

December 31, 2008, 2007 and 2006

Note 1 - Nature of Business and Significant Accounting Policies

Nature of Operations - Oxford Bank (the "Bank") operates in suburban communities in Oakland, Lapeer, and Genesee Counties in the state of Michigan. The Bank's revenue results primarily from providing real estate and commercial loans and, to a lesser extent, consumer loans. Its primary deposit products are savings and term certificate accounts.

Basis of Presentation and Consolidation - The consolidated financial statements include the accounts of Oxford Bank Corporation (the "Corporation") and its wholly owned subsidiary, Oxford Bank. Oxford Bank includes the accounts of its wholly owned subsidiary, Oxford Financial Services. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates - In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of investment securities, foreclosed real estate, and deferred tax assets.

Significant Group Concentrations of Credit Risk - Most of the Corporation's activities are with customers located within Michigan. Note 3 discusses the types of securities in which the Corporation invests. Note 4 discusses the types of lending in which the Corporation engages. The Corporation does not have any significant concentrations to any one industry or customer.

Cash and Cash Equivalents - For the purpose of the consolidated statement of cash flows, cash and cash equivalents include cash and balances due from banks and federal funds sold which mature within 90 days.

Securities - Debt securities that management has the positive intent and ability to hold-to-maturity are classified as "held-to-maturity" and recorded at amortized cost. Securities not classified as held-to-maturity or trading, including equity securities with readily determinable fair values, are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Loans - The Corporation grants mortgage, commercial, and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout Michigan. The ability of the Corporation's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

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

The accrual of interest on loans is 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 collected for loans that are placed on nonaccrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses - The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

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

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Note 1 - Nature of Business and Significant Accounting Policies continued

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

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

Large groups of homogeneous loans are collectively evaluated for impairment.

Banking Premises and Equipment - Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation computed on the straight-line method over the estimated useful lives of the assets.

Other Real Estate Owned - Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value at the date of the foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets.

Income Taxes - Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the various temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

Off-balance-sheet Instruments - In the ordinary course of business, the Corporation has entered into commitments under commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

Earnings per Share - Basic earnings per share represents income available to common stockholders divided by the weighted average number of common shares outstanding during the period. The weighted average number of shares was 1,156,690, 1,216,016, and 1,279,630 for the years ended December 31, 2008, 2007, and 2006, respectively.

Comprehensive Income - Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the consolidated balance sheet, such items, along with net income, are components of comprehensive income.

Reclassification - Certain amounts appearing in the prior year's financial statements have been reclassified to conform to the current year's financial statements.

New Accounting Pronouncement - In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157 (SFAS 157), Fair Value Measurements. SFAS 157 defines fair value and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. The provisions of SFAS 157 are effective for financial assets and liabilities for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-2, which defers the effective date of SFAS 157 for one year for certain nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. See Note 14 for further descriptions of the implementation of SFAS 157 on the Corporation's financial statements.

December 31, 2008, 2007 and 2006

Note 2 - Management's Plan

During 2008, Oxford Bank faced the harsh reality of the deteriorating Michigan economy. The Bank's market area experienced record foreclosures, elevated levels of unemployment, and precipitous declines in residential market values. These events had an adverse impact on the financial performance of the organization. Due to credit quality problems in the loan portfolio, the Bank was forced to dedicate significant time and resources to address inadequate lending and collection practices.

In 2008, the Bank provided \$17.3 million in provision for loan losses, had net loan charge-offs of \$16.3 million, and recorded \$4.7 million in costs associated with carrying and selling properties. Much of the costs of other real estate owned included maintenance and legal and professional fees associated with managing bank-owned properties.

The Bank also established a valuation reserve on the Corporation's deferred tax asset in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109) resulting in additional tax expense of approximately \$8.3 million. SFAS 109 requires companies to assess the need for valuation reserves respective to the future use of recorded deferred tax assets and liabilities. Based on all evidence obtained, both positive and negative, management concluded it was more likely than not that the Bank would not be able to utilize the deferred tax asset in accordance with SFAS 109 and placed a valuation allowance on the entire net asset.

The financial impact of the aforementioned events caused the capital condition of the Bank to deteriorate and ultimately led to the Bank being classified as undercapitalized by the Federal Deposit Insurance Corporation (FDIC) at December 31, 2008. This classification has resulted in the FDIC taking certain mandatory and discretionary measures under the Prompt and Corrective Action (PCA) provisions of the Federal Deposit Insurance Act.

In addition, the Bank entered into a Cease and Desist Order (the "Order") with the FDIC and State of Michigan Office of Financial and Insurance Regulation (OFIR). See Note 13 for disclosure of the requirements of the Order.

Management does not expect a dramatic improvement in the Michigan economy or a recovery in the weakened residential housing market in 2009. As a result, these economic factors will continue to negatively impact the Bank's overall performance and profitability. Despite these challenges, management has developed a strategic plan to mitigate the impact of these events on the financial position of the Bank. These objectives include sound interest earning asset and liability management to achieve net interest margin goals, liquidity planning, improving asset quality, operating cost reductions, as well as process enhancements and efficiency improvements. The successful implementation of all of these objectives is not expected to produce profitable results.

Management plans to strategically reduce the balance sheet in 2009 by not renewing loans and deposits that mature and through deposit pricing changes that will be implemented to reduce the Bank's reliance on non-core and high cost funding sources. The successful execution of this strategy will protect regulatory capital and improve the net interest margin by taking advantage of the current rate environment and reducing high interest-bearing non-core deposit balances. This strategy will be closely monitored to protect liquidity, maintain important customer relationships, and remain in compliance with policy and certain regulatory guidelines.

In 2009, management plans to increase access to contingent funding sources to improve the overall liquidity position of the Bank despite the decision to reduce non-core deposits. The additional liquidity will be generated by pledging eligible investments and commercial and mortgage loans as collateral to the Federal Reserve and the Federal Home Loan Bank. As of December 31, 2008, the Bank had access to approximately \$41.0 million in alternative funding with no outstanding borrowings. The Bank will continue to monitor and increase available sources to address potential funding needs.

Improving asset quality in 2009 will be paramount to the Bank's future. Management will continue to strengthen underwriting standards, review collection efforts to identify opportunities to enhance our current procedures, and develop more effective reports to analyze current trends and historical data. Loan officers in all departments will continue to initiate and maintain dialogue with customers experiencing financial difficulties and provide loan modifications where appropriate. This will allow the Bank to more effectively react to potential problems and reduce adversely classified assets. The Bank will continue to dedicate considerable resources to manage nonperforming assets and address the inherent credit issues in the loan portfolio. These continued efforts are designed to reduce net charge-off activity, provision for loan loss expense, and improve delinquency trends.

Management will also be implementing a cost-cutting initiative in 2009 to improve the Bank's operating efficiency. The cost reductions will include eliminating staff, reducing capital expenditures, and reducing overall operating costs. Each Bank department will review staffing capacity and make reductions where appropriate. Capital expenditures will be limited in 2009 to projects that will provide efficiency improvements or cost reductions and advertising and other discretionary costs will be cut or eliminated. The Bank also plans to reduce other loan expense and costs associated with managing bank owned properties in 2009 as well. During 2008, all delinquent property taxes on loans on bank-owned property and loans in the process of foreclosure were paid current. In addition, contracts with vendors and legal representatives have been negotiated at lower rates for 2009. Management continues to review vendor and supply management contracts in an effort to produce additional cost savings. Other cost savings and income producing opportunities are being pursued including the sale of non-essential assets and select Bank branches. These actions are vital and could provide additional income and help sustain capital levels in 2009.

Notes to Consolidated Financial Statements

December 31, 2008, 2007 and 2006

Note 2 - Management's Plan continued

The most important objective in 2009 will be to strengthen the capital position of the Bank. Currently, the Bank is in violation of the Order's capital requirement and is classified as undercapitalized under the Prompt and Corrective Action provisions of the Federal Deposit Insurance Act. A definitive plan to increase the regulatory capital ratios has been developed and includes successfully executing management's objectives, specifically reducing the size of the Bank, eliminating costs to improve the operating efficiency of the organization, and significantly improving asset quality. In addition, the board has retained an attorney and market professional to assist with raising capital. The Bank will aggressively pursue all potential alternatives and sources to restore capital to required capital levels. Potential alternatives include attempting to raise capital through the existing stockholder base, accessing capital market investors, and identifying suitors for a sale or merger.

There are no assurances these objectives will improve the Bank's financial condition and further deterioration in the capital position is possible. The economic environment of southeast Michigan and the local real estate conditions could continue to adversely impact results. Any further decline in capital may result in more severe and aggressive actions by the FDIC and OFIR.

Note 3 - Securities

The amortized cost and fair value of securities, with gross unrealized gains and losses, follow (000's omitted):

2008				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Available-for-sale securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 16,803	\$ 749	\$ -	\$ 17,552
Obligations of state and political subdivisions	16,800	319	(1)	17,118
Corporate securities	800	-	(89)	711
Mortgage-backed securities	11,871	180	(63)	11,988
Total available-for-sale securities	\$ 46,274	\$ 1,248	\$ (153)	\$ 47,369
Held-to-maturity securities -				
U.S. government and federal agency	\$ 9,174	\$ 115	\$ (1)	\$ 9,288
2007				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Available-for-sale securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 21,073	\$ 538	\$ (5)	\$ 21,606
Obligations of state and political subdivisions	12,397	106	(13)	12,490
Corporate securities	800	-	(36)	764
Mortgage-backed securities	4,720	31	-	4,751
Total available-for-sale securities	\$ 38,990	\$ 675	\$ (54)	\$ 39,611
Held-to-maturity securities -				
Obligations of state and political subdivisions	\$ 13,913	\$ 56	\$ (15)	\$ 13,954

At December 31, 2008 and 2007, securities with a carrying value of \$2,197,000 and \$2,533,000, respectively, were pledged to secure public deposits and for other purposes required or permitted by law. Additionally, the Bank has pledged securities with the Federal Reserve Bank (FRB), Comerica, and Federal Home Loan Bank (FHLB) totaling \$44,730,000 under various agreements to facilitate short-term funding needs at the Corporation. See Note 7 for borrowing information.

Notes to Consolidated Financial Statements

December 31, 2008, 2007 and 2006

Note 3 - Securities *continued*

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2007 follow (000's omitted):

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Market Value	Amortized Cost	Market Value
Due in one year or less	\$ 1,249	\$ 1,263	\$ 2,864	\$ 2,881
Due in one year through five years	22,253	22,859	3,470	3,520
Due after five years through ten years	9,102	9,544	2,265	2,312
Due after ten years	1,799	1,715	575	575
Total	34,403	35,381	9,174	9,288
Mortgage-backed securities	11,871	11,988	-	-
Total	\$ 46,274	\$ 47,369	\$ 9,174	\$ 9,288

For the years ended December 31, 2008, 2007, and 2006, proceeds from sales of securities available-for-sale amounted to \$618,000, \$0, and \$14,129,000, respectively. Gross realized losses amounted to \$71,000, \$0, and \$99,000, respectively. The tax benefit applicable to these net realized losses amounted to \$24,000, \$0, and \$34,000, respectively.

Information pertaining to securities with gross unrealized losses at December 31, 2008 and 2007, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows (000's omitted):

	December 31, 2008			
	Less Than 12 Months		Over 12 Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
Obligations of state and political subdivisions	\$ -	\$ -	\$ (1)	\$ 330
Mortgage-backed	(63)	5,599	-	-
Corporate securities	(89)	211	-	-
Total available-for-sale securities	\$ (152)	\$ 5,810	\$ (1)	\$ 330
Held-to-maturity securities:				
Obligations of state and political subdivisions	\$ (1)	\$ 99	\$ -	\$ -

	December 31, 2007			
	Less Than 12 Months		Over 12 Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. Treasury securities and obligations of U.S. government, corporations and agencies	\$ -	\$ -	\$ (5)	\$ 4,489
Obligations of state and political subdivisions	(11)	682	(2)	1,155
Corporate securities	(36)	764	-	-
Total available-for-sale securities	\$ (47)	\$ 1,446	\$ (7)	\$ 5,644
Held-to-maturity securities:				
Obligations of state and political subdivisions	\$ (1)	\$ 176	\$ (14)	\$ 3,085

The unrealized losses on the securities held in the portfolio are not considered other than temporarily impaired (OTTI) and have not been recognized into income. This decision is based on the Corporation's ability and intent to hold any potentially impaired security until maturity, the performance of the security based on the contractual terms of the agreement, the extent of the impairment, and the financial condition and credit quality of the issuer. The decline in market value is considered temporary and a result of changes in interest rates and other market variables.

Notes to Consolidated Financial Statements

December 31, 2008, 2007 and 2006

Note 4 - Loans

A summary of the balances of loans follows (000's omitted):

	2008	2007
Mortgage loans on real estate:		
Residential 1-4 family	\$ 65,541	\$ 79,322
Commercial loans	108,907	109,236
Construction and other	11,196	25,804
Total mortgage loans on real estate	185,644	214,362
Commercial loans	28,104	38,400
Consumer installment loans	60,144	77,619
Total loans	273,892	330,381
Less allowances for loan losses	10,664	9,690
Net loans	\$ 263,228	\$ 320,691

An analysis of the allowance for loan losses follows (000's omitted):

	2008	2007	2006
Balance at beginning of year	\$ 9,690	\$ 4,193	\$ 4,003
Provision for loan losses	17,300	11,997	2,026
Loans charged off	(17,452)	(7,690)	(3,303)
Recoveries of loans previously charged off	1,126	1,190	1,467
Balance at end of year	\$ 10,664	\$ 9,690	\$ 4,193

The following is a summary of information pertaining to impaired loans (000's omitted):

	2008	2007
Impaired loans without a valuation allowance	\$ 1,374	\$ 1,095
Impaired loans with a valuation allowance	4,553	6,042
Total impaired	\$ 5,927	\$ 7,137
Valuation allowance related to impaired loans	\$ 614	\$ 1,925
Total nonaccrual loans	15,255	23,154
Total loans past due 90 days or more and still accruing	\$ -	\$ 338

The following is a summary of information pertaining to impaired loans (000's omitted):

	2008	2007	2006
Average investment in impaired loans	\$ 6,454	\$ 5,506	\$ 2,303
Interest income recognized on impaired loans	\$ -	\$ -	\$ -
Interest income recognized on a cash basis on impaired loans	\$ 4	\$ -	\$ 2

In the ordinary course of business, the Bank has granted loans to principal officers and directors and their affiliates amounting to \$5,769,000 at December 31, 2008 and \$6,733,000 at December 31, 2007. During the year ended December 31, 2008, total principal additions were \$417,000 and total principal payments were \$1,381,000.

Notes to Consolidated Financial Statements

December 31, 2008, 2007 and 2006

Note 5 - Bank Premises and Equipment

A summary of the cost and accumulated depreciation of premises and equipment follows (000's omitted):

	2008	2007
Land	\$ 3,777	\$ 3,796
Buildings and building improvements	8,533	8,481
Furniture, fixtures, and equipment	5,228	5,088
Vehicles	136	88
Total premises and equipment	17,674	17,453
Accumulated depreciation	(8,419)	(7,857)
Net premises and equipment	\$ 9,255	\$ 9,596

Depreciation expense for the years ended December 31, 2008, 2007, and 2006 amounted to \$562,000, \$653,000, and \$609,000, respectively.

Note 6 - Deposits

The aggregate amount of time deposits in denominations of \$100,000 or more at December 31, 2008 and 2007 was \$48,176,000 and \$39,274,000, respectively. At December 31, 2008, the scheduled maturities of time deposits are as follows (000's omitted):

2009	\$ 110,069
2010	44,931
2011	4,986
2012	754
2013	395
Thereafter	5,357
Total	\$ 166,492

Note 7 - Borrowings

In 2008, the Bank entered into a discount window loan agreement with the Federal Reserve Bank that allows for advances of up to \$10,250,000. The advances are secured by investment securities with a fair value of approximately \$11,712,000. The interest rate on the advances is based on the quoted Federal Reserve discount window rates (effective rate of 0.50 percent as of December 31, 2008). At December 31, 2008, the Bank had \$0 in outstanding advances.

The Bank has an available line with Comerica Bank as of December 31, 2008. The line allows for advances of up to \$10,000,000. The line is secured by investment securities with a fair value of approximately \$11,447,000. At December 31, 2008, the Bank had \$0 outstanding on the line.

The Bank has the ability to obtain fixed and variable rate advances with the Federal Home Loan Bank of Indianapolis. Available borrowings with the Federal Home Loan Bank at December 31, 2008 total \$20,442,000 and were secured by available-for-sale securities with a fair value of \$21,571,000. At December 31, 2008, the Bank had \$0 in outstanding advances.



Notes to Consolidated Financial Statements

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Note 8 - Income Taxes

The Corporation has net operating loss carry forwards of approximately \$11,297,000 generated from inception through December 31, 2008 that are available to reduce future taxable income through the years ending December 31, 2028.

The components of the net deferred tax assets, included in other assets, are as follows (000's omitted):

Deferred tax assets:	2008	2007
Net operating loss carry forward	\$ 3,841	\$ -
Allowance for loan losses	3,626	3,295
Deferred compensation	55	229
Non-accrual loan interest	530	62
Other real estate owned	609	124
Other	110	141
Total deferred tax assets	8,771	3,851
Deferred tax liabilities:		
Accretion on investment securities	17	11
Original issue discount	86	116
Deferred loan fees and costs	125	158
Depreciation	92	111
Other	155	167
Total deferred tax liabilities	475	563
Valuation allowance	8,296	-
Net deferred tax assets	\$ -	\$ 3,288

At December 31, 2008 and 2007, the Bank had deferred tax liabilities attributable to unrealized gains on securities available for sale of \$372,000 and \$211,000, respectively.

During 2008, the Bank recorded a valuation allowance of \$8,296,000 based on principles of uncertainty about the Corporation's ability to generate sufficient future taxable income to realize all of the related temporary differences. The expense for recording the valuation allowance is a non-cash item, and the recording of this expense does not imply that the company owes additional income taxes. Management will continue to review tax criteria related to the recognition of deferred tax assets.

Allocation of income taxes between current and deferred portions is as follows (000's omitted):

	2008	2007	2006
Current	\$ (1,476)	\$ (1,510)	\$ 1,701
Deferred	(5,043)	(1,903)	(347)
Change in valuation allowance	8,296	-	-
Total income tax (recovery) expense	\$ 1,777	\$ (3,413)	\$ 1,354

Note 9- Employee Benefit Plans

The Bank maintains a noncontributory profit-sharing plan for all eligible employees. Contributions by the Bank are discretionary in such amounts as the board of directors may determine. The Bank did not make a discretionary contribution in 2008 or 2007. The Bank's contribution was \$350,000 in 2006.

The Bank also has a 401(k) profit-sharing plan. Eligible employees may defer a portion of their salary. The Bank made matching contributions of up to 3 percent, 6 percent, and 6 percent of the employee's contribution for 2008, 2007, and 2006, respectively. The Bank's contributions to the plan were \$144,000, \$270,000, and \$269,000 for 2008, 2007, and 2006, respectively.

Notes to Consolidated Financial Statements

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Note 10 - Off-Balance-Sheet Activities

Credit-Related Financial Instruments - The Corporation is a party to credit-related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters-of-credit, and commercial letters-of-credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet.

The Corporation's exposure to credit loss is represented by the contractual amount of these commitments. The Corporation follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

At December 31, 2008 and 2007, the following financial instruments were outstanding whose contract amounts represent credit risk (000's omitted):

	Contract Amount	
	2008	2007
Commitments to grant loans	\$ 45,800	\$ 127,399
Unfunded commitments under lines-of-credit	13,206	47,691
Commercial and standby letters-of-credit	722	963

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

Unfunded commitments under commercial lines-of-credit, revolving credit lines, and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines-of-credit are collateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Corporation is committed.

Commercial and standby letters-of-credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those letters-of-credit are used primarily to support public and private borrowing arrangements. Essentially all letters-of-credit issued have expiration dates within one year. The credit risk involved is extending loan facilities to customers. The Corporation generally holds collateral supporting those commitments if deemed necessary.

Collateral Requirements - To reduce credit risk related to the use of credit-related financial instruments, the Corporation might deem it necessary to obtain collateral. The amount and nature of the collateral obtained are based on the Corporation's credit evaluation of the customer. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant, and equipment, and real estate.

If the counterparty does not have the right and ability to redeem the collateral or the Corporation is permitted to sell or repledge the collateral on short notice, the Corporation records the collateral in its balance sheet at fair value with a corresponding obligation to return it.

Legal Contingencies - Various legal claims also arise from time to time in the normal course of business which, in the opinion of management, will have no material effect on the Corporation's financial statements.

Note 11 - Restrictions on Dividends, Loans, and Advances

Banking regulations place certain restrictions on dividends paid and loans or advances made by the Bank to the Corporation. The total amount of dividends which may be paid at any date is generally limited to the retained earnings of the Bank. However, dividends paid by the Bank would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum standards. At December 31, 2008, the Bank was not authorized to pay dividends to the Corporation without prior regulatory approval.

Loans or advances made by the Bank to the Corporation are generally limited to 10 percent of the Bank's capital stock and surplus.

Note 12 - Fair Value of Financial Instruments

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Corporation's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. SFAS 107 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Corporation.

The following methods and assumptions were used by the Corporation in estimating fair value disclosures for financial instruments:

Cash and Cash Equivalents - The carrying amounts of cash and cash equivalents approximate fair values.

Securities - Fair values of securities are based on quoted market prices. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. The carrying value of Federal Home Loan Bank stock approximates fair value based on the redemption provisions of the issuers.

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Note 12 - Fair Value of Financial Instruments *continued*

Loans Receivable - For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values of nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Deposit Liabilities - The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Short-term Borrowings - The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings maturing within 90 days approximate their fair values. Fair values of other short-term borrowings are estimated using discounted cash flow analyses based on the Corporation's current incremental borrowing rates for similar types of borrowing arrangements.

Accrued Interest - The carrying amounts of accrued interest approximate fair value.

Other Financial Instruments - The fair value of other financial instruments, including loan commitments and unfunded letters of credit, based on discounted cash flow analyses, is not material.

The estimated fair values and related carrying or notional amounts of the Corporation's financial instruments are as follows (000's omitted):

	2008		2007	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and equivalents	\$ 21,515	\$ 21,515	\$ 62,801	\$ 62,801
Available-for-sale securities	47,369	47,369	39,611	39,611
Held-to-maturity securities	9,174	9,288	13,913	13,954
Federal Home Loan Bank stock	1,096	1,096	1,096	1,096
Loans	263,228	263,598	320,691	320,498
Accrued interest receivable	1,747	1,747	2,518	2,518
Financial liabilities:				
Deposits	340,900	341,439	420,749	417,659
Short-term borrowings	1,258	1,258	681	681
Accrued interest payable	744	744	1,740	1,740

Note 13 - Minimum 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 Bank's 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 their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). As of December 31, 2008, management has determined that the Bank is undercapitalized.

As of December 31, 2008, the most recent notification from the Bank's primary regulator categorized the Bank as undercapitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category.

Notes to Consolidated Financial Statements

December 31, 2008, 2007 and 2006

Note 13 - Minimum Regulatory Capital Requirements *continued*

The Bank's actual capital amounts and ratios as of December 31, 2008 and 2007 are presented in the table (000's omitted).

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(000's omitted)						
As of December 31, 2008						
Total capital						
to risk-weighted assets	\$ 20,669	7.4%	\$ 22,920	8.0%	\$ 28,650	10.0%
Tier 1 capital						
to risk-weighted assets	17,106	6.2%	11,496	4.0%	17,245	6.0%
Tier 1 capital						
to average assets	17,106	4.6%	14,610	4.0%	14,370	5.0%
As of December 31, 2007						
Total capital						
to risk-weighted assets	42,000	12.2%	27,489	8.0%	34,361	10.0%
Tier 1 capital						
to risk-weighted assets	37,638	11.0%	13,744	4.0%	20,617	6.0%
Tier 1 capital						
to average assets	37,638	8.2%	18,339	4.0%	22,923	5.0%

Effective May 25, 2008, the Bank entered into a formal Cease and Desist Order (the "Order") with the Federal Deposit Insurance Corporation and the State of Michigan Office of Financial and Insurance Regulation (OFIR). The Order will remain in effect until modified or terminated by action of the FDIC and OFIR. The Order identifies certain deficiencies in the Bank's policies and procedures for safe and sound operation, board participation in the management of the Bank, credit underwriting and administration, asset/liability management, liquidity, funds management, and reduction of substandard assets and requires the Bank to maintain specified capital ratios for the life of the Order.

The Order requires the Bank to, among other things, file with the FDIC and OFIR within prescribed time periods updated progress plans, which specifically incorporate the requirements set forth in the Order. In addition, the Order requires the Bank to receive the permission of the FDIC and OFIR prior to (i) making or declaring any dividends; (ii) adding or replacing a director or hiring a senior executive officer; and (iii) making any golden parachute payments to any institution-affiliated party.

The Order requires the Bank to hire an independent consultant to provide a written analysis and assessment of the Bank's management needs and to develop a plan to implement their recommendations. The plan must be approved by the regulators and provide the Bank with qualified management who have experience commensurate with their responsibilities. In addition, the board of directors are required to increase their participation in the direction and management of the Bank.

The Order also requires the Bank to make adjustments to lending policies, procedures, and monitoring mechanisms. These actions include (i) creating an executive loan committee comprised of five members, the majority of whom are independent directors who will evaluate, monitor, and review lending activity and compliance with Bank policy; (ii) establishing a plan for reducing adversely classified assets; (iii) developing new internal loan review procedures to assist in identifying, categorizing, and monitoring problem credits; (iv) designing stratification reports based on specific loan attributes for board review; and (v) evaluating the adequacy and accuracy of the allowance for loan and lease losses methodology and calculation.

In addition, the Order contains recommendations for improving the reporting function of the Bank. These changes include (i) developing a reporting plan to verify information provided to management and the board of directors is accurate, consistent, and adequately identifies problem areas; (ii) creating a formal profit plan containing strategic objectives and core assumptions on how to reduce operating costs and improve earnings; (iii) evaluating on a quarterly basis the performance of the Bank in relation to the profit plan and documenting the results; and (iv) developing separate and distinct records for the Holding Company and Bank.

Under the Order, the Bank also must make improvements to specific policies and procedures. The recommendations include (i) developing and implementing a more comprehensive and effective asset/liability policy; (ii) creating and adopting a written plan addressing liquidity; and (iii) implementing procedures to prevent future violations of rules and regulations.

If the Bank is unable to timely comply with the Order, there could be material adverse effects on the Bank and the Corporation.

Notes to Consolidated Financial Statements

December 31, 2008, 2007 and 2006

Note 14 - Fair Value Measurements

The following tables present information about the Bank's assets measured at fair value on a recurring basis at December 31, 2008 and the valuation techniques used by the Bank to determine those fair values.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the Bank has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset or liability.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Bank's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

Assets Measured at Fair Value on a Recurring Basis at December 31, 2008

Quoted Prices in Active Markets for Identical Asset (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2008
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Assets - Investment securities available-for-sale

\$ -	\$ 46,658	\$ 711	\$ 47,369
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The Bank had two securities totaling \$711,000 classified as Level 3 at December 31, 2008. Of the Level 3 assets that were held by the Bank at December 31, 2008, there were unrealized losses of \$53,000 and no realized gains or losses on sales of securities recognized during the period. The Bank did not purchase any Level 3 assets during the year.

Both observable and unobservable inputs may be used to determine the fair value of positions classified as Level 3 assets and liabilities. As a result, the unrealized gains and losses for these assets and liabilities presented in the tables above may include changes in fair value that were attributable to both observable and unobservable inputs.

Available-for-sale investment securities categorized as Level 3 assets primarily consist of trust preferred securities in other financial institutions. The Bank estimates the fair value of these bonds based on the present value of expected future cash flows using management's best estimate of key assumptions, including forecasted interest yield and payment rates, credit quality, and a discount rate commensurate with the current market and other risks involved.

The Bank also has certain assets that are measured at fair value on a nonrecurring basis. These assets are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment.) At December 31, 2008, the Bank had impaired loans accounted for under SFAS 114 totaling \$5,927,000 categorized as Level 3 assets. The change in fair value for the year ended December 31, 2008 was \$3,757,000.

The fair value of impaired loans accounted for under SFAS 114 is estimated using either discounted cash flows or collateral value. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2008, substantially all of the total impaired loans were evaluated based on the fair value of collateral. In accordance with SFAS 157, impaired loans where an allowance is established based on fair value of collateral require classification in fair value hierarchy.

Impaired loans are categorized as Level 3 assets because the values are based on available collateral (typically based on outside appraisals) and customized discounting criteria, if deemed necessary. The change in fair value of impaired loans is accounted for in the allowance for loan losses (see Note 4).