

2016
**Annual
Report**



Kent Office



Ravenna Office

Neighbors Serving Neighbors

To Our Fellow Shareholders,

On behalf of the Board of Directors and Management, I am extremely pleased to share the financial results and successful performance of Portage Bancshares, Inc. (the “Company”), parent company of Portage Community Bank (the “Bank”), for the year ended December 31, 2016. Our continued emphasis on our vision of “Neighbors Serving Neighbors,” along with local ownership, local management, and, most importantly, local decisions have contributed new records for achievement for the Company in 2016.

Following a record financial year in 2015, I am pleased to report record net income of \$2,688,052 for 2016, which is up 2.25% from net income of \$2,628,891 for 2015. Because of our strong capital position, the Board of Directors increased the cash dividend to \$0.95 per share in 2016 from \$0.85 per share in 2015 – an 11.76% increase. Basic earnings per share came in at \$5.62 for 2016 as compared to \$5.67 for 2015. We are extremely proud of these outstanding financial results.

In 2016, we continued to follow a multifaceted long-term plan to grow the Company’s value through efficient operations, driving increased productivity, and the continual development, enhancement, and offering of dynamic banking solutions and resources to meet the needs of our customers. Through the continued implementation of our plan, we not only grew deposits by 7.34% in 2016, but we were also successful in migrating our deposit base towards more core related funding. Accordingly, we were able to lessen our dependence on wholesale funding and lower our overall wholesale funding ratio from 15.29% to 12.29% in 2016 and achieve a lower cost of funds. The Bank continues to see growth in the use of our electronic and mobile banking technologies and is properly positioned to take advantage of our strengthened retail deposit system to continue to reduce the need for wholesale funding on our balance sheet and further improve our cost of funds.

In addition, we are excited to share the following other 2016 highlights:

- The Portage Community Financial Services Division continued to excel by growing assets under management to \$70.3 million in 2016, up \$10.9 million or 15.47% from 2015.
- The Mortgage Division experienced their most successful year ever with \$820,233 in secondary market fees. Overall, the Mortgage Division made 283 loans totaling \$36.8 million in 2016 as compared to 245 loans totaling \$33.5 million in 2015; which is just another example of our Bank helping customers purchase the homes they desire.
- We completed the construction of our new Mortgage Division facility that replaced our previous facility next to the Kent Office on South Water Street. The improvements were considered necessary for our continued growth opportunities.
- For the 19th consecutive quarter, Portage Community Bank received a Five-Star “Superior” rating from Bauer Financial, Inc., the nation’s leading bank rating and research firm. The Five-Star “Superior” rating is the highest rating achievable and indicates the institution is one of the strongest banks in the nation.
- We continue to achieve very strong results through our outsourced, third party internal and external bank compliance, audit, and review service providers.

The successful performance of the Company would not have been possible without the efforts of our committed Board of Directors, dedicated management team, and loyal and knowledgeable staff. We believe as we move forward into 2017, we are well positioned to continue to meet the high standards we have set and to exceed your expectations. Most of all, thank you to our customers and shareholders for your continued support and having the confidence in us to continually make our “Company” successful.

Sincerely,



Richard J. Coe
Chief Executive Officer

PORTAGE BANCSHARES, INC.
CONSOLIDATED AUDITED FINANCIAL STATEMENTS
DECEMBER 31, 2016

Independent Auditors Report	2
Financial Statements	
Consolidated Balance Sheet.	3
Consolidated Statement of Income	4
Consolidated Statement of Comprehensive Income	5
Consolidated Statement of Changes in Stockholders' Equity	6
Consolidated Statement of Cash Flows	7
Notes to Consolidated Financial Statements	8 - 32

INDEPENDENT AUDITORS REPORT

Board of Directors and Shareholders
Portage Bancshares, Inc.
Ravenna, Ohio

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Portage Bancshares, Inc. and subsidiary which comprise the consolidated balance sheet as of December 31, 2016 and 2015; the related consolidated statement of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended; and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Portage Bancshares, Inc. and subsidiary as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Zeno, Pockl, Lilly and Cyrlus, A.C.

Wheeling, West Virginia
March 30, 2017

PORTAGE BANCSHARES, INC.
CONSOLIDATED BALANCE SHEET

December 31,

	2016	2015
Assets		
Cash and due from banks	\$ 13,086,132	\$ 14,985,544
Interest-bearing deposits in other financial institutions	1,891,787	1,259,396
Federal funds sold	—	1,000
Cash and cash equivalents	14,977,919	16,245,940
Investment securities available for sale	66,595,388	52,694,749
Loans held for sale	362,519	755,267
Loans	220,866,683	217,313,409
Less allowance for loan losses	2,815,706	2,856,417
Net loans	218,050,977	214,456,992
Regulatory stock	1,262,750	1,240,250
Premises and equipment, net	4,684,848	4,470,964
Bank-owned life insurance	7,820,807	6,630,830
Accrued interest receivable	847,963	752,680
Other assets	2,094,125	1,992,466
Total Assets	\$ 316,697,296	\$ 299,240,138
Liabilities		
Deposits		
Non-interest-bearing	\$ 40,335,365	\$ 35,924,405
Interest-bearing demand	31,814,772	25,390,817
Savings	114,156,419	109,519,418
Time	75,715,386	73,279,287
Total deposits	262,021,942	244,113,927
Federal funds purchased	490,000	—
Federal Home Loan Bank advances	15,467,212	18,068,532
Subordinated debentures	2,450,000	2,450,000
Accrued interest payable and other liabilities	3,129,608	2,650,083
Total Liabilities	283,558,762	267,282,542
Stockholders' Equity		
Common stock, no par value; 800,000 shares authorized, 505,205 and 501,605 shares issued; 476,200 and 477,848 outstanding	18,394,160	18,182,189
Retained earnings	17,346,632	15,115,006
Accumulated other comprehensive income (loss)	(334,966)	463,053
Treasury stock, at cost (29,005 and 23,757 shares)	(2,267,292)	(1,802,652)
Total Stockholders' Equity	33,138,534	31,957,596
Total Liabilities and Stockholders' Equity	\$ 316,697,296	\$ 299,240,138

See accompanying notes to consolidated financial statements.

PORTAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF INCOME

Year Ended December 31,

	2016	2015

Interest and Dividend Income		
Interest and fees on loans	\$ 10,002,358	\$ 9,966,345
Federal funds sold and other interest income	93,580	31,945
Investment securities:		
Taxable	564,312	464,625
Exempt from federal income tax	653,495	585,785
Other dividend income	57,342	56,883
Total interest and dividend income	11,371,087	11,105,583
Interest Expense		
Deposits	1,285,886	1,157,107
Federal Home Loan Bank advances	273,531	426,593
Subordinated debentures	75,402	82,178
Total interest expense	1,634,819	1,665,878
Net Interest Income	9,736,268	9,439,705
Provision for loan losses	—	—
Net Interest Income After Provision For Loan Losses	9,736,268	9,439,705
Noninterest Income		
Service charges on deposit accounts	138,855	144,434
Investment securities gains (losses), net	13,426	1,797
Secondary market fees	820,233	693,905
Earnings on bank-owned life insurance	189,977	169,346
Investment banking fees and commissions	259,563	248,542
Gain from other real estate owned	69,673	75,939
Other income	300,121	308,265
Total noninterest income	1,791,848	1,642,228
Noninterest Expense		
Salaries and employee benefits	4,473,511	4,167,400
Net occupancy and equipment expenses	452,073	390,657
Data processing	399,471	331,716
Professional fees	250,291	284,369
Marketing and business development	315,766	300,092
Financial institutions tax	213,013	192,045
Federal deposit insurance	159,151	182,409
Other expense	1,608,763	1,647,602
Total noninterest expense	7,872,039	7,496,290
Income before income taxes	3,656,077	3,585,643
Income taxes	968,025	956,752
Net Income	\$ 2,688,052	\$ 2,628,891
Earnings Per Share		
Basic	\$ 5.62	\$ 5.67
Diluted	5.41	5.42

See accompanying notes to consolidated financial statements.

PORTAGE BANCSHARES, INC.
 CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year Ended December 31,

	2016	2015
Net income	\$ 2,688,052	\$ 2,628,891
Other comprehensive income (loss):		
Unrealized holding loss arising during the period	(1,195,694)	(14,759)
Tax effect	406,536	5,018
Reclassification of investment securities losses recognized in net income	(13,426)	(1,797)
Tax effect	4,565	611
Total other comprehensive (loss) income	(798,019)	(10,927)
Comprehensive income	\$ 1,890,033	\$ 2,617,964

See accompanying notes to consolidated financial statements.

PORTAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2014	\$ 16,908,537	\$ 12,879,911	\$ 473,980	\$ (1,798,142)	\$ 28,464,286
Purchase of 5,139 shares of treasury stock				(418,993)	(418,993)
Stock-based compensation expense	15,574				15,574
Exercise of 23,476 shares of stock options	1,031,485				1,031,485
Tax benefits from exercise of stock options	131,328				131,328
Issuance of 5,965 shares of common stock for subscription and share purchase agreement	95,265			499,052	509,748
Cash dividends declared (\$0.85 per share)		(393,796)			(393,796)
Net income		2,628,891			2,628,891
Other comprehensive loss, net			(10,927)		(10,927)
Balance, December 31, 2015	18,182,189	15,115,006	463,053	(1,802,652)	31,957,596
Purchase of 5,248 shares of treasury stock				(464,640)	(464,640)
Stock-based compensation expense	11,103				11,103
Exercise of 3,600 shares of stock options	180,000				180,000
Tax benefits from exercise of stock options	20,868				20,868
Cash dividends declared (\$0.95 per share)		(456,426)			(456,426)
Net income		2,688,052			2,688,052
Other comprehensive loss, net			(798,019)		(798,019)
Balance, December 31, 2016	18,394,160	17,346,632	(334,966)	(2,267,292)	33,138,534

See accompanying notes to consolidated financial statements.

PORTAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

Year Ended December 31,

	2016	2015
Operating Activities		
Net income	\$ 2,688,052	\$ 2,628,891
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	—	—
Depreciation of premises and equipment	172,916	146,843
Net amortization of investment securities	496,334	489,272
Net realized gain on sales of investment securities	(13,426)	(1,797)
Secondary market income	(820,233)	(693,905)
Originations of loans held for sale	(27,468,352)	(23,376,903)
Proceeds from sale of loans held for sale	27,861,100	23,531,699
Net realized gain on sales of other real estate owned	(69,673)	(75,939)
Stock-based compensation expense	11,103	15,574
Earnings on bank-owned life insurance	(189,977)	(169,346)
Deferred income taxes	(79,042)	(11,734)
Net amortization of deferred loan fees	52,241	19,759
Tax benefit from exercise of stock options	(20,868)	(131,328)
Amortization of Federal Home Loan Bank restructuring fee	—	76,958
Other, net	526,631	659,367
Net cash provided by operating activities	<u>3,146,806</u>	<u>3,107,411</u>
Investing Activities		
Available for sale investment securities:		
Proceeds from sales	2,065,929	1,472,601
Proceeds from maturities, prepayments and calls	10,877,772	7,517,716
Purchases	(28,536,368)	(13,445,760)
Purchase of Federal Home Loan Bank stock	(22,500)	—
Loan originations and payments, net	(3,030,231)	(5,215,305)
Additions to premises and equipment	(386,800)	(680,141)
Purchase of bank-owned life insurance	(1,000,000)	—
Proceeds from sale of other real estate owned	540,874	474,425
Net cash used for investing activities	<u>(19,491,324)</u>	<u>(9,876,464)</u>
Financing Activities		
Net change in deposits	17,908,015	16,146,123
Proceeds from Federal Home Loan Bank advances	3,750,000	4,500,000
Repayment of Federal Home Loan Bank advances	(6,351,320)	(5,868,371)
Net change in federal funds purchased	490,000	—
Purchase of treasury stock	(464,640)	(418,993)
Proceeds from the sale of treasury stock	—	509,748
Tax benefit from exercise of stock options	20,868	131,328
Proceeds from exercise of stock options	180,000	1,031,485
Cash dividends paid	(456,426)	(393,796)
Net cash provided by financing activities	<u>15,076,497</u>	<u>15,637,524</u>
Increase (decrease) in cash and cash equivalents	(1,268,021)	8,868,471
Cash and Cash Equivalents		
at Beginning of Year	<u>16,245,940</u>	<u>7,377,469</u>
Cash and Cash Equivalents		
at End of Year	<u>\$ 14,977,919</u>	<u>\$ 16,245,940</u>

See accompanying notes to consolidated financial statements.

PORTAGE BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting and reporting policies applied in the presentation of the accompanying financial statements follows:

Nature of Operations and Basis of Presentation

Portage Bancshares, Inc. (the “Company”) is a bank holding company whose principal activity is the ownership and management of its wholly owned subsidiary, Portage Community Bank (the “Bank”). The Bank generates commercial, mortgage, and consumer loans and receives deposits from customers located primarily in Portage County in Ohio and the surrounding areas. The Bank is subject to regulations by the State of Ohio Division of Financial Institutions and the Company is subject to regulations by the Federal Reserve System through the Federal Reserve Bank of Cleveland.

The consolidated financial statements include the accounts of the Company and the Bank after elimination of all significant intercompany transactions and balances.

The accounting principles followed by the Company and the methods of applying these principles conform to U.S. generally accepted accounting principles and to general practice within the banking industry. Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the balance sheet date and reported amounts of revenues and expenses for that period. Actual results could differ from those estimates.

Investment Securities

Currently, the Company’s investment securities portfolio is classified as available for sale. The portfolio serves principally as a source of liquidity and is carried at fair value with unrealized holding gains and losses for available for sale securities reported in other comprehensive income, net of tax, until realized. Debt securities are adjusted for amortization of premium and accretion of discount, which are computed using the interest method and recognized as adjustments of interest income. Realized security gains and losses are computed using the specific identification method. Interest and dividends on investment securities are recognized as income when earned.

Securities are periodically reviewed for other-than-temporary impairment based upon a number of factors, including, but not limited to, the length of time and extent to which the fair value has been less than cost, the financial condition of the underlying issuer, the ability of the issuer to meet contractual obligations, the likelihood of the security’s ability to recover any decline in its fair value, and whether or not the Company intends to sell the security or whether it’s more likely than not that the Company would be required to sell the security before its anticipated recovery in fair value. A decline in value that is considered to be other

than temporary is recorded as a loss within noninterest income in the Consolidated Statement of Income.

Common stock of the Federal Home Loan Bank (“FHLB”) and Federal Reserve Bank represents ownership in institutions which are wholly owned by other financial institutions.

The Bank is a member of the FHLB of Cincinnati and, as such, is required to maintain a minimum investment in stock of the FHLB that varies with the level of advances outstanding with the FHLB. The stock is bought from and sold to the FHLB based upon its \$100 par value. The stock does not have a readily determinable fair value and, as such, is classified as restricted stock, carried at cost and evaluated by management. The stock’s value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) the significance of the decline in net assets of the FHLB as compared with the capital stock amount and the length of time this situation has persisted, (b) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance, (c) the impact of legislative and regulatory changes on the customer base of the FHLB, and (d) the liquidity position of the FHLB. Management evaluated the stock and concluded that the stock was not impaired for the periods presented herein. Management considered that the FHLB maintains regulatory capital ratios in excess of all regulatory capital requirements; liquidity appears adequate, new shares of FHLB stock continue to change hands at \$100 par value, and the resumption of dividends.

Loans Held for Sale

Loans held for sale are carried at the lower of cost or estimated fair value, as determined on an aggregate basis. Loans held for sale were \$362,519 and \$755,267 at December 31, 2016 and 2015, respectively.

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 unearned interest, deferred loan fees and costs, and an allowance for loan losses.

Interest income is accrued on the interest method based upon the unpaid principal balance and includes amortization of net deferred loan fees and costs over the loan term. Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. Past-due status is based on the contractual terms of the loan. Consumer loans are typically

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loans (Continued)

charged off no later than 120 days past due. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal and 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 ensured.

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 collectability 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 collectability 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, since it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component is related to impaired loans, which are commercial and commercial real estate loans for which it is probable that the Company will not be able to collect all amounts 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 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. Impairment is measured on a loan-by-loan basis for commercial and commercial mortgage loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the loan's obtainable market price or the fair value of the collateral if the loan is collateral-dependent. The Company individually evaluates such loans for impairment and does not aggregate

loans by major risk classifications. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. A component is maintained to cover uncertainties that could affect management's estimate of probable losses. This 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.

Large groups of smaller-balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential mortgage loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is principally computed on the straight-line method over the estimated useful lives of the related assets, which range from 3 to 10 years for furniture, fixtures, and equipment and 25 to 50 years for building premises. Leasehold improvements are amortized over the shorter of their estimated useful lives or their respective lease terms, which range from 7 to 15 years. Expenditures for maintenance and repairs are expensed as incurred. Costs of major additions and improvements are capitalized.

Bank-Owned Life Insurance (BOLI)

The Company owns insurance on the lives of a certain group of key employees. The policies were purchased to help offset the increase in the costs of various fringe benefit plans including healthcare. The cash surrender value of these policies is included as an asset on the Consolidated Balance Sheet, and any increases in the cash surrender value are recorded as noninterest income on the Consolidated Statement of Income. In the event of the death of an insured individual under these policies, the Company would receive a death benefit, which would be recorded as non-interest income.

Other Real Estate Owned

Other real estate acquired through or in lieu of foreclosure is initially recorded at the lower of cost or fair value, less estimated costs to sell, and any loan balance in excess of fair value is charged to the allowance for loan losses. Subsequent valuations are periodically performed and write-downs are included in noninterest expense, as are gains or losses upon sale and expenses related to maintenance of the properties.

Advertising Costs

Advertising costs are expensed as incurred.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Taxes

The Company and the Bank file a consolidated federal income tax return. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Benefit Plans

The 401(k) plan expense is the amount contributed and is determined by formula and by Board of Directors decision. Supplemental retirement expense allocates the benefits over the years of service. The director deferral plan expense is comprised of the annual amount of director fees deferred by participating directors and related interest earned.

Stock Options

During the years ended December 31, 2016 and 2015, the Company recorded \$11,103 and \$15,574 in compensation expenses on the Company's Consolidated Statement of Income. As of December 31, 2016 and 2015, there was \$18,513 and \$29,616 of unrecognized compensation cost related to unvested share-based compensation awards granted. That cost is expected to be recognized over the next three years.

The cash flows from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for stock-based awards (excess tax benefits) are classified as financing cash flows. The Company recognized \$20,868 and \$131,328 of excess tax benefits included as a financing cash inflow for the years ended December 31, 2016 and 2015, in the Consolidated Statement of Cash Flows.

For purposes of calculating compensation expense, the Company estimated the fair values of stock options using the Black-Scholes option-pricing model. The model requires the use of subjective assumptions that can materially affect fair value estimates. The fair value of each option is amortized into compensation expense on a straight-line basis between the grant date for the option and each vesting date.

Earnings Per Share

The Company provides dual presentation of basic and diluted earnings per share. Basic earnings per share are calculated utilizing net income as reported in the numerator and average shares outstanding in the denominator. The computation of diluted earnings per share differs in that the dilutive effects of any stock options are adjusted in the denominator.

Basic weighted-average common shares outstanding totaled 478,148 and 463,749 for December 31, 2016 and 2015, respectively. Diluted weighted-average common shares outstanding totaled 496,583 and 484,683 for December 31, 2016 and 2015, respectively. The diluted weighted-average common shares outstanding are solely the result of stock options.

Comprehensive Income

The Company is required to present comprehensive income (loss) and its components in a full set of general-purpose financial statements for all periods presented. Other comprehensive income (loss) comprises unrealized holding gains (losses) on the available for sale investment securities portfolio.

Cash Flow Information

For the purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits with other financial institutions, and federal funds sold with original maturities of less than 90 days.

Cash payments for interest in 2016 and 2015 were \$1,634,819 and \$1,668,550, respectively. Income tax payments totaled \$805,000 in 2016 and \$800,000 in 2015. The Company transferred \$204,238 and \$804,940 of loans from the portfolio to other real estate owned in 2016 and 2015, respectively. Fair value adjustments for securities available for sale in 2016 and 2015 were (\$1,209,121) and (\$16,556), respectively.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) 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 (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Reclassification

Certain items in the prior year's financial statements have been reclassified to conform to the current-year presentation. Such reclassifications did not affect consolidated net income or consolidated stockholders' equity.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 2: INVESTMENT SECURITIES AVAILABLE FOR SALE

The amortized cost, gross unrealized gains, gross unrealized losses, and fair values of investment securities available for sale are as follows:

	<u>2016</u>			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government sponsored entities and agencies	\$ 12,251,498	\$ 4,379	\$ (203,893)	\$ 12,051,984
Obligations of states and political subdivisions	31,357,806	253,563	(383,747)	31,227,622
Mortgage-backed securities: residential	18,108,296	119,914	(195,096)	18,033,114
Mortgage-backed securities: commercial	5,385,312	53	(102,697)	5,282,668
Total	<u>\$ 67,102,912</u>	<u>\$ 377,909</u>	<u>\$ (885,433)</u>	<u>\$ 66,595,388</u>

	<u>2015</u>			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government sponsored entities and agencies	\$ 6,731,000	\$ 32,936	\$ (26,459)	\$ 6,737,477
Obligations of states and political subdivisions	26,878,880	640,889	(63,513)	27,456,256
Mortgage-backed securities: residential	18,383,273	205,360	(87,617)	18,501,016
Total	<u>\$ 51,993,153</u>	<u>\$ 879,185</u>	<u>\$ (177,589)</u>	<u>\$ 52,694,749</u>

The amortized cost and fair value of investment securities at December 31, 2016, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due within one year	\$ 2,457,873	\$ 2,468,471
Due after one year through five years	14,335,010	14,266,476
Due after five years through ten years	11,867,611	11,816,263
Due after ten years	14,948,810	14,728,396
Mortgage-backed securities: residential	18,108,296	18,033,114
Mortgage-backed securities: commercial	5,385,312	5,282,668
Total	<u>\$ 67,102,912</u>	<u>\$ 66,595,388</u>

Investment securities with a carrying value of \$18,400,573 and \$11,700,172 at December 31, 2016 and 2015, respectively, were pledged to secure deposits and other purposes as required by law.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 2: INVESTMENT SECURITIES AVAILABLE FOR SALE (CONTINUED)

In 2016, the Company realized gross gains of \$34,407 and gross losses of \$20,981 as a result of proceeds of \$2,065,929 in investment securities available for sale. In 2015, the Company realized gross gains of \$18,742 and gross losses of \$16,945 as a result of proceeds of \$1,472,601 in investment securities available for sale.

The following table shows the Company's gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, at December 31:

	2016					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government sponsored entities and agencies	\$ 10,542,871	\$ (203,893)	\$ —	\$ —	\$ 10,542,871	\$ (203,893)
Obligations of states and political subdivisions	15,239,436	(373,394)	309,804	(10,353)	15,549,240	(383,747)
Mortgage-backed securities: residential	8,890,445	(144,001)	2,464,419	(51,095)	11,354,864	(195,096)
Mortgage-backed securities: commercial	4,719,920	(102,697)	—	—	4,719,920	(102,697)
Total	\$ 39,392,672	\$ (823,985)	\$ 2,774,223	\$ (61,448)	\$ 42,166,895	\$ (885,433)

	2015					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government sponsored entities and agencies	\$ 4,726,894	\$ (24,459)	\$ —	\$ —	\$ 4,726,894	\$ (26,459)
Obligations of states and political subdivisions	2,345,853	(47,015)	275,760	(16,498)	2,621,613	(63,513)
Mortgage-backed securities: residential	6,035,449	(50,510)	1,361,793	(37,107)	7,397,242	(87,617)
Total	\$ 13,108,196	\$ (123,984)	\$ 1,637,553	\$ (53,605)	\$ 14,745,749	\$ (177,589)

The Company reviews its position quarterly and has asserted that at December 31, 2016, the declines outlined in the above table represent temporary declines and the Company does not intend to sell these securities and does not believe it will be required to sell these securities before recovery of their cost basis, which may be at maturity. There were one hundred and thirteen positions that were temporarily impaired at December 31, 2016. The Company has concluded that the unrealized losses disclosed above are not other than temporary but are the result of interest rate changes that are not expected to result in the noncollection of principal and interest during the period.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 3: LOANS

The composition of net loans is as follows at December 31:

	2016	2015
Commercial loans	\$ 24,176,852	\$ 22,537,219
Commercial real estate loans	107,139,421	109,827,706
Consumer loans	5,458,236	4,729,593
Residential loans	57,047,575	54,316,167
Home equity lines of credit	27,215,356	26,156,400
	<u>221,037,440</u>	<u>217,567,085</u>
Net deferred loan fees	(170,757)	(253,676)
Less allowance for loan losses	<u>(2,815,706)</u>	<u>(2,856,417)</u>
Net loans	<u>\$ 218,050,977</u>	<u>\$ 214,456,992</u>

The Company's primary business activity is with customers located within its local trade area, which is concentrated in Portage County in Ohio. Commercial loans, commercial real estate loans, consumer loans, residential loans, and home equity lines of credit are granted. Although the Company has a diversified loan portfolio at December 31, 2016 and 2015, a substantial portion of its debtors' ability to honor their loan agreements is dependent upon the economic stability of its immediate trade area.

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Company has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: commercial loans, commercial real estate loans, consumer loans, residential loans, and home equity lines of credit. Historical loss percentages for each risk category are calculated and used as the basis for calculating allowance allocations. These historical loss percentages were calculated over a 60-month period for all portfolio segments for the years ended December 31, 2016 and 2015. Certain qualitative factors are then added to the historical allocation percentage to get the adjusted factor to be applied to nonclassified loans.

The following qualitative factors are analyzed for each portfolio segment:

- ▶ Changes in trends in lending policies and procedures
- ▶ Changes in economic trends
- ▶ Changes in volume and terms
- ▶ Changes in experience, depth, and ability of management
- ▶ Changes in levels and trends in delinquencies
- ▶ Changes in historical loss allocations
- ▶ Changes in trends determined through loan review
- ▶ Changes in collateral dependent loan values
- ▶ Changes in concentrations of credit
- ▶ Changes in trends in external factors

These qualitative factors are reviewed each quarter and adjusted based upon relevant changes within the portfolio. During 2016, the qualitative factor percentages for commercial loans and commercial real estate loans increased throughout the year, while the qualitative factor percentages for consumer loans, residential loans, and home equity lines of credit slightly decreased throughout the year. The increase in qualitative factor percentages for commercial loans and commercial real estate loans was driven by elevated market competition resulting from aggressive underwriting being implored in the market coupled with slower than desired segment growth. Additionally, slightly increased economic trends as well as slightly increased levels and trends in delinquencies within these loan portfolio segments also factored into the increase. The qualitative factor percentages for consumer loans, residential loans, and home equity lines of credit decreased primarily due to overall declines in delinquencies and nonaccrual loan levels within these loan portfolio segments. Historical loss rates decreased over the course of 2016 for commercial loans, commercial real estate loans, consumer loans, residential loans, and home equity lines of credit.

The ending reserve balances for commercial loans, consumer loans, residential loans, and home equity lines of credit declined slightly across all portfolios as compared to the prior end of year reserve balances. The basis for the decrease was primarily driven by a lower level of charge-off activity being experienced overall in 2016 as compared to prior years. In 2015, the commercial real estate portfolio experienced two significant charge-offs as well as two significant recoveries. In 2016, the level of charge-offs and recoveries experienced collectively was relatively marginal in nature with a number of lesser balance items driving the activity.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 3: LOANS (CONTINUED)

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the balance sheet date. The Company considers the allowance for loan losses of \$2.8 million adequate to cover loan losses inherent in the loan portfolio, at December 31, 2016. The following tables presents, by portfolio segment, the changes in the allowance for loan losses and the recorded investment in loans as of December 31:

2016

	Commercial	Commercial Real Estate	Consumer	Residential	Home Equity Lines of Credit	Unallocated	Total
Allowance for loan losses:							
Beginning balance	\$ 262,498	\$ 1,641,298	\$ 90,567	\$ 502,305	\$ 143,909	\$ 215,840	\$ 2,856,417
Charge-offs	(39,427)	—	(6,212)	(107,878)	(8,571)	—	(162,088)
Recoveries	15,441	97,265	8,171	500	—	—	121,377
Reallocations	63,677	(213,360)	(10,203)	30,307	(2,005)	131,584	—
Ending balance	\$ 302,189	\$ 1,525,203	\$ 82,323	\$ 425,234	\$ 133,333	\$ 347,424	\$ 2,815,706
Ending balance: individually evaluated for impairment	\$ 15,963	\$ 170,243	\$ 44,197	\$ 59,776	\$ —	\$ —	\$ 290,179
Ending balance: collectively evaluated for impairment	\$ 286,226	\$ 1,354,960	\$ 38,126	\$ 365,458	\$ 133,333	\$ 347,424	\$ 2,525,527
Loans receivable:							
Ending balance	\$ 24,176,852	\$ 107,139,421	\$ 5,458,236	\$ 57,047,575	\$ 27,215,356	\$ —	\$ 221,037,440
Ending balance: individually evaluated for impairment	\$ 626,415	\$ 1,254,377	\$ 78,792	\$ 306,507	\$ —	\$ —	\$ 2,266,091
Ending balance: collectively evaluated for impairment	\$ 23,550,437	\$ 105,885,044	\$ 5,379,444	\$ 56,741,068	\$ 27,215,356	\$ —	\$ 218,771,349

2015

	Commercial	Commercial Real Estate	Consumer	Residential	Home Equity Lines of Credit	Unallocated	Total
Allowance for loan losses:							
Beginning balance	\$ 285,516	\$ 2,094,059	\$ 110,687	\$ 416,200	\$ 107,373	\$ 57,022	\$ 3,070,857
Charge-offs	(2,736)	(298,339)	(18,533)	(54,392)	(38,386)	—	(412,386)
Recoveries	12,742	145,189	4,800	35,215	—	—	197,946
Reallocations	(33,024)	(299,612)	(6,386)	105,282	74,922	158,818	—
Ending balance	\$ 262,498	\$ 1,641,297	\$ 90,568	\$ 502,305	\$ 143,909	\$ 215,840	\$ 2,856,417
Ending balance: individually evaluated for impairment	\$ 8,850	\$ 305,116	\$ 48,048	\$ 63,776	\$ —	\$ —	\$ 425,790
Ending balance: collectively evaluated for impairment	\$ 253,648	\$ 1,336,181	\$ 42,520	\$ 438,529	\$ 143,909	\$ 215,840	\$ 2,430,627
Loans receivable:							
Ending balance	\$ 22,537,219	\$ 109,827,706	\$ 4,729,593	\$ 54,316,167	\$ 26,156,400	\$ —	\$ 217,567,085
Ending balance: individually evaluated for impairment	\$ 86,319	\$ 1,914,404	\$ 92,041	\$ 314,651	\$ —	\$ —	\$ 2,407,415
Ending balance: collectively evaluated for impairment	\$ 22,450,900	\$ 107,913,302	\$ 4,637,552	\$ 54,001,516	\$ 26,156,400	\$ —	\$ 215,159,670

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 NOTE 3: LOANS (CONTINUED)

Credit Quality Information

The following tables represent credit exposures by internally assigned grades for the years ended December 31, 2016 and 2015, respectively. The grading analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled or at all. The Company's internal credit risk grading system is based on experiences with similarly graded loans.

Management utilizes a seven-point internal risk rating system to monitor the credit quality of the overall portfolio. The first three categories are considered not criticized and are aggregated as Pass-rated. Pass-rated loans are protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral. The criticized rating categories utilized by management generally follow bank regulatory definitions. Special Mention category loans have a potential weakness or risk that exists, which could cause a more serious problem if not corrected. The Substandard category loans have a well-defined weakness based on objective evidence and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. The Doubtful category loans have all the weaknesses inherent in a substandard asset. In addition, these weaknesses make collection or liquidation in full highly questionable and improbable, based on existing circumstances. The Loss category loans are considered uncollectible, or of such value that continuance as an asset is not warranted.

	As of December 31, 2016		
	Commercial	Real Estate	Total
Pass	\$ 22,554,534	\$ 99,453,009	\$ 122,007,543
Special mention	247,550	3,243,830	3,491,380
Substandard	1,374,768	4,442,582	5,817,350
Doubtful	—	—	—
Loss	—	—	—
Total	\$ 24,176,852	\$ 107,139,421	\$ 131,316,273

	As of December 31, 2015		
	Commercial	Real Estate	Total
Pass	\$ 21,603,954	\$ 101,165,829	\$ 122,769,783
Special mention	320,700	3,751,125	4,071,825
Substandard	606,443	4,910,752	5,517,195
Doubtful	6,122	—	6,122
Loss	—	—	—
Total	\$ 22,537,219	\$ 109,827,706	\$ 132,364,925

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 NOTE 3: LOANS (CONTINUED)

Credit Quality Information (Continued)

For consumer loans, residential loans, and home equity lines of credit, the Company evaluates credit quality based on whether the loan is considered performing or non-performing. Non-performing loans include those loans that are considered nonaccrual and all loans past due 90 or more days. The following tables present the balances of these loans by classes of the loan portfolio based on payment performance as of December 31:

2016

	Consumer	Residential	Home Equity Lines of Credit	Total
Performing	\$ 5,427,829	\$ 56,719,466	\$ 27,133,382	\$ 89,280,677
Nonperforming	30,407	328,109	81,974	440,490
Total	\$ 5,458,236	\$ 57,047,575	\$ 27,215,356	\$ 89,721,167

2015

	Consumer	Residential	Home Equity Lines of Credit	Total
Performing	\$ 4,711,102	\$ 53,903,526	\$ 26,111,894	\$ 84,726,522
Nonperforming	18,491	412,641	44,506	475,638
Total	\$ 4,729,593	\$ 54,316,167	\$ 26,156,400	\$ 85,202,160

Age Analysis of Past Due Loans Receivable by Class

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of December 31:

2016

	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days Or Greater & Accruing	Total Past Due	Current	Nonaccrual	Total Loans
Commercial loans	\$ 19,758	\$ —	\$ —	\$ 19,758	\$ 24,089,897	\$ 67,197	\$ 24,176,852
Commercial real estate loans	425,788	—	—	425,788	105,530,897	1,182,736	107,139,421
Consumer loans	62,166	7,587	20,620	90,373	5,358,076	9,787	5,458,236
Residential loans	202,769	—	—	202,769	56,516,697	328,109	57,047,575
Home equity lines of credit	—	—	—	—	27,133,382	81,974	27,215,356
Total	\$ 710,481	\$ 7,587	\$ 20,620	\$ 738,688	\$ 218,628,949	\$ 1,669,803	\$ 221,037,440

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 NOTE 3: LOANS (CONTINUED)

Age Analysis of Past Due Loans Receivable by Class (Continued)

	2015						
	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days Or Greater & Accruing	Total Past Due	Current	Nonaccrual	Total Loans
Commercial loans	\$ —	\$ —	\$ —	\$ —	\$ 22,416,205	\$ 121,014	\$ 22,537,219
Commercial real estate loans	315,731	162,643	—	478,373	108,449,333	900,000	109,827,706
Consumer loans	163,395	14,110	4,743	182,249	4,533,596	13,748	4,729,593
Residential loans	985,233	82,611	6,283	1,074,127	52,835,682	406,358	54,316,167
Home equity lines of credit	44,949	145,456	—	190,405	25,921,489	44,506	26,156,400
Total	\$ 1,509,308	\$ 404,820	\$ 11,026	\$ 1,925,154	\$ 214,156,305	\$ 1,485,626	\$ 217,567,085

Interest income that would have been recorded had nonaccrual loans not been placed on nonaccrual status was \$81,404 and \$86,752 in 2016 and 2015, respectively.

Impaired Loans

The following tables present the recorded investment and unpaid principal balances of impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of December 31:

	2016				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial loans	\$ —	\$ —	\$ —	\$ 3,401	\$ 605
Commercial real estate loans	1,164,525	1,519,405	—	1,388,570	37,789
Consumer loans	34,595	83,544	—	38,931	3,471
Residential loans	93,215	93,215	—	93,714	3,834
Home equity lines of credit	—	—	—	—	—
	\$ 1,292,335	\$ 1,696,164	\$ —	\$ 1,524,616	\$ 45,699
With an allowance recorded:					
Commercial loans	\$ 67,197	\$ 90,664	\$ 15,963	\$ 74,072	\$ 12,474
Commercial real estate loans	649,070	800,250	170,243	602,903	7,654
Consumer loans	44,197	44,197	44,197	46,240	2,949
Residential loans	213,292	213,292	59,776	215,742	11,866
Home equity loans of credit	—	—	—	—	—
	\$ 973,756	\$ 1,148,403	\$ 290,179	\$ 938,957	\$ 34,943
Total:					
Commercial loans	\$ 67,197	\$ 90,664	\$ 15,963	\$ 77,473	\$ 13,078
Commercial real estate loans	1,813,595	2,319,655	170,243	1,991,473	45,443
Consumer loans	78,792	127,741	44,197	85,172	6,421
Residential loans	306,507	306,507	59,776	309,455	15,700
Home equity lines of credit	—	—	—	—	—
	\$ 2,266,091	\$ 2,844,567	\$ 290,179	\$ 2,463,573	\$ 80,642

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 NOTE 3: LOANS (CONTINUED)

Impaired Loans (Continued)

2015

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial loans	\$ —	\$ —	\$ —	\$ 1,351,490	\$ 88,110
Commercial real estate loans	822,579	1,090,745	—	1,499,537	27,564
Consumer loans	43,993	91,435	—	48,719	2,908
Residential loans	94,521	96,393	—	95,389	3,737
Home equity lines of credit	—	—	—	—	—
	<u>\$ 961,093</u>	<u>\$ 1,278,573</u>	<u>\$ —</u>	<u>\$ 2,995,135</u>	<u>\$ 122,319</u>
With an allowance recorded:					
Commercial loans	\$ 86,319	\$ 144,481	\$ 8,850	\$ 86,364	\$ 2,022
Commercial real estate loans	1,091,825	1,599,516	305,116	1,149,180	17,607
Consumer loans	48,048	48,048	48,048	49,400	3,103
Residential loans	220,130	220,130	63,776	222,460	12,533
Home equity loans of credit	—	—	—	—	—
	<u>\$ 1,446,322</u>	<u>\$ 2,012,175</u>	<u>\$ 425,790</u>	<u>\$ 1,507,404</u>	<u>\$ 35,265</u>
Total:					
Commercial loans	\$ 86,319	\$ 144,481	\$ 8,850	\$ 1,437,854	\$ 90,132
Commercial real estate loans	1,914,404	2,690,261	305,116	2,648,717	45,171
Consumer loans	92,041	139,483	48,048	98,119	6,011
Residential loans	314,651	316,523	63,776	317,849	16,270
Home equity lines of credit	—	—	—	—	—
	<u>\$ 2,407,415</u>	<u>\$ 3,290,748</u>	<u>\$ 425,790</u>	<u>\$ 4,502,539</u>	<u>\$ 157,584</u>

On January 1, 2015, the Company adopted Accounting Standards Update (ASU) 2014-04, Receivables - Troubled Debt Restructuring by Creditors. As of December 31, 2016, the Company had \$268,209 of foreclosed real estate property obtained by physical possession and \$98,348 of consumer mortgage loans secured by residential real estate properties for which foreclosure proceedings are in process according to local jurisdiction.

Troubled Debt Restructurings

As of December 31, 2016 and 2015, the Company has a recorded investment in troubled debt restructurings of \$1,491,502 and \$1,685,977 respectively. The Company allocated \$170,890 and \$318,889 of specific allowance for those loans at December 31, 2016 and 2015, respectively.

The tables below summarize the Company's troubled debt restructurings before and after modifications for the year ended December 31, 2016:

2016

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:			
Commercial real estate loans	2	105,923	105,923

There were no new troubled debt restructurings entered into for the year ended December 31, 2015.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 3: LOANS (CONTINUED)

Troubled Debt Restructurings (Continued)

The modification of the terms of the commercial real estate and residential loans performed during the year ended December 31, 2016 included extension of the terms of the originals loans. No principal reductions were made and no lowering of the stated interest rates. Additional interest income of \$32,472 and \$62,917 would have been recognized for the years ended December 31, 2016 and 2015, respectively, at the original interest rate as compared to the adjusted interest rate on the troubled debt restructurings.

The Company did not have any payment defaults on troubled debt restructuring contracts during 2016. The Company had payment defaults on three troubled debt restructuring contracts during 2015 comprised of three commercial real estate loans totaling \$291,689.

NOTE 4: PREMISES AND EQUIPMENT

Major classifications of premises and equipment are summarized as follows:

	<u>2016</u>	<u>2015</u>
Land and land improvements	\$ 1,576,056	\$ 1,576,056
Building and leasehold improvements	3,801,748	3,500,097
Furniture, fixtures, and equipment	1,992,346	1,907,197
	<u>7,370,150</u>	<u>6,983,350</u>
Less accumulated depreciation	(2,685,302)	(2,512,386)
Total	<u>\$ 4,684,848</u>	<u>\$ 4,470,964</u>

Depreciation charged to operations was \$172,916 in 2016 and \$146,843 in 2015.

NOTE 5: DEPOSITS

Time deposits at December 31, 2016, mature \$43,705,916, \$13,097,569, \$7,930,677, \$3,533,822, \$5,735,239, and \$1,712,163 during 2017, 2018, 2019, 2020, 2021, 2022 and thereafter, respectively.

Time deposits include certificates of deposit and other time deposits in denominations of \$100,000 or more. Such deposits aggregated \$3,641,771 and \$1,632,487 at December 31, 2016 and 2015, respectively.

The aggregate amount of time deposit accounts that meet or exceed the FDIC insurance limit of \$250,000 totaled \$1,496,469 and \$1,520,416 at December 31, 2016 and 2015, respectively.

Included in certificates of deposit at December 31, 2016 and 2015, were \$18,739,913 and \$22,265,639, respectively, obtained through the Certificate of Deposit Account Registry Services (CDARS). This service allows deposit customers to maintain fully insured balances in excess of the \$250,000 FDIC insurance limit without the inconvenience of having multi-banking relationships. Under the reciprocal program, which the Company is currently participating in, customers agree to allow the Company to place their deposits with participating banks in the CDARS program, in insurable amounts under \$250,000. In exchange, other banks in the program agree to place their deposits with Portage Community Bank, also in insurable amounts under \$250,000.

Related-party deposits were \$1,345,090 and \$1,354,432 at December 31, 2016 and 2015, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 6: FHLB ADVANCES

The following table sets forth information concerning other borrowings with the FHLB:

Description	Maturity range		Weighted- average interest rate	At December 31,	
	from	to		2016	2015
Mortgage match - amortizing	03/01/18	11/01/29	1.71%	\$ 12,967,212	\$ 13,952,732
Mortgage match - non-amortizing	06/16/17	07/02/21	1.56	2,500,000	4,115,800
Total			1.68%	<u>\$ 15,467,212</u>	<u>\$ 18,068,532</u>

At December 31, 2016, the Bank had a cash management line of credit enabling it to borrow up to \$15.0 million from the Federal Home Loan Bank of Cincinnati (“FHLB”). The line of credit must be renewed on an annual basis. There were no borrowings from the line of credit outstanding as of December 31, 2016 and December 31, 2015. The Bank has a remaining borrowing capacity of \$46.9 million at December 31, 2016.

Borrowings from FHLB are secured with a blanket security agreement and required investment in FHLB member bank stock. As part of the security agreement, the Bank maintains unencumbered qualifying assets (principally 1-4 family residential mortgage loans) in an amount at least as much as the advances from the FHLB. Additionally, the Bank’s FHLB stock of \$899,100 and \$876,600 at December 31, 2016 and 2015, respectively, is pledged to secure these advances. Maturities over the next five years and thereafter were as follows:

Year Ending December 31,	Amount	Weighted- Average Rate
2017	\$ 3,567,349	1.65 %
2018	2,483,867	1.62
2019	2,446,666	1.58
2020	1,479,227	1.57
2021	2,699,701	1.58
Thereafter	2,790,402	1.04
Total	<u>\$ 15,467,212</u>	1.68 %

Monthly principal and interest payments are due on the mortgage match fixed rate amortizing borrowings; additionally, a 5 percent, 10 percent, or up to 20 percent principal curtailment is due on each borrowing’s anniversary date. Monthly interest payments are due on the mortgage match fixed rate non-amortizing borrowings and principal payments are paid in total at maturity.

The Company and Bank each maintain a \$1,000,000 unsecured line of credit with another financial institution. No amounts were outstanding under these lines of credit at December 31, 2016 and 2015.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 7: SUBORDINATED DEBENTURES

In March 2004, Portage Bancshares Capital Trust I, a trust formed by the Company, issued \$2,500,000 of floating rate, trust preferred securities as part of a pooled offering of such securities. The Company issued \$2,450,000 subordinated debentures to the trust in exchange for the proceeds of the offering. The debentures and related debt issuance costs represent the sole assets of the trust. The trust is not consolidated with the Company's financial statements, but rather the subordinated debentures are shown as a liability. The trust preferred securities must be redeemed no later than April 23, 2034. The Company had the option to call the trust preferred securities at par at five years from date of issuance. The subordinated debentures are also redeemable in whole or in part from time to time, upon the occurrence of specific events defined within the trust indenture. The Company has the option to defer interest payments on the subordinated debentures from time to time for a period not to exceed five consecutive years. The subordinated debentures may be included in Tier I capital with certain limitations applicable under current regulatory guidelines and interpretations.

The interest rate on the trust preferred securities and the subordinated debentures is computed as the three-month London Interbank Offering Rate (LIBOR) plus 285 points. At December 31, 2016 and 2015, this equated to 3.83 percent and 3.39 percent, respectively.

NOTE 8: INCOME TAXES

The provision for federal income taxes consists of:

	<u>2016</u>	<u>2015</u>
Current payable	\$ 1,047,067	\$ 968,486
Deferred	(79,042)	(11,734)
Total provision	<u>\$ 968,025</u>	<u>\$ 956,752</u>

No valuation allowance was established at December 31, 2016 and 2015, in view of the Company's ability to carryback to taxes paid in previous years and certain tax strategies, coupled with the anticipated future taxable income as evidenced by the Company's earnings potential. The tax effects of deductible and taxable temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

	<u>2016</u>	<u>2015</u>
Deferred tax assets:		
Allowance for loan losses	\$ 655,901	\$ 655,901
Accrued expenses and employee benefits	645,663	525,220
Unrealized loss on available-for-sale securities	172,558	—
Deferred loan fees	46,980	71,921
Stock-based compensation	77,865	88,173
Other	7,682	7,682
Deferred tax assets	<u>1,606,649</u>	<u>1,348,897</u>
Deferred tax liabilities:		
Depreciation	134,249	132,059
Unrealized gain on available-for-sale securities	—	238,543
Federal Home Loan Bank stock dividends	45,526	45,526
Prepaid expenses	14,295	9,968
Security accretion	1,482	1,848
Deferred tax liabilities	<u>195,552</u>	<u>427,944</u>
Net deferred tax assets	<u>\$ 1,411,097</u>	<u>\$ 920,953</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 8: INCOME TAXES (CONTINUED)

The reconciliation between the federal statutory rate and the Company's effective consolidated income tax rate is as follows:

	<u>2016</u>		<u>2015</u>	
	Amount	% of Pretax Income	Amount	% of Pretax Income
Provision at statutory rate	\$ 1,243,066	34.0 %	\$ 1,219,119	34.0 %
Tax-exempt interest	(220,733)	(6.0)	(198,465)	(5.5)
Earnings on bank-owned life insurance	(64,592)	(1.8)	(57,578)	(1.6)
Other	10,284	0.3	(6,324)	(0.2)
Actual tax expense and effective rate	<u>\$ 968,025</u>	<u>26.7 %</u>	<u>\$ 956,752</u>	<u>26.7 %</u>

The Company prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

There is currently no liability for uncertain tax positions and no known unrecognized tax benefits. The Bank recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the income taxes in the Consolidated Statement of Income. With few exceptions, the Bank is no longer subject to U.S. federal income tax examinations by tax authorities for years before 2013.

NOTE 9: EMPLOYEE BENEFITS

401(k) Plan

The Company sponsors a 401(k) plan covering substantially all employees. The Company matches contributions at the rate of 100 percent of each participant's voluntary contributions, limited to a maximum of 6 percent of a covered employee's annual compensation. In addition to the Company's matching contribution, a profit sharing contribution to the plan can be made at the discretion of the Board. Employee voluntary contributions and employers' matching contributions are vested immediately. The expense related to the plan was \$198,151 and \$183,621 for the years ended December 31, 2016 and 2015, respectively.

Supplemental Retirement Plan

The Company sponsors a supplemental retirement plan ("SERP") which covers several key members of management. Participants will receive annually a percentage of their base compensation at the time of their retirement for a maximum of ten years. The liability recorded at December 31, 2016 and 2015, was \$1,494,084 and \$1,253,624, respectively. The expense related to the plan was \$261,361 and \$253,858 for 2016 and 2015, respectively. Distributions to participants were \$22,738 and \$26,209 in 2016 and 2015, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 NOTE 9: EMPLOYEE BENEFITS (CONTINUED)

Director Deferral Plan

The Company sponsors a director deferral plan to provide post-separation payments to participating directors who elect to defer their directors' fees. The plan allows participating directors to defer a portion or all director fees during any plan year. The participants' deferral account balance within the plan is credited annually with interest, based on the Bank's return on equity on a tax-deferred basis. The liability recorded at December 31, 2016 and 2015, was \$404,924 and \$291,140, respectively. The expense related to the plan was \$113,784 and \$99,432 for 2016 and 2015, respectively.

Stock Option Plan

The Company has two share based compensation plans. The Company's 2004 and 2016 Stock Incentive Plans, which are shareholder approved, both permit the grant of share options to its directors, officers, and other key employees of the Company and its subsidiaries for up to 200,000 and 50,000 shares of common stock, respectively. The exercise price for the purchase of shares subject to a stock option may not be less than 100 percent of the fair market value of the shares covered by the option on the date of the grant. The term of stock options will not exceed ten years from the date of grant. Vesting occurs at 20 percent per year of service.

The following table presents share data related to the outstanding options:

	2016	Weighted-Average Exercise Price	2015	Weighted-Average Exercise Price
Outstanding, January 1	60,375	\$ 57.89	83,931	\$ 54.01
Granted	—	—	—	—
Exercised	(3,600)	50.00	(23,476)	43.94
Forfeited	—	—	(80)	77.00
Outstanding, December 31	<u>56,775</u>	\$ 58.39	<u>60,375</u>	\$ 57.89
Exercisable at year-end	<u>52,121</u>	\$ 56.82	<u>53,413</u>	\$ 55.69

The following table summarizes the characteristics of stock options at December 31, 2016:

Grant Date	Exercise Price	Shares	<u>Outstanding</u>		<u>Exercisable</u>	
			Remaining Average Life	Average Exercise Price	Shares	Average Exercise Price
1/24/2007	50.00	19,560	0.06	\$ 50.00	19,560	\$ 50.00
10/22/2008	58.50	25,675	1.81	58.50	25,675	58.50
1/24/2011	63.10	2,400	4.06	63.10	2,400	63.10
1/25/2012	67.65	1,700	5.07	67.65	1,360	67.65
1/31/2013	71.50	750	6.08	71.50	450	71.50
2/19/2014	77.00	1,950	7.14	77.00	780	77.00
4/23/2014	77.00	4,740	7.31	77.00	1,896	77.00
		<u>56,775</u>		\$ 57.89	<u>52,121</u>	\$ 55.69

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 10: LOAN COMMITMENTS

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance-sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party.

The contractual amounts of financial instruments with off-balance-sheet risk at year-end were as follows:

	<u>2016</u>		<u>2015</u>	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Unused business lines of credit	\$ 2,185,655	\$ 21,069,901	\$ 762,170	\$ 20,275,585
Unused construction lines of credit	916,536	761,312	1,951,902	360,646
Unused consumer lines of credit	94,885	22,023,123	105,241	20,035,091
Standby letters of credit	—	131,291	—	131,291
Total	\$ 3,197,076	\$ 43,985,627	\$ 2,891,313	\$ 40,802,613

Commitments to make loans are generally made for periods of 60 days or less. The fixed rate loan commitments have interest rates ranging from 2.45 percent to 18.00 percent at December 31, 2016 and December 31, 2015.

Standby letters of credit represent conditional commitments issued to guarantee performance of a customer to a third party. The coverage period for these instruments is typically a one-year period with renewal option subject to prior approval by management. Fees earned from the issuance of these letters are recognized over the coverage period. For secured letters of credit, the collateral is typically Bank deposit instruments.

NOTE 11: REGULATORY RESTRICTIONS

Contingent Liabilities

The Company is involved in various legal actions from the normal course of business activities. Management believes the liability, if any; arising from such actions will not have a material adverse effect on the Company's financial position.

Restriction on Cash and Due From Banks

The Bank is required to maintain reserve funds in cash or on deposit with the Federal Reserve Bank. The required reserve was \$1,447,000 and \$1,106,000 for the years ended December 31, 2016 and 2015, respectively.

Loans

Federal law prevents the Company from borrowing from the Bank unless the loans are secured by specific obligations. Further, such secured loans are limited in amount up to 10 percent of the Bank's common stock and capital surplus.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 NOTE 11: REGULATORY RESTRICTIONS (CONTINUED)

Dividends

The Bank is subject to a dividend restriction that generally limits the amount of dividends that can be paid by an Ohio state-chartered bank. Under the Ohio Banking Code, cash dividends may not exceed net profits as defined for that year, combined with retained net profits for the two preceding years less any required transfers to surplus. Under this formula, the amount available for payment of dividends in 2017 is \$5,510,836 plus 2017 profits retained up to the date of the dividend declaration.

NOTE 12: REGULATORY CAPITAL MATTERS

Banks and bank holding companies are subject to regulatory capital requirements administered by federal and state banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the Basel III rules, the Company must hold a capital conservation buffer above the adequately capitalized risk-based capital rules. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2016 is 0.625%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of December 31, 2016 and 2015, that the Company and Bank met or exceeded all capital adequacy requirements to which they are subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2016 and 2015, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

Actual and required capital amounts and ratios are presented below at year-end.

	Actual		Required for Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2016						
Total Capital (to risk-weighted assets):						
Consolidated	\$ 36,171,455	16.34%	\$ 17,711,090	8.00%	\$ 22,138,862	10.00%
Portage Community Bank	37,002,518	16.74	17,685,950	8.00	22,107,437	10.00
Tier 1 (Core) Capital (to risk-weighted assets):						
Consolidated	\$ 33,403,500	15.09%	\$ 13,283,317	6.00%	\$ 17,711,090	8.00%
Portage Community Bank	34,38,443	15.49	13,264,462	6.00	17,685,950	8.00
Common Equity Tier 1 (CET1) Capital (to risk-weighted assets):						
Consolidated	\$ 33,403,500	15.09%	\$ 9,962,488	4.50%	\$ 14,390,261	6.50%
Portage Community Bank	34,238,443	15.49	9,948,347	4.50	14,369,834	6.50
Tier 1 (Core) Capital (to average assets):						
Consolidated	\$ 33,403,500	10.57%	\$ 12,646,536	4.00%	\$ 15,808,170	5.00%
Portage Community Bank	34,238,443	10.85	12,626,526	4.00	15,783,158	5.00

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
NOTE 12: REGULATORY CAPITAL MATTERS (CONTINUED)

	Actual		Required for Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2015						
Total Capital (to risk-weighted assets):						
Consolidated	\$ 34,087,985	16.01%	\$ 17,030,592	8.00%	\$ 21,288,240	10.00%
Portage Community Bank	34,093,431	16.04	17,005,452	8.00	21,256,815	10.00
Tier 1 (Core) Capital (to risk-weighted assets):						
Consolidated	\$ 31,424,543	14.76%	\$ 12,772,944	6.00%	\$ 17,030,592	8.00%
Portage Community Bank	31,433,868	14.79	12,754,089	6.00	17,005,452	8.00
Common Equity Tier 1 (CET1) Capital (to risk-weighted assets):						
Consolidated	\$ 31,424,543	14.76%	\$ 9,579,708	4.50%	\$ 13,837,356	6.50%
Portage Community Bank	31,433,868	14.79	9,565,567	4.50	13,816,929	6.50
Tier 1 (Core) Capital (to average assets):						
Consolidated	\$ 31,424,543	10.52%	\$ 11,944,691	4.00%	\$ 14,930,864	5.00%
Portage Community Bank	31,433,868	10.58	11,880,797	4.00	14,850,996	5.00

NOTE 13: FAIR VALUE MEASUREMENTS

The following disclosures show the hierarchal disclosure framework associated with the level of pricing observations utilized in measuring assets and liabilities at fair value. The three broad levels defined by U.S. generally accepted accounting principles are as follows:

- Level I:** Quoted prices are available in active markets for identical assets or liabilities as of the reported date.
- Level II:** Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair-valued using other financial instruments, the parameters of which can be directly observed.
- Level III:** Assets and liabilities that have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

This hierarchy requires the use of observable market data when available. The following tables set forth the Company's financial assets by level within the fair value hierarchy that were measured at fair value on a recurring basis at December 31:

	2016			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fair value measurements on a recurring basis:				
Securities available for sale:				
U.S. government sponsored entities and agencies	\$ 12,051,984	\$ —	\$ 12,051,984	\$ —
Obligations of states and political subdivisions	31,227,622	—	31,227,622	—
Mortgage-backed securities: residential	18,033,114	—	18,033,114	—
Mortgage-backed securities: commercial	5,282,668	—	5,282,668	—
Total	\$ 66,595,388	\$ —	\$ 66,595,388	\$ —

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 NOTE 13: FAIR VALUE MEASUREMENTS (CONTINUED)

2015

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fair value measurements on a recurring basis:				
Securities available for sale:				
U.S. government sponsored entities and agencies	\$ 6,737,477	\$ —	\$ 6,737,477	\$ —
Obligations of states and political subdivisions	27,456,256	—	27,456,256	—
Mortgage-backed securities: residential	18,501,016	—	18,501,016	—
Total	\$ 52,694,749	\$ —	\$ 52,694,749	\$ —

The Company's investment securities are valued by a third-party pricing service commonly used in the banking industry utilizing observable inputs. The pricing provider utilizes evaluated pricing models that vary based on asset class. These models incorporate available market information including quoted prices of investment securities with similar characteristics and, because many fixed-income investment securities do not trade on a daily basis, apply available information through processes such as benchmark yield curves, benchmarking of like investment securities, sector groupings, and matrix pricing. In addition, model processes, such as an option adjusted spread model, are used to develop prepayment estimates and interest rate scenarios for investment securities with prepayment features.

Management uses a recognized third-party pricing service to obtain fair values for the Company's fixed income securities portfolio. Documentation is maintained as to the methodology and summary of inputs used by the pricing service for the various types of securities, and management notes that the servicer maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Management does not have access to all of the individual specific assumptions and inputs used for each security. The significant observable inputs include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including market research publications.

Based on management's review of the methodology and summary of inputs used, management has concluded these assets are properly classified as Level 2 assets.

The following tables set forth the Company's financial and non-financial assets by level within the fair value hierarchy that were measured at fair value on a non-recurring basis at December 31:

2016

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans	\$ 1,975,912	\$ —	\$ —	\$ 1,975,912
Other real estate owned	268,209	—	—	268,209

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 13: FAIR VALUE MEASUREMENTS (CONTINUED)

2015

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans	\$ 1,730,749	\$ —	\$ —	\$ 1,730,749
Other real estate owned	535,172	—	—	535,172

Impaired loans that are collateral-dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secures the impaired loan include: quoted market prices for identical assets classified as Level I inputs and observable inputs, employed by certified appraisers, for similar assets classified as Level II inputs. In cases where valuation techniques included inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level III input.

Other real estate owned (“OREO”) is measured at fair value, less cost to sell at the date of the foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management. The assets are carried at fair value, less cost to sell. Income and expense from operations and changes in valuation allowance are included in the net expenses from OREO.

The following tables present additional quantitative information about assets measured at fair value on a nonrecurring basis for which the Company has utilized Level III inputs to determine fair value at December 31 2016 and 2015, respectively:

	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted Averages)
Impaired loans (collateral-dependent)	\$ 1,975,912	Appraisal of collateral (1)	Appraisal adjustments (2)	0% - 39.00% (33.93%)
Other real estate owned	268,209	Appraisal of collateral (1), (3)	Appraisal adjustments (2)	9%

	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted Averages)
Impaired loans (collateral-dependent)	\$ 1,730,749	Appraisal of collateral (1)	Appraisal adjustments (2)	0% - 38.57% (31.23%)
Other real estate owned	535,172	Appraisal of collateral (1), (3)	Appraisal adjustments (2)	9%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which include various Level III inputs which are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions, aging, and/or estimated liquidation expenses incurred when selling collateral. The range and weighted average of appraisal adjustments and liquidation expenses are presented as a percentage of the appraisal.

(3) Includes qualitative adjustments by management and estimated liquidation expenses.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
14: FAIR VALUE DISCLOSURE OF FINANCIAL INSTRUMENTS

The estimated fair value of the Company's financial instruments at December 31 is as follows:

2016

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
Financial assets:					
Cash and cash equivalents	\$ 14,977,919	\$ 14,977,919	\$ —	\$ —	\$ 14,977,919
Investment securities available for sale	66,595,388	—	66,595,388	—	66,595,388
Loans held for sale	362,519	362,519	—	—	362,519
Net loans	218,050,977	—	—	217,575,193	217,575,193
Bank-owned life insurance	7,820,807	7,820,807	—	—	7,820,807
Regulatory stock	1,262,750	1,262,750	—	—	1,262,750
Accrued interest receivable	847,963	847,963	—	—	847,963
Financial liabilities:					
Deposits	\$ 262,021,942	\$ 186,306,556	\$ —	\$ 75,251,705	\$ 261,558,261
Federal Home Loan Bank advances	15,467,212	—	—	15,514,852	15,514,852
Subordinated debentures	2,450,000	—	—	2,082,500	2,082,500
Accrued interest payable	141,459	141,459	—	—	141,459

2015

	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
Financial assets:					
Cash and cash equivalents	\$ 16,245,940	\$ 16,245,940	\$ —	\$ —	\$ 16,245,940
Investment securities available for sale	52,694,749	—	52,694,749	—	52,694,749
Loans held for sale	755,267	755,267	—	—	755,267
Net loans	214,456,992	—	—	214,548,018	214,548,018
Bank-owned life insurance	6,630,830	6,630,830	—	—	6,630,830
Regulatory stock	1,240,250	1,240,250	—	—	1,240,250
Accrued interest receivable	752,680	752,680	—	—	752,680
Financial liabilities:					
Deposits	\$ 244,113,927	\$ 170,834,640	\$ —	\$ 72,999,995	\$ 243,834,635
Federal Home Loan Bank advances	18,068,532	—	—	18,156,718	18,156,718
Subordinated debentures	2,450,000	—	—	2,021,250	2,021,250
Accrued interest payable	111,810	111,810	—	—	111,810

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 14: FAIR VALUE DISCLOSURE OF FINANCIAL INSTRUMENTS (CONTINUED)

Financial instruments are defined as cash, evidence of ownership interest in an entity, or a contract which creates an obligation or right to receive or deliver cash or another financial instrument from/to a second entity on potentially favorable or unfavorable terms.

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties other than in a forced liquidation sale. If a quoted market price is available for a financial instrument, the estimated fair value would be calculated based upon the market price per trading unit of the instrument.

If no readily available market exists, the fair value estimates for financial instruments should be based upon management's judgment regarding current economic conditions, interest rate risk, expected cash flows, future estimated losses, and other factors as determined through various option pricing formulas or simulation modeling. As many of these assumptions result from judgments made by management based upon estimates which are inherently uncertain, the resulting estimated fair values may not be indicative of the amount realizable in the sale of a particular financial instrument. In addition, changes in assumptions on which the estimated fair values are based may have a significant impact on the resulting estimated fair values.

As certain assets such as deferred tax assets and premises and equipment are not considered financial instruments, the estimated fair value of financial instruments would not represent the full value of the Company.

The Company employed simulation modeling in determining the estimated fair value of financial instruments for which quoted market prices were not available based upon the following assumptions:

Cash and Cash Equivalents, Regulatory Stock, Accrued Interest Receivable, and Accrued Interest Payable

The fair value is equal to the current carrying value.

Investment Securities Available for Sale

The fair value of investment securities available for sale is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities.

Loans Held for Sale

The carrying amount of loans held for sale is the amount funded and approximates fair value due to the insignificant time between origination and date of sale.

Net Loans

The fair value is estimated by discounting the future cash flows using a simulation model that estimates future cash flows through the utilization of current market inputs at which loans with similar terms and qualities would be made to borrowers of similar credit quality. Where quoted market prices were available, primarily for certain residential mortgage loans, such market rates were utilized as estimates of fair value.

Bank-Owned Life Insurance

The fair value is equal to the cash surrender value of the life insurance policies.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 14: FAIR VALUE DISCLOSURE OF FINANCIAL INSTRUMENTS (CONTINUED)

Deposits, Federal Home Loan Bank Advances, and Subordinated Debentures

Demand, savings, and money market deposit accounts are valued at the amount payable on demand as of year-end. Fair value for time deposits, Federal Home Loan Bank advances, and subordinated debentures is estimated by discounting the future cash flows using a simulation model which estimates future cash flows and constructs discount rates that consider reinvestment opportunities, operating expenses, noninterest income, credit quality, and prepayment risk.

Commitments to Extend Credit

These financial instruments are generally not subject to sale, and estimated fair values are not readily available. The carrying value, represented by the net deferred fee arising from the unrecognized commitment or letter of credit, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, are not considered material for disclosure. The contractual amounts of unfunded commitments and letters of credit are presented in Note 10.

NOTE 15: ACCUMULATED OTHER COMPREHENSIVE INCOME

The following tables present the changes in accumulated other comprehensive income (loss) by component net of tax for the years ended December 31, 2016 and 2015:

	<u>Net Unrealized Gains (Losses) on Investment Securities</u>
Accumulated other comprehensive income, January 1, 2016	\$ 463,053
Other comprehensive loss before reclassification, net of tax	(789,158)
Amount reclassified from accumulated other comprehensive income	(8,861)
Total other comprehensive loss	(798,019)
Accumulated other comprehensive loss, December 31, 2016	<u>\$ (334,966)</u>

	<u>Net Unrealized Gains (Losses) on Investment Securities</u>
Accumulated other comprehensive loss, January 1, 2015	\$ 473,980
Other comprehensive income before reclassification, net of tax	(9,741)
Amount reclassified from accumulated other comprehensive loss	(1,186)
Total other comprehensive income	(10,927)
Accumulated other comprehensive income, December 31, 2015	<u>\$ 463,053</u>

The following table presents significant amounts reclassified out of accumulated other comprehensive income (loss) for the years ended December 31, 2016 and 2015:

	<u>Amount Reclassified from Accumulated Other Comprehensive Income (Loss)</u>	<u>Affected Line Item on the Consolidated Statement of Income</u>
Details about other comprehensive loss:		
Net unrealized gain (losses) on investment securities	\$ (13,426)	Investment securities gains (losses), net
	4,565	Income taxes
	<u>\$ (8,861)</u>	Net of tax
Details about other comprehensive income:		
Net unrealized gain (losses) on investment securities	\$ (1,797)	Investment securities gains (losses), net
	611	Income taxes
	<u>\$ (1,186)</u>	Net of tax

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 16: SUBSCRIPTION AND SHARE PURCHASE AGREEMENT

The Company offered shares of no par common stock for purchase through the terms of the Agreement entered into on December 20, 2015 and ending on December 30, 2015. The Agreement allowed the Company to sell up to 10,000 shares of common stock at an offering price of \$85.90 per share to a limited number of offerees. The minimum purchase by a subscriber was 350 shares. Through the Agreement, the Company sold 5,965 shares of its common stock and received proceeds of \$509,748, net of offering expenses of \$2,464.

NOTE 17: SUBSEQUENT EVENTS

The Company assessed events occurring subsequent to December 31, 2016, through March 30, 2017, for potential recognition and disclosure in the consolidated financial statements. No events have occurred that would require additional adjustments to or disclosure in the consolidated financial statements, which were issued on March 30, 2017.

PORTAGE BANCSHARES, INC

Officers

Margaret F. Medzie
President

Thomas S. Siciliano
Treasurer

Timothy E. Crock
Secretary

PORTAGE COMMUNITY BANK

Directors

Timothy E. Crock
Chairman of the Board

Paul Huchok
Vice Chairman of the Board

Richard J. Coe
Director

James V. Damicone
Director

Kevin T. Lewis
Director

Richard L. Leonard
Director

Margaret F. Medzie
Director

Dr. Aaron A. Moats
Director

Thomas S. Siciliano
Director

Dr. Emilio D. Ferrara
Director Emeritus

DIVISIONAL RESPONSIBILITIES

Adam B. Rubin
Vice President, Real Estate Division

Dennis P. Juvan
Registered Representative
Portage Community Financial Services

PORTAGE COMMUNITY BANK

Officers

Richard J. Coe
Chief Executive Officer

Kevin T. Lewis
President & Chief Lending Officer

Donald D. Herman
Vice President & Chief Financial Officer

Constance M. Bennett
Vice President & Chief Operations Officer

Jill M. Conard
Vice President & Main Office Administrator

Dominic Bellino
Vice President, Loan Operations

Deborah A. Bish
Vice President, Commercial Lending

Douglas L. Blay
Vice President, Commercial Lending

Thomas K. Cargo
Vice President, Commercial Lending

Karen L. Duffy
Vice President, Kent Office Manager

Robert S. Standardi
Vice President, Controller

Tracy L. Cettomai
Assistant Vice President, Consumer Lending

Grace H. Beers
Compliance Officer

Thomas M. Biltz
Loan Operations Officer

Pamela M. England
Marketing Officer

Shelly K. Feciuch
Loan Operations Officer

Marissa L. Platt
Mortgage Loan Underwriting Officer

Michelle A. Spellman
Operations Officer

