certain compliance, operational and procedural changes within specified periods of time as defined in the order. The order was released on June 4, 2013.

The Company has been party to various legal claims that have arisen from time to time in the normal course of business, which, in the opinion of management, will not have a material effect on the Company's consolidated financial statements.

## NOTE 18 – RELATED PARTY TRANSACTIONS

Available lines of credit to directors, officers and their affiliates at December 31, 2013 and 2012 amounted to $83,101 and $125,000, of which $52,630 and $46,834 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, 2013 and 2012.

The Bank had demand deposits of $755,602 and $601,190 from directors, officers and their affiliates as of December 31, 2013 and 2012, respectively. The Bank also holds demand deposits from various employees in the normal course of business.

## NOTE 19 – FEDERAL HOME LOAN BANK ADVANCES

The Bank has a line of credit available from the FHLB. The limit on this line was $2,500,000 and $3,000,000 as of December 31, 2013 and 2012, respectively. There were no advances on this line of credit as of December 31, 2013 and 2012. Borrowings are secured by the pledge of specific mortgage loans held for investment along with FHLB stock, trading securities, and available-for-sale securities. As of December 31, 2013 and 2012, the Bank had unutilized and available credit under the line of credit of $2,500,000 and $3,000,000, respectively.

## 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 Company is currently required to get written consent prior to declaring or paying any dividend. The Bank paid no dividends to the holding company, University Bancorp, Inc., during 2013 and 2012. University Bancorp, Inc. did not pay any dividends to common shareholders during 2013 or 2012.

### 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.

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

**Regulatory Capital Requirements** (Continued)

The Bank is also subject to prompt corrective action capital requirement regulations set forth by the FDIC. The FDIC requires the Bank to maintain a minimum of total capital and Tier 1 capital (as defined) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average total assets (as defined). As of December 31, 2013 and 2012, 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 Under Prompt Corrective Action Provisions | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratios | Amount | Ratios | Amount | Ratios |
| As of December 31, 2013: | | | | | | |
| Total capital (to risk-weighted assets) | $ 13,714,000 | 21.03% | $ 8,476,000 | 13.00% | $ 8,476,000 | 13.00% |
| Tier 1 capital (to risk-weighted assets) | 12,897,000 | 19.78% | 2,608,000 | 4.00% | 3,912,000 | 6.00% |
| Tier 1 capital (to average assets) | 12,897,000 | 12.75% | 8,345,000 | 8.25% | 8,345,000 | 8.25% |
| As of December 31, 2012: | | | | | | |
| Total capital (to risk-weighted assets) | $ 12,362,000 | 15.54% | $ 10,343,000 | 13.00% | $ 10,343,000 | 13.00% |
| Tier 1 capital (to risk-weighted assets) | 11,365,000 | 14.29% | 3,182,000 | 4.00% | 4,773,000 | 6.00% |
| Tier 1 capital (to average assets) | 11,365,000 | 9.69% | 9,679,000 | 8.25% | 9,679,000 | 8.25% |

**NOTE 21 – OTHER CAPITAL REQUIREMENTS**

The Bank, Midwest and ULG 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.

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

The Bank's, Midwest's and ULG's actual capital amounts and the minimum amounts required for capital adequacy purposes, by investor, are as follows as of December 31, 2013 and 2012:

| | Actual Capital | Minimum Capital |
|---|---|---|
| As of December 31, 2013: | | |
| Bank | | |
| HUD | $ 13,758,875 | $ 1,000,000 |
| FHLMC | 13,758,875 | 3,374,927 |
| FNMA | 13,758,875 | 2,818,930 |
| Midwest | | |
| HUD | $ 9,975,905 | $ 1,692,697 |
| FHLMC | 9,975,905 | 2,506,022 |
| FNMA | 9,975,905 | 2,918,054 |
| GNMA | 9,975,905 | 2,500,000 |
| ULG | | |
| HUD | $ 6,480,082 | $ 1,788,874 |

| | Actual Capital | Minimum Capital |
|---|---|---|
| As of December 31, 2012: | | |
| Bank | | |
| HUD | $ 12,680,998 | $ 1,000,000 |
| FHLMC | 12,680,998 | 3,102,557 |
| FNMA | 12,680,998 | 2,502,342 |
| Midwest | | |
| HUD | $ 9,095,155 | $ 1,000,000 |
| FHLMC | 9,095,155 | 2,504,473 |
| FNMA | 9,095,155 | 2,978,363 |
| ULG | | |
| HUD | $ 5,519,664 | $ 1,000,000 |

As of December 31, 2013 and 2012, Midwest and ULG were also each required to have a minimum amount of liquid assets under certain liquidity requirements. As of December 31, 2013 and 2012, both Midwest and ULG 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.

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.

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

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.

*Trading and Available-for-Sale Securities*

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

*Loans Held for Sale*

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

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

Loans held for sale are recorded at fair value based on quoted market prices, where available, or are determined by discounting cash flows using interest rates approximating the Company's current origination rates for similar loans and adjusted to reflect the inherent credit risk. In most situations, these loans are locked into buckets to be sold under forward loan sales commitments (as discussed below), in which case the fair value of these loans held for sale are approximated by the value to be received soon thereafter under the forward sales commitments. Loans held for sale are considered to be level 2 assets in the valuation hierarchy. Net changes in the fair value of the Company's loans held for sale are included in earnings. The net gain on change in fair value of loans held for sale at December 31, 2013 and 2012 was $901,274 and $1,593,267, respectively, which is included in the other income section in the consolidated statements of operations.

*Mortgage Servicing Rights*

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

*Derivatives – Interest Rate Lock Commitments and Forward Commitments*

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

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

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

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

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

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

*Other Real Estate Owned*

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

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

The following tables summarize financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2013 and 2012, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

| | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|
| December 31, 2013 | | | |
| Assets: | | | |
| Trading and available-for-sale securities | $ - | $ 1,703,676 | $ - |
| Loans held for sale | - | 27,407,166 | - |
| Mortgage servicing rights | - | - | 7,170,318 |
| Interest rate lock commitments | - | - | 396,855 |
| Forward sales commitments | - | - | 80,837 |
| Total assets at fair value | $ - | $ 29,110,842 | $ 7,648,010 |
| Liabilities: | | | |
| Contingent earn-out liability | $ - | $ - | $ 153,310 |

| | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|
| December 31, 2012 | | | |
| Assets: | | | |
| Trading and available-for-sale securities | $ - | $ 2,289,838 | $ - |
| Loans held for sale | - | 43,645,515 | - |
| Mortgage servicing rights | - | - | 3,963,470 |
| Interest rate lock commitments | - | - | 830,813 |
| Total assets at fair value | $ - | $ 45,935,353 | $ 4,794,283 |
| Liabilities: | | | |
| Forward sales commitments | $ - | $ - | $ 43,367 |
| Contingent earn-out liability | - | - | 153,310 |
| Total assets at fair value | $ - | $ - | $ 196,677 |

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

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

| | Mortgage Servicing Rights | Interest Rate Lock Commitments | Forward Sales Commitments | Contingent Earn-out Liability |
|---|---|---|---|---|
| Fair value at January 1, 2012 | $ 2,452,156 | $ 671,312 | $ (110,331) | $ - |
| Purchases, sales, issuances, settlements, net | 1,613,222 | (671,312) | 110,331 | (153,310) |
| Net gains (losses) | (101,908) | 830,813 | (43,367) | - |
| Fair value December 31, 2012 | 3,963,470 | 830,813 | (43,367) | (153,310) |
| Purchases, sales, issuances, settlements, net | 2,055,443 | (830,813) | 43,367 | - |
| Net gains (losses) | 1,151,405 | 396,855 | 80,837 | - |
| Fair value December 31, 2013 | $ 7,170,318 | $ 396,855 | $ 80,837 | $ (153,310) |

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

| | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|
| Year ended December 31, 2013 | | | |
| Other real estate owned | $ - | $ 189,006 | $ - |
| Year ended December 31, 2012 | | | |
| Other real estate owned | $ - | $ 769,393 | $ - |
| Net assets acquired in a business combination | $ - | $ 527,548 | $ 359,969 |

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.

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

*Loans and Financings, Net*

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

The estimated fair values of financial instruments as of December 31, 2013 and 2012 are as follows (in thousands):

| | December 31, | | | |
|---|---|---|---|---|
| | 2013 | | 2012 | |
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Significant financial assets: | | | | |
| Cash and due from banks | $ 6,152 | $ 6,152 | $ 9,153 | $ 9,153 |
| Certificates of deposit | 7,000 | 7,000 | 7,250 | 7,250 |
| Trading securities | - | - | 662 | 662 |
| Securities available-for-sale | 1,704 | 1,704 | 1,628 | 1,628 |
| Federal Home Loan Bank stock | 1,072 | 1,072 | 1,072 | 1,072 |
| Loans and financings, held for sale | 27,407 | 27,407 | 43,646 | 43,646 |
| Loans and financings, net | 48,496 | 49,665 | 53,744 | 54,629 |
| Mortgage servicing rights | 7,170 | 7,170 | 3,963 | 3,963 |
| Derivatives | 478 | 478 | 831 | 831 |
| Significant financial liabilities: | | | | |
| Deposits: | | | | |
| Demand - non-interest bearing | $ 59,184 | $ 59,184 | $ 77,499 | $ 77,499 |
| Demand - interest bearing and profit sharing | 20,692 | 20,692 | 21,754 | 21,754 |
| Savings | 278 | 278 | 271 | 271 |
| Time | 5,378 | 5,549 | 8,644 | 8,887 |
| Derivatives | - | - | 43 | 43 |

## NOTE 23 – BUSINESS COMBINATIONS

On December 27, 2012, the Company acquired 100% of the stock of AAIC, an insurance agency, and 100% of the membership interest of 2621 Carpenter Road, LLC, which owns the building and property at which AAIC operates. The acquisition was made to enable the Company to expand the insurance products that it can offer to its existing and new customers, and to expand the customer base of the Company.

The following table summarizes the consideration paid for the net assets acquired through the acquisition:

| | |
|---|---|
| Cash | $ 684,477 |
| Forgiveness of seller mortgage | 302,126 |
| Contingent earn-out arrangement | 153,310 |
| Fair value of total consideration | $ 1,139,913 |

The following table summarizes the fair value of assets acquired and liabilities assumed that were recognized at the acquisition date:

| | |
|---|---|
| Accounts receivable | $ 27,000 |
| Prepaid expenses | 11,289 |
| Premises and equipment | 527,548 |
| Customer relationships | 498,000 |
| Other liability | (7,000) |
| Deferred tax liability | (169,320) |
| Total identifiable net assets | 887,517 |
| Goodwill | 252,396 |
| | $ 1,139,913 |

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 potential amount of all future payments that the Company would be required to make under this arrangement was between $0 and $153,310. The fair value of this contingent earn-out arrangement was estimated based on expected retention of customers. As of both December 31, 2013 and 2012, the fair value of the contingent earn-out liability was $153,310. As a result, 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, 2013 and 2012.

**NOTE 23 – BUSINESS COMBINATIONS** (Continued)

As a result of this acquisition, the Company recognized goodwill of $252,396 on the date of acquisition. The goodwill recorded primarily reflects a history of operating margins and profitability and the benefit the Company will receive from synergies between AAIC and the Company. This goodwill is not being amortized for tax purposes.

The identifiable assets acquired and liabilities assumed were recorded at fair value as of the acquisition date. The identifiable net assets acquired include fixed assets with fair values that were determined by appraisal. Identifiable net assets also included an intangible asset with a fair value that was determined by the multiperiod excess earnings method. Inputs and assumptions used were based on the acquiree's history, projections and current market conditions. All other identifiable assets acquired and liabilities assumed had carrying amounts that approximated fair value, or the amount/benefit to be paid or received.

**NOTE 24 – PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION**

**CONDENSED BALANCE SHEETS**

| | December 31, | |
|---|---|---|
| | **2013** | **2012** |
| **ASSETS** | | |
| Cash and cash equivalents | $ 63,308 | $ 35,720 |
| Investment in University Bank | 9,850,221 | 8,595,648 |
| Accounts receivable - University Bank | 660,488 | - |
| Other assets | 36,800 | - |
| Total assets | $ 10,610,817 | $ 8,631,368 |
| **LIABILITIES AND EQUITY** | | |
| Accounts payable and other liabilities | $ 139,882 | $ 46,797 |
| Preferred stock subject to mandatory redemption | 1,031,450 | 1,031,450 |
| Total liabilities | 1,171,332 | 1,078,247 |
| Total equity | 9,439,485 | 7,553,121 |
| Total liabilities and equity | $ 10,610,817 | $ 8,631,368 |

**NOTE 24 – PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION** (Continued)

**CONDENSED STATEMENTS OF OPERATIONS**

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| **OTHER INCOME** | | |
| Interest and dividend income | $ 57 | $ 20 |
| Other income | - | 25,463 |
| | 57 | 25,483 |
| **EXPENSES** | | |
| Professional fees and public listing | 10,350 | 3,344 |
| Other miscellaneous | 7,533 | 1,774 |
| Share-based compensation | - | 94,000 |
| Interest expense | 93,085 | 93,938 |
| Total expenses | 110,968 | 193,056 |
| Net loss before income taxes and net income of subsidiary | (110,911) | (167,573) |
| Income tax benefit | (697,288) | - |
| Net income (loss) before net income of subsidiary | 586,377 | (167,573) |
| Net income of subsidiary | 1,239,631 | 2,083,432 |
| Net income | $ 1,826,008 | $ 1,915,859 |

**NOTE 24 – PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION** (Continued)

**CONDENSED STATEMENTS OF CASH FLOWS**

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Net income | $ 1,826,008 | $ 1,915,859 |
| Adjustments to reconcile net income to net cash flows from operating activities: | | |
| Share-based compensation | - | 94,000 |
| Preferred dividends recorded as interest expense | 93,085 | 93,938 |
| Net change in: | | |
| Accounts receivable and other assets | (697,288) | 5,000 |
| Accounts payable and other liabilities | - | (16,517) |
| Net income of subsidiary | (1,239,631) | (2,083,432) |
| Net cash provided by (used in) operating activities | (17,826) | 8,848 |
| **FINANCING ACTIVITIES** | | |
| Redemption of preferred stock | - | (17,820) |
| Exercise of stock options | 45,414 | 25,000 |
| Net cash provided by financing activities | 45,414 | 7,180 |
| **NET CHANGE IN CASH** | 27,588 | 16,028 |
| **Cash and Cash Equivalents, Beginning of Year** | 35,720 | 19,692 |
| **Cash and Cash Equivalents, End of Year** | $ 63,308 | $ 35,720 |
| **SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTIONS:** | | |
| Dividends payable on preferred stock converted to additional shares of preferred stock | $ - | $ 89,220 |