Arbor Bancorp, Inc.
2013 Annual Report

We're getting older.

And we're repeating ourselves.

In 2013—at the ripe old age of 17—we did something well worth repeating.

For the fourth consecutive year, we attained record-level performance.

We turned an empty building in downtown Saline into our newest banking center.

Longtime Saline resident Walt Byers is the new president of our Saline district.

Shelley Rankin is the Saline office branch manager.

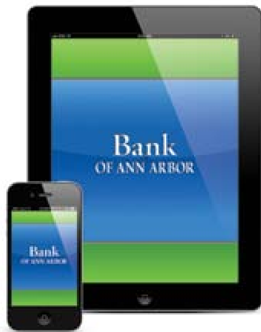
Dear fellow shareholders:

Bank of Ann Arbor was founded in 1996 as a locally owned bank with one location and fifteen employees. Today, we have seven locations and 175 employees. We remain locally owned and fiercely independent. But most importantly, we help more businesses and individuals in more communities than ever before.

2013 was another outstanding year for Bank of Ann Arbor, our fourth consecutive year of record-level performance. We used our success to invest in people, buildings, technology, the arts and much more, to preserve and add jobs, all to help Ann Arbor, Washtenaw County and Plymouth to become even stronger, more vibrant communities. Here are some of the ways we've helped:

We invested in downtown Saline. An empty, dated building was transformed into our newest office, a state-of-the-art banking facility that opened in January 2013. We also stepped up our participation in this wonderful town. Walt Byers, a longtime Saline resident who joined the team at our Ellsworth Road/Pittsfield Township branch back in 2009, was promoted to Saline District President. Walt's entire team is active in the Saline community, participating in numerous local events and organizations. Shelley Rankin, our Saline branch manager, serves as president of the Saline Chamber of Commerce. In one year, we experienced considerable growth in Saline, and anticipate taking advantage of other opportunities going forward. The only other local bank in town recently announced being sold to an out-of-state bank.

We invested in a local company, and preserved and created jobs in the process. In 2013, Bank of Ann Arbor acquired Ervin Leasing, a 35-year-old local company. To help Ervin grow, we provided state-of-the-art technology, telecommunications systems, sales management resources, and a stable funding source. R.J. Grimshaw, an experienced leasing sales professional, joined the Ervin team in August 2013 as Executive Vice President and Chief Sales Officer and has managed the company's sales efforts admirably. Three proven, talented regional sales managers were added. By December, Ervin's monthly lease originations had doubled and the company's pipeline of new business was at its highest level in four years. We extend a very special thank you to Bruce Gaffney, who led Ervin Leasing for 35 years prior to our purchase. Bruce will retire at the end of March 2014. We wish him the very best.



With Mobile Banking, customers can make transactions on their smartphones and tablets.

We invested in technology that helps enhance our clients' banking experience. Our Mobile Banking for smartphones was introduced in late 2012, and was a success almost immediately. Soon after, our customized Mobile Banking app was made available. In 2013, Mobile Deposit was added. This allowed checks to be deposited simply through a smartphone photo of the check. An iPad version of Mobile Banking was rolled out in late 2013. We have also added Popmoney, which allows for transfer of funds—typically in amounts of $500 or less—from one individual to another, via an email address or cell phone number.

Sonic Lunch 2013 included shows by Glee's Darren Criss (above) and Martha Reeves (below, with Bank of Ann Arbor's Tim Marshall and Matthew Altruda).

We invested in community life. Throughout the bank's history, helping organizations that make our community a better place to live and work has been important to us. We remain proud ongoing supporters of the University Musical Society, Ann Arbor Symphony, Ann Arbor Summer Festival, The Ark, Michigan Philharmonic, Michigan Theater, and Purple Rose Theatre in Chelsea. The exceptional lineup of outdoor concerts in Liberty Plaza made our 2013 Sonic Lunch Summer Concert Series the best ever, starting with Motown legend Martha Reeves and the Vandellas, who entertained thousands in Liberty Plaza. Later in the series, Darren Criss, U-M grad and star of TV's *Glee*, packed the Michigan Theater.

We invested in school arts programs. Our jumpstARTS Facebook contest helped the creative and performing arts programs at a dozen area schools, many of which had been enduring severe budget cuts. Schools that received the most Facebook votes were awarded a $3,000 jumpstARTS donation to support their programs.

Our jumpstARTS Facebook contest granted twelve area schools $3,000 each to support their creative and performing arts programs.

We also continued our support of more than 200 health and human service non-profit organizations. As the bank continues to succeed financially, we give more time and donations. Many Bank of Ann Arbor team members sit on nonprofit boards, participate in fundraising events and make significant contributions of their own. In 2013, 29 Leadership level ($1,000 or more) contributors to the annual United Way campaign were from Bank of Ann Arbor.

Financially speaking…our 2013 growth significantly impacted our earnings, which reached an all-time high of nearly $9.7 million. That's an improvement over the previous record (set last year) of 14%. Earnings per share increased to $10.93 per share, up from $9.62 in 2012.

We overcame the net interest margin challenges facing the entire banking industry and continued to grow our balance sheet and loan portfolio. The net interest margin compression is a result of extremely low interest rates. Most banks, including ours, have lowered deposit rates, but longer-term loans and investments established several years ago are renewing at much lower rates. The resulting lower net interest margin has led to lower revenue for many banks. Though our margin declined in 2013, revenue and earnings were up significantly. Operating expense or noninterest expense at the bank declined by nearly 4% year over year. Our increase in noninterest expense for the holding company, Arbor Bancorp, Inc., is due mainly to the addition of the operating expenses of Ervin Leasing Company.

GROWTH IN EARNINGS AND EARNINGS PER SHARE

	2013	2012	2011	2010
Earnings (In millions)	$9,674	8,449	6,583	5,097
Earnings per share	$10.93	9.62	7.55	5.90
Book value per share	$72.00	66.19	57.00	47.84

Also contributing to our improved earnings was the growth in assets and fee income in our Trust and Investment Group and the strong performance of our mortgage bankers. The Trust and Investment Group finished 2013 with nearly $916 million in assets and record-level fee income of $3.9 million. Deborah Jones, formerly with TIAA-CREF, joined our team in early 2013 and has helped grow our investment advisory business significantly for clients with retirement assets in a 403(b) plan, primarily but not limited to the University of Michigan or Eastern Michigan University. Our investment advisory business is now approaching $30 million.

We continue to help area non-profits both financially and as volunteers and event participants.

Though mortgage rates edged up in 2013, resulting in more home purchases and less refinancings, our mortgage team held its own in fee income. The impact of the Dodd-Frank Wall Street Reform and Consumer Protection legislation, signed into federal law in July 2010 and providing the most significant changes to financial and banking regulation since the Great Depression, continues to impact how mortgages are delivered. While Bank of Ann Arbor and other community banks typically provide mortgages to customers they know and who can adhere to the payment schedule, we are faced with many new mortgage-related regulations that are demanding and burdensome to both the bank and our mortgage clients. We are concerned that an unintended consequence of Dodd-Frank will be less mortgage credit available in the market. In spite of the regulatory challenges, we are proud of the contributions that our mortgage bankers made to our higher earnings.

Saline Fiddlers.

We continue to be one of the top performing banks in the country as measured by return on shareholder equity.

Based on our earnings performance, we paid a 25% higher dividend to you, our valued shareholders, than last year. The rest of our earnings were used to grow the bank by $426 million over the past four years without having to raise additional capital to maintain our "well-capitalized" status, the FDIC's highest possible designation. By year-end, our shareholders equity was $63.1 million. With earnings at $10.93 per share, we continue to be one of the top performing banks in the country as measured by return on shareholder equity.

RETURN ON EQUITY

	2013	2012	2011	2010
National % Rank	95.6	94.6	93.8	90.6

Our loans and deposits reached record levels. Thankfully, the economy in southeastern Michigan continued to improve, and our lending team took full advantage. Total loans grew by $77 million or by 14.5% as loans outstanding exceeded $600 million for the first time in bank history. Our Commercial Banking Group has had two successful years in a row with loan growth of $55 million in 2013 and $38 million in 2012. In addition, our commercial bankers have generated fee income revenue exceeding $1 million in each of the last two years.

Total deposits reached $847 million at year end as our sales teams continue to attract new clients and expand existing relationships. Over the past three years, total deposits have grown by $238 million, or 39%. We are now, according to the FDIC, the second largest bank in Ann Arbor. (In 2012 we were the third largest; in 2011, fourth; in 2010, seventh.)

Two individuals who've made major contributions to our growth in loans and deposits, Charlie Crone and Patti Judson, were both promoted to Executive Vice President in December 2013. In addition to his Commercial Banking Group management responsibilities, Charlie will add day-to-day oversight for other revenue-generating areas. Patti, an employee of the bank since it opened in 1996, is now the bank's Chief Operating Officer. It's gratifying to see our colleagues grow personally and professionally as the bank continues to grow.

Deb Jones
formerly with TIAA-CREF, now leads our investment advisory business

Charles Crone
new Executive Vice President and Chief Revenue Officer

Patti Judson
new Executive Vice President and Chief Operating Officer

Our balance sheet ended 2013 at $968 million in total assets, an increase of more than $77 million.

Our credit quality in 2013 was exceptional as measured internally and by the FDIC. One way to evaluate future credit quality is to look closely at the companies and individuals who are 30-59 days, 60-89 days, or over 90 days past due on a payment. On December 31, 2013, only three loans totaling $307 thousand were in one of those three past-due categories. In addition, significant year-over-year improvement was evident in a number of credit quality metrics, which allowed us to reduce our provision for loan loss for a fourth consecutive year, approximately 20% lower at the bank level. Early in 2013, we stopped reserving for mortgage loan buybacks as the housing market continued to stabilize.

TOTAL DEPOSITS AND ASSETS

(In millions)	2013	2012	2011	2010
Total deposits	$847	793	686	609
Total assets	$968	891	774	689

Our Credit Administration team and all of our lenders create a very strong credit culture. Lending money to businesses and consumers who can honor their loan agreement is the best way to remain successful.

Our record-level performance 2013 could only happen because of the contributions of many: the can-do attitude and exceptional work ethic of the entire Bank of Ann Arbor team, a.k.a. the World's Best Bankers; the oversight of our exceptional Board members; and the continued support from all of our shareholders. Our strength and stability, unwavering commitment to the community, and consistently strong execution has fueled our growth, and allowed us to do what we love to do most: help more and more individuals and businesses.

According to the FDIC's most recent bank comparative report, Bank of Ann Arbor again outperformed other Michigan and U.S. banks in key metrics such as net charge-offs to total loans, loss allowance to noncurrent loans, and noncurrent loans to total loans.

CREDIT QUALITY METRICS

	BOAA	U.S. Banks	MI Banks
Net charge-offs to total loans	0.01%	0.72%	0.81%
Loss allowance to noncurrent loans	389.40%	64.49%	50.78%
Noncurrent loans to total loans	0.49%	2.83%	4.42%

Saline Chamber of Commerce ribbon cutting for new Saline office. Top right: Walt Byers (right) with Bob Rosenberger (left) from Saline Main Street. Bottom right: Music & Mocha; Samantha West and Ann Arbor's 107one's Martin Bandyke.

Our success has gotten others to take notice.

- Washtenaw County recognized Bank of Ann Arbor as a healthy workplace.
- *Crain's Detroit Business* put Bank of Ann Arbor on their Honor Roll of healthiest employers in Michigan.
- *American Banker* magazine named us one of the country's Best Banks to Work For, #20 out of nearly 7,000 U.S. banks.
- Financial Management Consulting Group, which rates banks in the Midwest, named our bank the #1 performing bank in Michigan during 2013.
- Independent Community Bankers of America, the community bank trade association, ranked Bank of Ann Arbor #2 in its "Top 50 Community Bank Leaders in Social Media" for our "fresh content," "thought leadership," and our advice and consistent touchpoints to our brand.
- Independent Community Bankers of America listed President & CEO, Tim Marshall and Matthew Altruda, our social media and event coordinator, on its "Top 20 Community Bank Influencers on Twitter."
- Financial Brand.com, one of the top websites in the world for strategic insights, practical ideas, and actionable intelligence for financial marketing professionals, listed Bank of Ann Arbor as the 92nd highest performing bank among the "Power 100 for Social Media." All domestic and international banks were included in its evaluation.
- Financial Brand.com listed us on the "Top 100 Most Liked Banks on Facebook" and the "Top 100 Banks on Twitter with the Most Followers."

#1 performing bank in Michigan during 2013

-Financial Management Consulting Group

Renderings of our headquarters after renovation and expansion.

We're fixing up the place. In 2014, we'll completely remodel and expand our headquarters in downtown Ann Arbor. We will to continue to conduct business at that location as usual, but we appreciate your patience and understanding over the next eighteen months.

Much hard work yielded exceptional results in 2013. We're planning on more of the same in 2014. Interest rates are projected to remain low and will require above-average loan growth and skillful management of margins to compensate for the net interest margin compression. The regulatory environment will stay challenging and require additional expenses for us to remain compliant with new laws and regulations the industry is facing. We will also watch our operating expenses closely while continuing to provide exceptional customer service. Maintaining high credit quality standards in 2014 will be vital to our success.

A sincere thank you to everyone who helps Bank of Ann Arbor succeed on a day-to-day basis. Record-level results like what we've enjoyed the past four years could only happen because of the contributions of our employees, directors, shareholders, clients and the community.

With our highly energized team of the World's Best Bankers, we will work extremely hard to deliver a fifth consecutive year of record-level performance.

Sincerely,

Timothy G. Marshall
President & CEO

William C. Martin
Chairman

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2013 AND 2012

	2013	2012
ASSETS		
Cash and due from financial institutions	$ 15,174	$ 19,804
Interest-bearing balances in banks	148,563	118,944
Cash and cash equivalents	163,737	138,748
Securities available-for-sale	155,015	176,513
Loans held for sale	1,355	5,589
Loans, excluding covered loans, net	584,760	493,593
Covered loans	21,413	30,410
Total loans	606,173	524,003
Federal Home Loan Bank stock, at cost	2,634	2,634
Premises and equipment, net	12,277	12,214
Cash surrender value of life insurance	12,686	12,274
Other real estate owned	1,546	2,420
FDIC indemnification asset	1,978	6,277
Accrued interest receivable and other assets	10,610	10,216
	$968,011	**$890,888**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$ 242,975	$ 212,191
Interest-bearing	603,657	580,478
Total deposits	846,632	792,669
Other borrowings	881	–
Federal Home Loan Bank advances	1,053	1,235
Repurchase agreements	42,333	21,482
Accrued expense and other liabilities	8,843	11,587
Subordinated debentures	5,155	5,155
Total liabilities	904,897	832,128
Shareholders' equity		
Common stock, no par value; 2,000,000 shares authorized; 876,396 and 887,784 shares issued and outstanding at December 31, 2013 and 2012	4,966	6,410
Retained earnings	58,976	49,302
Accumulated other comprehensive income/(loss)	(828)	3,048
Total shareholders' equity	63,114	58,760
	$ 968,011	**$ 890,888**

All dollar amounts in thousands except per share data. Unaudited.

CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
Interest income		
Loans, including fees	$ 32,327	$ 28,940
Securities:		
Taxable	1,430	1,217
Tax exempt	2,230	2,203
Federal funds sold and other	265	321
	36,252	32,681
Interest expense		
Deposits	1,633	1,917
Federal Home Loan Bank advances	28	74
Subordinated debentures	174	184
Other borrowings	77	–
Repurchase agreements	104	98
	2,016	2,273
Net interest income	34,236	30,408
Provision for loan losses	2,495	2,500
Net interest income after provision for loan losses	31,741	27,908
Noninterest income		
Service charges on deposit accounts	441	462
Income from fiduciary activities	3,891	3,670
Net gains on sales of loans	1,427	2,034
Net gains on sales of securities	27	–
Gain (loss) on sales of OREO	534	464
Other	1,581	1,527
	7,901	8,157
Noninterest expense		
Salaries and employee benefits	16,861	14,018
Occupancy and equipment	2,282	1,915
Marketing and business promotion	1,170	1,044
FDIC expense	504	495
Provision for loan repurchase liability	750	2,400
Other	5,061	4,909
	26,628	24,781
Income before income taxes	13,014	11,284
Income tax expense	3,340	2,835
Net income	**$ 9,674**	**$ 8,449**
Basic earnings per share	$ 10.93	$ 9.62
Diluted earnings per share	10.36	8.97

All dollar amounts in thousands except per share data. Unaudited.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
Net income	$ 9,674	$ 8,449
Other comprehensive income:		
Unrealized gains/losses on securities:		
Unrealized holding gain/(loss) arising during the period	(5,845)	2,258
Reclassification adjustment for losses (gains) included in net income	(27)	–
Tax effect	1,996	(768)
Net of tax	(3,876)	1,490
Comprehensive income	**$ 5,798**	**$ 9,939**

All dollar amounts in thousands except per share data. Unaudited.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2013 AND 2012

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, January 1, 2012	**$** 6,230	**$** 42,090	**$**1,558	**$** 49,878
Net income	–	8,449	–	8,449
Other comprehensive income	–	–	1,490	1,490
Deferred shares plan	31	–	–	31
Exercise of stock options (25,623 shares)	948	–	–	948
Repurchase of 19,453 shares of common stock	(1,215)	–	–	(1,215)
Stock based compensation expense	416	–	–	416
Cash dividends paid (January) - $0.60 per share	–	(525)	–	(525)
Cash dividends paid (December) - $0.80 per share	–	(712)	–	(712)
Balance, December 31, 2012	6,410	49,302	3,048	58,760
Net income	–	9,674	–	9,674
Other comprehensive income (loss)	–	–	(3,876)	(3,876)
Deferred shares plan	30	–	–	30
Exercise of stock options (29,028 shares)	1,022	–	–	1,022
Repurchase of 40,816 shares of common stock	(2,969)	–	–	(2,969)
Issuance of common stock (400 shares)	28	–	–	28
Stock based compensation expense	445	–	–	445
Balance, December 31, 2013	**$ 4,966**	**$ 58,976**	**$ (828)**	**$ 63,114**

All dollar amounts in thousands except per share data. Unaudited.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Principles of Consolidation: The consolidated financial statements include Arbor Bancorp, Inc. and its wholly owned subsidiary, Bank of Ann Arbor ("Bank"), together referred to as "the Corporation." On January 1, 2013, the Corporation, through a newly established Bank subsidiary, Bank of Ann Arbor Leasing ("Leasing Company"), acquired all of the stock of the Ervin Leasing Company, an Ann Arbor, Michigan based leasing company which provides business equipment direct financing leases to companies across the United States. Intercompany transactions and balances are eliminated in consolidation.

The Bank provides financial services through its offices in Washtenaw and Wayne counties. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are residential mortgage, commercial, and installment loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Commercial loans are expected to be repaid from cash flow from operations of businesses. Other financial instruments, which potentially represent concentrations of credit risk, include deposit accounts in other financial institutions and federal funds sold.

Subsequent Events: The Corporation has evaluated subsequent events for recognition and disclosure through February 12, 2014, which is the date the financial statements were available to be issued.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for loan losses, the reserve for repurchase of sold loans, the carrying amount of the FDIC Indemnification Asset, lease residual values and the fair values of financial instruments are particularly subject to change.

Cash Flows: Cash and cash equivalents includes cash, deposits with other financial institutions under 90 days, short-term investments and federal funds sold. Net cash flows are reported for customer loan and deposit transactions, federal funds purchased and repurchase agreements.

Interest-Bearing Deposits in Banks: Interest bearing deposits in banks mature within one year and are carried at cost. The balance outstanding at year end 2013 and 2012 was at the Federal Reserve Bank.

Securities: Debt securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax. Interest income includes amortization of purchase premium or discount. Gains and losses on sales are based on the amortized cost of the security sold.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment ("OTTI") on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer and also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) other-than-temporary impairment (OTTI) related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Federal Home Loan Bank (FHLB) Stock: The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Loans Held for Sale: Loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value, in the aggregate, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Loans are sold with servicing released. Buyers do not have recourse against the Corporation for subsequent loan losses. However, in certain situations, the buyer can require the Corporation to repurchase loans.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of purchase premiums and discounts 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. Interest income on all loans is generally discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process

of collection. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Covered Loans: Loans acquired in 2010 in a Federal Deposit Insurance Corporation (FDIC)-assisted transaction are covered under a loss sharing agreement and are referred to as "covered loans." Pursuant to the terms of the loss sharing agreements, covered loans are subject to a stated loss threshold whereby the FDIC will reimburse the Corporation for 80% of losses incurred. The Corporation will reimburse the FDIC for its share of recoveries with respect to losses for which the FDIC paid the Corporation a reimbursement under the loss sharing agreement. The FDIC's obligation to reimburse the Corporation for losses with respect to covered loan begins with the first dollar of loss incurred.

Covered loans were recorded at fair value at the time of acquisition. Fair values for covered loans are based on a discounted cash flow methodology that considered various factors including the type of loan and related collateral, classification status, fixed or variable interest rate, term of loan and whether or not the loan was amortizing, and a discount rate reflecting the Corporation's assessment of risk inherent in the cash flow estimates. Covered loans were grouped together according to similar characteristics and were treated in the aggregate when applying various valuation techniques.

At purchase, certain covered loans had evidence of credit deterioration since origination. These loans are accounted for individually. The Corporation estimates the amount and timing of expected cash flows for each purchased loan, and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan or pool (accretable yield). The excess of the loan's or pool's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference). Over the life of the loan or pool, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Direct Financing Lease Receivables: The Corporation's equipment leasing activities result in direct financing leases recorded within loans on the consolidated balance sheet. These direct financing leases provide for full recovery of the equipment cost over the term of the lease.

The Corporation's net investment in direct financial leases is comprised of the following elements: minimum lease payments receivable, the estimated unguaranteed residual value of the leased equipment at the lease termination dates, and unamortized initial direct costs, less unearned income. Estimated guaranteed residual values are reviewed periodically to determine if the current estimate of the equipment's fair value appears to be below its recorded estimate. If required, residual values are adjusted downward to reflect adjusted estimates of fair market values. Upward adjustments to residual values are not permitted.

Unearned income is the amount by which the minimum lease payments receivable plus the estimated unguaranteed residual value exceeds the cost of the leased equipment at the inception of the lease. Unearned income is amortized over the initial lease term to produce a constant rate of return on the net investment in the lease. Initial direct costs of acquiring a lease are capitalized when incurred and amortized over the life of the lease consistent with the method used to recognize interest income.

The Corporation evaluates the collectability of its lease receivables based upon certain factors, such as historical collection trends and aging categories. Lease receivables are written off against the allowance for loan losses when the receivable is determined to be uncollectible.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge offs less recoveries. Management estimates the allowance balance required using past loan loss experience, the nature and volume of 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, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers non classified loans and is based on historical loss experience adjusted for current factors.

A loan is impaired when full payment under the loan terms is not expected. Non-homogeneous loan classes such as commercial and commercial real estate loans and homogeneous loan segments, such as mortgage and consumer, are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are

collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component covers non impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Corporation over the most recent three years. For the commercial land development segment of loans, an actual loss history of one year is used. For all segments, the actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified:

Commercial – Loans to businesses that are sole proprietorships, partnerships, limited liability companies and corporations. These loans are for commercial, industrial, or professional purposes. The risk characteristics of these loans vary based on the borrowers' business and industry as repayment is typically dependent on cash flows generated from the underlying business. Within this loan segment, the Corporation has identified loan classes of commercial and industrial, commercial real estate and commercial land development.

Real Estate – Loans to purchase or refinance single family residences. The risks associated with this segment are generally dependent on the overall real estate value environment and individual payment obligations. Real estate is subject to changes in market valuation and can be unstable for a variety of reasons. Within this segment the Corporation has identified classes of residential and home equity loans.

Consumer – Term loans or lines of credit for the purchase of consumer goods, vehicles or home improvement. The risk characteristics of the loans in this segment vary depending on the type of collateral but generally repayment is expected from a customer continuing to generate a cash flow that supports the calculated payment obligation. Secondary support could involve liquidation of collateral.

Leases – Direct Finance equipment leases. Risk characteristics vary based from the borrower's business and industry as repayment is typically dependent upon cash flows generated from the borrower's operations. Secondary support could involve repossessing the leased collateral.

FDIC Indemnification Asset: The FDIC indemnification asset results from the loss share agreements in the FDIC-assisted transaction. The asset is measured separately from the related covered assets as they are not contractually embedded in the assets and are not transferable with the assets should the Corporation choose to dispose of them and represent the acquisition date fair value of expected reimbursements from the FDIC. Pursuant to the terms of the loss sharing agreement, covered loans are subject to a stated loss threshold whereby the FDIC will reimburse the Corporation for 80% of losses incurred. These expected reimbursements do not include reimbursable amounts related to future covered expenditures. These cash flows are discounted to reflect a metric of uncertainty of the timing and receipt of the loss sharing reimbursement from the FDIC. This asset decreases when losses are realized and claims are submitted to the FDIC or when customers repay their loans in full and expected losses do not occur. This asset also increases when estimated future losses increase and decreases when estimated future losses decrease. When estimated future loan losses increase, the Corporation records a provision for loan losses and increases its allowance for loan losses accordingly. The resulting increase in the FDIC indemnification asset is recorded as an offset to the provision for loan losses. During 2013 and 2012, the provision for loan losses was offset by $1,266 and $1,621 related to increases in the FDIC indemnification asset.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

OREO acquired by the Corporation through loan defaults by customers on covered loans or acquired by the Corporation as part of its acquisition of New Liberty Bank are covered under the loss sharing agreement discussed above. Pursuant to the terms of the loss sharing agreement, covered assets are subject to a stated loss threshold whereby the FDIC will reimburse the Corporation for 80% of losses incurred. Any gains or losses realized at the time of disposal are partially offset by the FDIC loss share and are reflected in income. At year-end 2013 and 2012, $155 and $2,119 of the Corporation's OREO was subject to the loss sharing agreement.

Premises, Equipment and Leasehold Improvements: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation, generally computed on the straight-line basis over the assets' useful lives, and over the terms of the lease or the estimated useful lives for leasehold improvements, whichever is shorter.

Cash Surrender Value Life Insurance: The Corporation has purchased life insurance policies on certain key executives. Cash surrender value life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

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

Repurchase Agreements: Substantially all repurchase agreement liabilities represent amounts advanced by various customers. These balances are not deposits and are not covered by federal deposit insurance. Securities are pledged to cover these liabilities.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Corporation, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Stock-Based Compensation: Compensation cost is recognized for stock options and restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options.

Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

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

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

Earnings Per Share: Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share include the dilutive effect of additional potential common shares issuable under equity based plans. Earnings and dividends per share are restated for all stock splits and dividends through the date of issue of the financial statements.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale and currency translation which are also recognized as separate components of equity.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

Restrictions on Cash: Cash on hand or on deposit with the Federal Reserve Bank of $1,342 and $1,328 was required to meet regulatory reserve and clearing requirements at year end 2013 and 2012.

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

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the bank to the holding company or by the holding company to shareholders.

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

Adoption of New Accounting Standards: In February 2013, the FASB amended existing guidance related to reporting amounts reclassified out of other comprehensive income out of accumulated other comprehensive income. These amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. These amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional details about those amounts. These amendments are effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The effect of adopting this standard is not expected to have a material effect on the Corporation's operating results or financial condition.

In October 2012, the Financial Accounting Standards Board ("FASB") issued guidance on the subsequent accounting for an indemnification asset recognized at the acquisition date as a result of a government assisted acquisition of a financial institution. When an entity recognizes such an indemnification asset and subsequently a change in the cash flows expected to be collected on the indemnification asset occurs as a result of a change in the cash flows expected to be collected on the indemnified asset, the guidance requires the entity to recognize the change in the measurement of the indemnification asset on the same basis as the indemnified assets. Any amortization of changes in value of the indemnification asset should be limited to the lesser of the term of the indemnification agreement and the remaining life of the indemnified assets. The amendments are effective for fiscal years beginning on or after December 15, 2012 and early adoption is permitted. The amendments are to be applied prospectively to any new indemnification assets acquired after the date of adoption and to indemnification assets existing as of the date of adoption arising from a government-assisted acquisition of a financial institution. The effect of adopting this standard did not have a material effect on the Corporation's operating results or financial condition.

BUSINESS COMBINATIONS

Ervin Leasing Business Combination

On January 1, 2013, the Corporation acquired 100% of the outstanding common shares of Ervin Leasing Corporation in exchange for cash totaling $4,622. Under the terms of the acquisition, all common shareholders received cash equal to total equity of Ervin Leasing as of December 31, 2012 plus $600. Ervin Leasing Company results of operations were included in the Corporation's results beginning January 1, 2013. The fair value of the common shares issued as part of the consideration paid for Ervin Leasing was determined in the basis of the closing price of the Corporation's common shares on the acquisition date.

The following table summarizes the consideration paid for Ervin Leasing Company and the amounts of the assets acquired and liabilities assumed recognized at the acquisition date:

Consideration	
Cash	$ 4,622
Fair Value of Total Consideration Transferred	**$ 4,622**
Recognized amounts of identifiable assets acquired and liabilities assumed	
Cash and cash equivalents	$ 366
Direct financing leases	11,304
Noncompete agreement	100
Other assets	1,098
Total assets acquired	12,868
Notes payable	7,514
Other liabilities	732
Total liabilities assumed	8,246
Total identifiable net assets	**$ 4,622**

No goodwill or other intangible assets, beyond the noncompete agreement above, were generated as part of the Ervin Leasing business combination.

New Liberty Business Combination

On May 14, 2010, the Corporation entered into a purchase and assumption agreement (New Liberty Agreement) with the Federal Deposit Insurance Corporation (FDIC), as receiver, pursuant to which the Corporation acquired certain assets and assumed substantially all of the deposits and certain liabilities of New Liberty Bank (New Liberty). New Liberty operated one banking center in Plymouth, Michigan.

In connection with the New Liberty acquisition, the Corporation entered into a loss sharing agreement with the FDIC that covers most of New Liberty's assets, based upon the seller's records, including single family residential mortgage loans, commercial real estate and commercial and industrial loans, and OREO (collectively, covered assets). The loss sharing agreements are subject to certain servicing procedures as specified in agreements with the FDIC. The loss sharing agreements applicable to single family residential mortgage loans provide for FDIC loss sharing and Corporation reimbursement to the FDIC for ten years. The loss sharing agreements applicable to all other covered assets provide for FDIC loss sharing for five years and Corporation reimbursement of recoveries to the FDIC for eight years. The expected reimbursements under the loss sharing agreements were recorded as an indemnification asset at an estimated fair value of $15,949 on the acquisition date which represented the present value of the expected net cash reimbursement related to the loss sharing agreements.

The Corporation acquired certain other New Liberty assets not covered by the loss sharing agreement with the FDIC, including cash and securities purchased at fair value. At acquisition, in aggregate, loans acquired had an unpaid principal balance of $91,772 and a fair value of $69,069 and deposits assumed had a balance of $90,117.

ADDITIONAL INFORMATION

We have included financial information for the year ended December 31, 2013. Our full financial statements including notes were audited by Crowe Horwath, our independent public accountant, and Crowe Horwath gave an unqualified opinion. The complete audited financial statements including the auditors opinion and notes are available upon request.

If you would like a copy of the audited financial statements or if you have any questions concerning the annual meeting, please contact your bank president Timothy G. Marshall at 125 South Fifth Avenue, P.O. Box 8009, Ann Arbor, Michigan 48107.

The Bank of Ann Arbor Team

Executive Management

Timothy G. Marshall
President & Chief Executive Officer

Charles E. Crone, Jr.
Executive Vice President & Chief Revenue Officer

Patti H. Judson
Executive Vice President & Chief Operating Officer

Lyle F. Dahlberg
First Vice President, Trust & Investment Group Manager

Cynthia J. Livesay
First Vice President, Credit Administration

Mark J. Slade
First Vice President & Chief Financial Officer

Retail Banking

Patti H. Judson
Executive Vice President & Chief Operating Officer

Joan C. Hendricks
Vice President & Main Office Branch Manager

Christine G. Johnson
Vice President, Cash Management

Kristina L. Mayer
Vice President & Plymouth Branch Manager

Russell D. Hines, Jr.
Stadium Office Branch Manager

David K. Pate
Ypsilanti Office Branch Manager

Shelley L. Rankin
Saline Office Branch Manager

Dennis D. Ticknor
Ellsworth Office Branch Manager & Health Savings Account Specialist

Sandra L. Beever
Deposit Operations Officer

Kimberly K. Snow
Relationship Banking & Cash Management Officer

Mortgage

Kirsty E. Haboian
Vice President & Mortgage Department Manager

Charles W. Cracraft
Vice President & Retail Mortgage Sales Manager

Kimberly A. Clugston
Vice President & Senior Mortgage Loan Officer

Carl D. Ent
Vice President & Mortgage Loan Officer

Joseph Craigmile
Mortgage Loan Officer

Kevin C. Salley
Mortgage Loan Officer

William E. Smith
Mortgage Loan Officer

Private Banking Services

Maryanne B. Dunleavy
Senior Vice President & Private Banking Manager

Linda S. Brewer
Vice President & Private Banking Officer

Mary Hays
Vice President & Private Banking Officer

Kevin M. Kramer
Vice President & Private Banking Officer

Trust and Investment Management

Lyle F. Dahlberg
First Vice President, Trust & Investment Group Manager

Thomas R. Kallewaard
First Vice President & Senior Trust Officer

Stephen J. Seymour
Senior Vice President & Senior Investment Officer

Sonia S. Patel
Senior Vice President & Investment Officer

Cathleen L. Savoie
Senior Vice President & Investment Officer

Erin E. Archambault
Vice President, Trust Operations

Eric P. Helber
Vice President & Director of Business Development

Deborah A. Jones
Vice President & Business Development Officer

Sandra S. Taggie
Vice President & Trust Officer

Margaret L. Vogel
Vice President & Trust Officer

Jacqueline Jenkins
Assistant Vice President, Portfolio Manager & Business Development Officer

Mitzi J. Talon
Assistant Vice President & Trust Officer

Sara Dobson Campbell
Trust Officer

Mark A. Skiff
Investment Officer

Finance and Compliance

Mark J. Slade
First Vice President & Chief Financial Officer

Barbara L. Morrison
Vice President

Bella M. Fernandez
Assistant Vice President & Accounting Officer

John E. Foster
Vice President, Security, Compliance & BSA Officer

Cynthia K. Shaeffer
BSA/Security/Compliance Administrative Officer

Commercial Lending

Charles E. Crone, Jr.
Executive Vice President &
Chief Revenue Officer

Walter G. Byers
President,
Saline District

Michael L. Michon
President,
Plymouth District

Patrick A. Tamblyn
President,
Ypsilanti District

Michael A. Cole
Group President,
Technology Industry Group

Hans W. Maier
Senior Vice President,
Specialty Banking

Robert R. Rose
Vice President &
Senior Loan Officer

Satish B. Jasti
Vice President &
Senior Loan Officer

Mark D. Baily
Vice President &
Commercial Loan Officer

Michelle M. Burger
Vice President &
Commercial Loan Officer

Jonathon F. Bowdler
Vice President &
Commercial Real Estate Manager

James J. Plummer
Vice President &
Commercial Loan Officer

Mark H. Holtz
Vice President,
Technology Industry Group

Information Systems

Jeffrey J. Stanton
Vice President &
Chief Technology Officer

Essi E. Weber
Senior Technical Analyst &
Technology Officer

Human Resources and Marketing

James A. Miller
Vice President & Director,
Human Resources

Rhonda J. Foxworth
Vice President &
Marketing Department Manager

Credit Administration

Cynthia J. Livesay
First Vice President,
Credit Administration

Dawn M. Prescott
Senior Vice President &
Managed Assets Officer

Trina M. VanNest
Vice President &
Credit Manger

Sara L. Simon
Assistant Vice President &
Small Business Lending Officer

Stephanie N. Harrigan
Assistant Vice President,
Consumer Credit & Compliance

Pamela J. Wetzel
Credit Administration Officer

Ervin Equipment Finance

Raymond J. Grimshaw
President &
Chief Executive Officer

Thomas J. Conzelmann
Secretary, Treasurer &
Chief Financial Officer

Directors

Thomas P. Borders
President, Midtown Group, Inc.

Richard P. Eidswick
Founding Director,
Arbor Partners

Jan L. Garfinkle
Founder & Managing Director,
Arboretum Ventures

Isadore J. King
President &
Chief Executive Officer,
Synergy Partners, LLC

Timothy G. Marshall
President &
Chief Executive Officer,
Bank of Ann Arbor

Michael C. Martin
Vice President,
First Martin Corporation

William C. Martin, Chairman
Athletic Director Emeritus,
University of Michigan

Ernest G. Perich
President,
Perich + Partners, Ltd.

David R. Sarns
Managing Partner,
360 Advisors, LLC

Joseph A. Sesi
Owner, Sesi Motors, Inc.

Cynthia H. Wilbanks
Vice President for
Government Relations,
University of Michigan

Jeffrey S. Williams
Chairman &
Chief Executive Officer,
Tangent Medical Technologies
Molecular Systems Corporation

Directors Emeritus

James W. Anderson, Jr.
President,
The Anderson Associates

Jan Barney Newman
Vice President,
Ann Arbor District Library Board

Richard N. Robb, DDS
Regent Emeritus,
Eastern Michigan University

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Downtown Saline
179 E. Michigan Avenue
Saline, 48176
734-470-5001

Downtown Ypsilanti
7 W. Michigan Avenue
Ypsilanti, 48197
734-485-9400

Ellsworth Rd. & Airport Blvd.
801 W. Ellsworth Road
Ann Arbor, 48108
734-669-8900

Plymouth
1333 W. Ann Arbor Road
Plymouth, 48170
734-455-1511

Stadium & Liberty
2204 W. Stadium Boulevard
Ann Arbor, 48103
734-822-1900

Traver Village Shopping Center
2601 Plymouth Road
Ann Arbor, 48105
734-662-3800

Thurston Elementary School
Three Thousand and no/100

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Abbot Elementary School
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It is the mission of Bank of Ann Arbor to be a dynamic, growing and sustainable community bank that is the premier financial institution within the markets it operates; it will be owned by individuals in its markets, managed locally, and responsive to the needs of its communities. The Bank will serve and partner with its customers and communities to achieve their financial goals through high quality products delivered by energized employees and through community service comprised of donations, time, and leadership. Our shareholders will achieve superior long-term value; our employees are valued and will work in a culture that invests in their development and rewards their positive contributions.

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