March 30, 2011

To Sturgis Bancorp Stockholders,

On behalf of the Board of Directors and employees of Sturgis Bancorp, Inc., I am pleased to provide this copy of the 2010 Annual Report to Stockholders.

If you have questions on the information contained in this Annual Report, or have suggestions, do not hesitate to contact me or President Eric L. Eishen at (269) 651-9345.

Thank you for your continuing support of the Bancorp and our Bank.

Sincerely,

Brian P Hoggatt

Brian P. Hoggatt
CFO, Secretary, Treasurer

CONTENTS

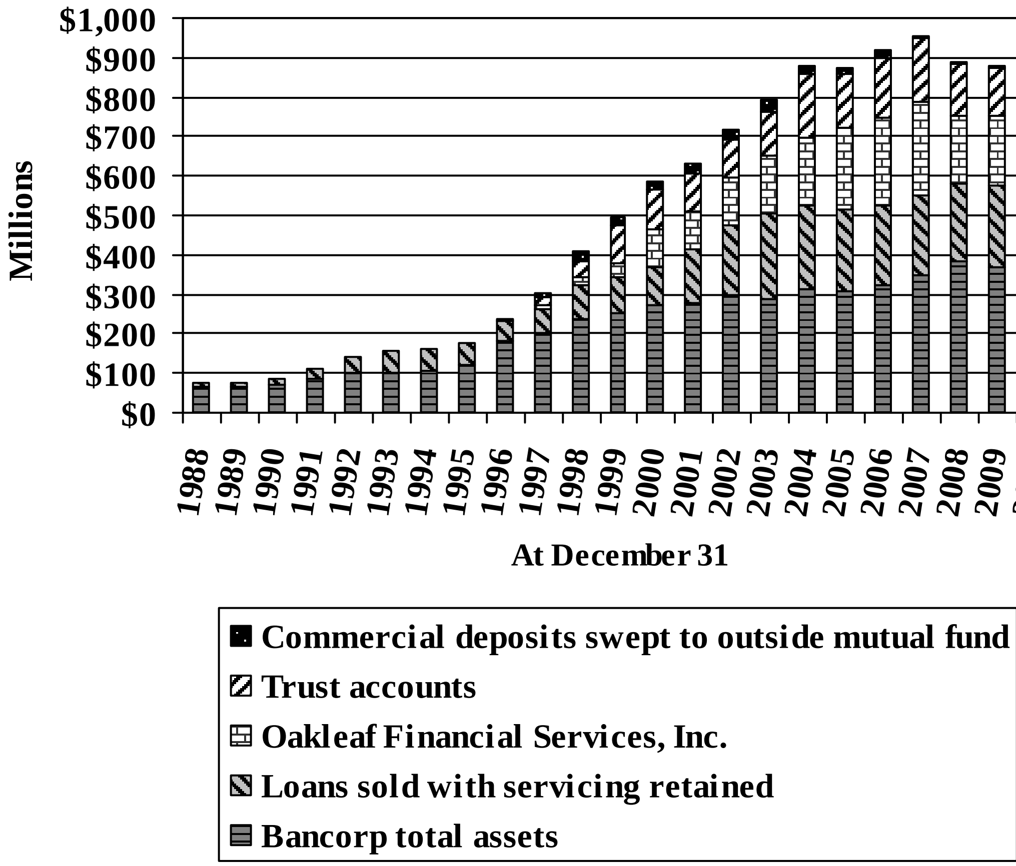
SELECTED FINANCIAL DATA

	(Dollars in Thousands) At December 31, 2010	2009	2008	2007	2006
Total assets	$369,961	$369,921	$383,394	$347,202	$320,858
Cash and investment securities	36,362	18,297	17,539	28,191	29,463
Loans and loans held for sale	263,607	278,822	282,445	270,845	241,751
Mortgage -backed securities (1)	34,619	37,759	49,407	15,880	19,590
Allowance for loan losses	6,691	3,983	2,838	2,699	2,523
Deposits	265,951	259,151	237,517	220,122	216,134
Short-term borrowings	-	4,442	7,287	-	-
Long-term borrowings	53,000	53,500	79,000	83,000	61,000
Repurchase agreements	25,000	25,000	30,500	13,000	13,000
Stockholders' equity	23,315	25,427	25,750	27,680	27,549
Book Value per share	11.56	12.60	12.76	12.20	11.40
Shares outstanding (actual number)	2,017,245	2,017,245	2,017,245	2,268,607	2,416,511

	(Dollars in Thousands) Year Ended December 31, 2010	2009	2008	2007	2006
Interest income	$15,779	$17,296	$20,483	$21,703	$19,610
Interest expense	5,726	7,558	10,239	10,267	8,425
Provision for loan losses	5,385	2,534	489	513	493
Noninterest income	5,661	5,624	4,733	4,885	4,438
Noninterest expense	11,818	11,620	11,584	10,958	10,599
Federal income tax	(780)	293	598	1,506	1,380
Net income (loss)	(709)	915	2,306	3,344	3,151
Earnings (loss) per share (basic)	(0.34)	0.45	1.13	1.43	1.29
Earnings (loss) per share (diluted)	(0.34)	0.45	1.13	1.43	1.29
Cash dividends per share	0.12	0.39	0.48	0.53	0.45
Dividend payout ratio	(34.14%)	86.00%	42.48%	36.97%	34.93%
Equity/Assets ratio	6.30%	6.87%	6.72%	7.97%	8.59%
Return on assets	(0.19%)	0.24%	0.62%	1.00%	1.02%
Return on equity	(2.78%)	3.55%	9.14%	12.04%	11.66%
Weighted average shares outstanding (actual number):					
Basic	2,017,245	2,017,245	2,047,114	2,340,269	2,466,823
Diluted	2,017,245	2,017,245	2,047,114	2,340,554	2,449,643

(1) This amount includes the amortized cost of mortgage-backed securities and collateralized mortgage obligations. For information regarding fair values, see NOTE 2 - SECURITIES in the financial statements.

Gross Assets Managed



This graph illustrates the growth of relationships for the Company since 1988. Each of these relationships indicates a point of contact with customers.

Branch acquisitions with related deposits assumed are shown below:

Seller Name	Date	Branch Locations	Total Deposits
First Federal of Michigan	March 12, 1988	Three Rivers	$10,354,773
Fidelity Federal	June 29, 1990	Three Rivers	3,068,392
Standard Federal Bank	July 6, 1991	Sturgis	9,755,357
Great Lakes Bancorp	March 15, 1996	Coldwater and South Haven	24,016,569
KeyBank	December 8, 1997	Bronson and Constantine	16,883,609
First of America Bank	September 11, 1998	Centreville, Climax, Covert, and South Haven	45,140,000

The graph shows growth, even after the most recent branch acquisitions in 1998, to over 200% of the 1998 sum.

CORPORATE YEAR IN REVIEW

On December 11, 2001, the shareholders of Sturgis Bank & Trust Company (the "Bank") approved the reorganization of the Bank to become a wholly owned subsidiary of Sturgis Bancorp, Inc. (the "Bancorp"), a financial holding company. The Bancorp is a financial holding company under the Bank Holding Company Act of 1956, as amended. This reorganization was effective January 1, 2002. As a result, historical information in this Annual Report for periods before the January 1, 2002 effective date relate to the Bank. Throughout this Annual Report Sturgis Bancorp, Inc. will be referred to as Bancorp and Sturgis Bank & Trust Company will be referred to as the Bank.

The Bank, a Michigan savings bank, was founded in 1905 as a state chartered mutual building and loan. The original mission of the Bank was to promote personal savings and provide financing for the purchase of homes. Today we remain committed to the same objectives by offering consumer, educational, and property improvement loans, along with a large selection of investment opportunities to our community.

Although the Bank's primary business has historically been and will continue to be the origination of first mortgage loans on 1-4 family unit homes, it has implemented strategies in the last few years that have increased commercial real estate and small business loans within its primary market area. All segments of the Bank's loan portfolio contracted in 2010.

The Bank has its main office in Sturgis and branch offices in Bronson, Centreville, Climax, Colon, South Haven, Sturgis, Three Rivers and White Pigeon, Michigan. The Bank's market area includes all of St. Joseph County and parts of Cass, Branch, Calhoun, Van Buren, Allegan, Hillsdale and Kalamazoo Counties in Michigan.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward Looking Statements

This report contains statements that constitute forward-looking statements. These statements appear in several places in this report and include statements regarding intent, belief, outlook, objectives, efforts, estimates or expectations of Bancorp, primarily with respect to future events and the future financial performance of Bancorp. Any such forward-looking statements are not guarantees of future events or performance and involve risks and uncertainties, and actual results may differ materially from those in the forward-looking statement. Factors that could cause a difference between an ultimate actual outcome and a preceding forward-looking statement include, but are not limited to, changes in interest rates and interest rate relationships; demand for products and services; the degree of competition by traditional and non-traditional competitors; changes in banking laws and regulations; changes in tax laws; changes in prices, levies, and assessments; the impact of technological advances; government and regulatory policy changes; the outcome of any pending and future litigation and contingencies; trends in consumer behavior and ability to repay loans; and changes of the world, national and local economies. Bancorp undertakes no obligation to update, amend or clarify forward-looking statements as a result of new information, future events, or otherwise.

Results of Operations

Bancorp reported a net loss for the year ended December 31, 2010 of $709,000, or $0.34 per share compared to earnings of $915,000, or $0.45 per share, for the year ended December 31, 2009. The primary component of the decrease in net income was provisions for loan losses of $5.4 million in 2010, compared to $2.5 million in 2009. Net interest income increased 3.2% to $10.1 million, from $9.7 million for 2009. The increase is primarily due to the increase in the tax equivalent net interest margin to 3.01% in 2010 from 2.82% in 2009. Average interest-earning assets decreased to $338.3 million in 2010 from $349.6 million in 2009.

Interest Income

Interest income decreased $1.5 million to $15.8 million from $17.3 million. This decrease is primarily due to the decrease in market interest rates, with adjustable rate loans resetting lower throughout 2009 and 2010. Average interest-earning assets decreased to $338.3 million in 2010 from $349.6 million in 2009. The average interest rate earned on loans decreased to 5.21% in 2010 from 5.42% in 2009. This decrease in the average interest rate earned is primarily due to adjustable rate loans repricing lower through 2009 and 2010. Most commercial loans are priced on a variable basis and the expansion of non-interest bearing commercial deposit accounts helps to reduce the average funding costs. The average yield on interest-earning assets decreased to 4.66% in 2010 from 4.95% in 2009.

Interest Expense

Interest expense decreased $1.8 million to $5.7 million in 2010 from $7.6 million in 2009. This was primarily due to the decrease in average interest rates on interest-bearing liabilities to 1.79% in 2010 from 2.29% in 2009. The average rate paid on interest-bearing deposits was 1.43% in 2010, compared to 1.84% in 2009. The average rate paid on borrowed funds decreased to 2.88% in 2010 from 3.31% in 2009. Average interest-bearing liabilities decreased to $320.2 million in 2010 from $329.9 million in 2009.

Net Interest Income

Net interest income for the year ended December 31, 2010 was $10.1 million compared to $9.7 million for the year ended December 31, 2009, an increase of $315,000. This increase was caused primarily by an increase in net interest margin, which increased to 2.97% in 2010 from 2.79% in 2009

Average Balances, Interest Rates and Yields. Net interest income is affected by the difference ("interest rate spread") between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities and the relative amounts of interest-bearing liabilities and interest-earning assets. When the total of interest-earning assets approximates or exceeds the total of interest-bearing liabilities, any positive interest rate spread will generate net interest income. Financial institutions have traditionally used interest rate spreads as a measure of net interest income. Another indication of an institution's net interest income is its "net yield on interest-earning assets" or "net interest margin," which is net interest income divided by average interest-earning assets. The Bank's net interest margin for 2010 and 2009 was, 2.97% and 2.79%, respectively. The Bank has generally positioned itself for net interest income to increase with rising interest rates, with most loans adjusting with changes in related indices. The Bank's interest-earning assets reprice at a faster pace than interest-bearing liabilities. A benefit to the positive gap strategy is the protection from unusually high market interest rates. The most significant risk to the positive gap strategy is decreases in market interest rates.

(In thousands)

Average Balances and Interest Rates
Year Ended December 31,

	2010			2009		
	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate
Interest-Earning Assets:						
Loans (1)	$ 274,102	$ 14,275	5.21%	$ 283,703	$ 15,384	5.42%
Mortgage-backed securities	35,519	1,037	2.92%	41,470	1,341	3.23%
Investment securities (2)	6,486	158	2.45%	6,638	209	3.16%
Interest-bearing deposits	22,238	309	1.39%	17,780	362	2.04%
Total interest-earning assets	$ 338,345	$ 15,779	4.66%	$ 349,591	$ 17,296	4.95%
Interest-Bearing Liabilities:						
Deposits	$ 240,116	$ 3,422	1.43%	$ 228,024	$ 4,184	1.84%
FHLB advances and repurchase agreements	80,106	2,304	2.88%	101,886	3,374	3.31%
Total interest-bearing liabilities	$ 320,222	$ 5,726	1.79%	$ 329,910	$ 7,558	2.29%
Net interest income		$ 10,053			$ 9,738	
Interest rate spread			2.87%			2.66%
Net interest-earning assets	$ 18,123			$ 19,681		
Net interest margin			2.97%			2.79%

(1) Interest on loans includes fees. Nonaccrual loans and loans held for sale have been included in the average balances of loans.
(2) Yield on investment securities is reported on an actual and not a tax equivalent basis

The following table presents information regarding the weighted average yields received on loans and other assets and the weighted average rates paid on deposits and borrowings on the last day of the years indicated. Non-accruing loans have been included in the table as loans carrying a zero yield.

	December 31,	
	2010	**2009**
Weighted average rate:		
Loans	5.10%	5.28%
Mortgage-backed securities	3.38%	3.64%
Investments(1)	2.65%	2.48%
Interest-bearing deposits	1.20%	3.00%
All interest-earning assets	4.64%	4.99%
Weighted average cost:		
Deposits (interest-bearing)	1.24%	1.63%
FHLB advances other borrowings	2.32%	3.00%
All interest-bearing liabilities	1.51%	1.82%
Interest rate spread	3.13%	3.17%

(1) Yield on investment securities is reported on an actual and not a tax equivalent basis.

Rate/Volume Analysis. The following table sets forth certain information regarding changes in interest income and interest expense of Bancorp for the periods indicated. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to: (i) changes in volume (change in volume multiplied by the prior year rate) and (ii) changes in rate (change in rate multiplied by the prior year volume). Rate/volume variances have been allocated proportionately to the change due to rate and the change due to volume.

	(In thousands)					
	Year Ended December 31, 2010 vs 2009 Increase (Decrease) Due To:			Year Ended December 31, 2009 vs 2008 Increase (Decrease) Due To:		
Interest Income:	Volume	Rate	Total	Volume	Rate	Total
Loans	$ (511)	$ (598)	$ (1,109)	$ 419	$ (2,852)	$ (2,433)
Mortgage-backed securities	(181)	(123)	(304)	399	(664)	(265)
Investment securities	(5)	(46)	(51)	5	(20)	(15)
Interest-bearing deposits	78	(131)	(53)	(115)	(359)	(474)
Total interest-earning assets	(619)	(898)	(1,517)	708	(3,895)	(3,187)
Interest Expense:						
Deposits	212	(974)	(762)	283	(1,878)	(1,595)
FHLB advances and borrowings	(663)	(407)	(1,070)	(154)	(932)	(1,086)
Total interest-bearing liabilities	(451)	(1,381)	(1,832)	129	(2,810)	(2,681)
Net Interest Income	$ (168)	$ 483	$ 315	$ 579	$ (1,085)	$ (506)

Provision for Loan Losses

The provision for loan losses was $5.4 million for the year ended December 31, 2010 and $2.5 million for the year ended December 31, 2009, an increase of $2.9 million. The provision for loan losses was based upon management's assessment of relevant factors, including types and amounts of non-performing loans, historical and anticipated loss experience on such types of loans, and economic conditions. Loans charged off during 2010, net of recoveries, were $2.7 million, compared to $1.4 million during 2009.

Nonperforming loans decreased to $6.5 million at December 31, 2010 from $8.2 million at December 31, 2009. This decrease in nonperforming loans was primarily in commercial real estate loans. At December 31, 2010, the Bank had another $9.0 million of troubled debt restructured loans in addition to the nonperforming loans, compared to none at December 31, 2009. The Bank restructures loans when such restructures are expected to minimize the Bank's potential losses on the loans.

The allowance for loan losses as a percentage of total (gross) loans increased to 2.50% in 2010 from 1.41% in 2009. This increase is primarily due to Management's assessment of credit losses and exposure. Management monitors the increasing exposure to commercial lending and economic developments the Bank's market area, among other factors, in determining appropriate provisions to the allowance for loan losses.

Noninterest Income

Noninterest income was $5.7 million in 2010, compared to $5.6 million in 2009. The Company realized $1.1 million of gains on sales of available-for-sale securities in 2010, compared to $1.2 million in 2009. Commission income from brokerage activities increased $133,000 to $1.2 million, partially due to higher market values of assets against which fees are assessed.

Noninterest Expense

Noninterest expense was $11.8 million in 2010, compared to $11.6 million in 2009. The largest component of noninterest expense is compensation and related expenses, which increased $325,000, or 5.1%, primarily due to a decrease in deferral of loan origination expenses with slower loan volume. Real estate owned expense increased $253,000, as the Company wrote down the carrying value of foreclosed assets with declines in market values. At December 31, 2010, goodwill was not impaired. Management actively minimizes noninterest expense, although certain noninterest expenses are outside of Management's direct control.

The effective federal income tax rate was (52.4%) in 2010 and 24.3% in 2009.

Financial Condition

General. Bancorp's total assets at December 31, 2010 were $370.0 million compared to $369.9 million at December 31, 2009, a decrease of $40,000. Most of the change in total assets was in available for sale securities.

Loans. Net loans decreased to $261.4 million at December 31, 2010 from $278.2 million at December 31, 2009. Residential mortgages and residential construction loans decreased $7.0 million, as residential borrowers paid down loans in 2010. The Bank sells long-term, fixed rate, residential mortgages in the secondary market. The major buyers of these loans are Federal Home Loan Mortgage Corporation (FHLMC) and FHLB. Commercial loans, including net commercial construction loans, decreased to $119.1 million, or 45.6% of gross loans at December 31, 2010 from $124.6 million, or 44.2% of gross loans, at December 31, 2009. The proceeds from sales of loans (fixed-rate, residential mortgages) were $29.9 million and $65.5 million for the years ended December 31, 2010 and 2009, respectively. The mortgage loans originated for sale ($31.1 million in 2010 and $63.8 million in 2009) were primarily funded by the secondary mortgage market sales. The decision to sell fixed-rate mortgages with original maturities of 10-years or greater protects the Bank from the interest rate risk inherent in holding these longer term, fixed-rate loans and provides a source of liquidity to fund loan demand. Reductions in market interest rates generally increase the pace of refinance activity in the residential loan portfolio.

At December 31, 2010, outstanding commitments to originate loans were $1.7 million and $44.3 million on fixed and variable-rate loans, respectively. Of these loan commitments, Management expects $5.9 million to be disbursed for new loans during the first half of 2011. The additional loan commitments are unused lines of credit, which may be drawn at any time by the borrower. These loan commitments will be funded by interest-bearing deposits, maturing assets, and additional FHLB borrowings, if needed.

Loans serviced for others was $201.3 million and $204.3 million at December 31, 2010 and 2009, respectively. This servicing portfolio consists of loans originated by the Bank and sold in the secondary mortgage market with servicing retained by the Bank. Management believes retaining servicing provides the Bank with a competitive advantage in its market. The retention of servicing requires the Bank to keep a higher staffing level than if the servicing would be sold. But many consumers have discovered the difficulties encountered when loan servicing is sold. The retention of servicing also allows the Bank to cross-sell other banking products and services to these customers. The value of the right to service is appraised quarterly and any temporary impairment of the value of servicing rights is recognized quarterly. The originated mortgage servicing rights asset required a valuation allowance of $15,000 at December 31, 2010. The Bank will continue to monitor the valuation of the servicing rights asset. If subsequent analysis shows changes in the appraised impairment, the valuation allowance will be adjusted to match the impairment.

Bancorp has no purchased mortgage servicing portfolio.

The following table provides an analysis of the allowance for loan losses:

	(Dollars in thousands) Year Ended December 31, 2010	2009
Balance at the beginning of the period	$ 3,983	$ 2,838
Charge-offs:		
Residential mortgages	1,116	538
Commercial mortgages	151	307
Commercial nonmortgage loans	1,481	552
Other consumer and installment loans	91	11
Total charge-offs	2,839	1,408
Recoveries		
Residential mortgages	34	-
Commercial mortgages	8	-
Commercial nonmortgage loans	48	14
Other consumer and installment loans	72	5
Total recoveries	162	19
Net charge-offs	2,677	1,389
Provision for loan losses	5,385	2,534
Balance at the end of the period	$ 6,691	$ 3,983
Ratio of net charge-offs during the period to average loans outstanding during the period	0.98%	0.49%
Allowance for loan losses to total (gross) loans	2.50%	1.41%
Nonperforming assets to total assets	2.31%	2.78%
Allowance for loan losses to nonperforming assets	78.39%	38.75%

Loans in nonaccrual status at December 31, 2010 were $5.3 million, down from $6.9 million at December 31, 2009. The following table presents the aggregate amount of troubled asset categories as of the dates indicated:

	(Dollars in thousands) December 31,	
	2010	2009
Past due – 90 days or greater	$ 1,245	$ 1,306
Nonaccrual loans	5,258	6,886
Real estate owned	1,730	2,086
Total nonperforming assets	8,233	10,278
Restructured assets	9,016	-
Total troubled assets	$17,249	$10,278
Ratio of troubled assets to total loans	6.43%	3.64%
Ratio of troubled assets to total assets	4.66%	2.78%

Interest-earning Deposits in Banks. Interest-bearing deposits in banks were $10.3 million at December 31, 2010, compared to $7.6 million at December 31, 2009, an increase of $2.7 million.

Securities – Available for sale. Investment securities available for sale of $27.7 million at December 31, 2010 and $31.9 million at December 31, 2009 consisted primarily of mortgage-backed securities and collateralized mortgage obligations issued by the GNMA. The Bank's investment strategy has historically been to carry its mortgage-backed securities in the held-to-maturity portfolio. Management has changed this strategic decision, so that a balanced investment portfolio can more directly contribute to future liquidity needs, by being carried as available-for-sale. During 2010, the Bank sold $37.7 million of available for sale securities at a gain of $1.1 million, before applicable taxes. Proceeds of the sales were reinvested in available-for-sale securities at market rates.

Securities – Held-to-maturity. At December 31, 2010 and December 31, 2009, investment securities held-to-maturity consist of U.S agency mortgage-backed securities and municipal obligations. The investment securities held-to-maturity were $6.5 million at December 31, 2010 compared to $7.6 million at December 31, 2009, a decrease of $1.1 million. The decrease was primarily due to principal reductions on mortgage-backed securities guaranteed by the Small Business Association (full faith and credit of the U. S. Government).

Deposits and Borrowed Funds. Deposits were $266.0 million at December 31, 2010 compared to $259.2 million at December 31, 2009, an increase of $6.8 million or 2.6%. Interest-bearing deposits decreased to $236.3 million at December 31, 2010 from $234.3 million at December 31, 2009. Certificates of deposit with balances greater than or equal to $100,000 (commonly referred to as jumbo certificates), which carry greater interest rate sensitivity, decreased by $4.9 million to $25.3 million at December 31, 2010 from $30.2 at December 31, 2009. Other certificates of deposit, including brokered certificates of deposit parsed into $1,000 increments, decreased to $70.6 million at December 31, 2010 from $79.5 million at December 31, 2009. Brokered certificates of deposit, mostly included in the certificates under $100,000, decreased to $25.7 million at December 31, 2010 from $32.8 million at December 31, 2009. The Bank uses brokered and jumbo certificates as sources of liquidity. Transaction savings accounts and checking accounts increased $15.9 million, or 12.8%, from December 31, 2009 to December 31, 2010. Transaction savings accounts and checking accounts represent 52.81% of deposits at December 31, 2010, compared to 48.07% of deposits at December 31, 2009. Bank management is actively attempting to increase these core deposit account relationships. Transaction savings accounts and checking accounts provide relatively inexpensive funding for future growth, compared to alternative certificates of deposit and borrowed funds at higher interest rates. The Bank offers competitive rates on its time deposits and uses jumbo certificates or borrowed funds, when that strategy enhances net interest income.

The Bank has an available six-month line of credit with FHLB which provides for advances up to $5.0 million and matures in March. The Bank anticipates renewal of the line of credit at maturity in March 2011. All borrowings from FHLB are collateralized by substantially all mortgage loans and securities backed by the US Government.

Long-term advances were $48.5 million at December 31, 2010 compared to $53.5 million at December 31, 2009, a decrease of $5.0 million. No short-term advances were outstanding at December 31, 2010 or 2009.

At December 31, 2010, Bancorp had $4.5 million outstanding on an open-end line of credit with another financial institution. The line of credit matures in April 2013.

Capital Resources

The stockholders' equity of the Bancorp was $23.3 million at December 31, 2010 compared to $25.4 million at December 31, 2009, a decrease of $2.1 million, or 8.31%. The primary component of this decrease was a reduction in the fair value of available for sale securities. Cash dividends of $243,000, or $0.12 per share, were paid in 2010, out of retained earnings. The stockholders' equity was 6.30% of total assets at December 31, 2010. Management continues to monitor and evaluate the best capital structure of Bancorp. A structure that provides sufficient capital to fund future growth, yet maximizes earnings per share, is deemed optimal. Management does not project a need for capital beyond what can be provided by retained earnings.

The Federal Reserve Board ("FRB")'s risk-based capital guidelines are inapplicable to Bancorp, due to Bancorp qualifying as a "small bank holding company". However, if Bancorp's total assets exceed $500 million, the guidelines will then apply to Bancorp. The guidelines require that financial holding companies with over $500 million in total assets maintain capital no less than that required by subsidiary banks.

Management deems the current capitalization level adequate for current and anticipated strategies. Management does not expect Bancorp to grow in the foreseeable future to the $500 million asset level.

Although not currently required by FRB, the following table summarizes the capital ratios of Bancorp at the dates indicated:

		December 31, 2010	December 31, 2009
Equity to assets		6.3%	6.9%
Tier I leverage		5.4%	5.8%
Risk-based:	Tier I capital	8.9%	8.8%
	Total capital	10.1%	10.0%

Asset/Liability Management

The primary component of Bancorp's earnings is net interest income of the Bank. The Bank's asset/liability management strategy is to maximize net interest income over time by reducing the impact of fluctuating interest rates. This is accomplished by matching the mix and maturities of its assets and liabilities. At the same time, the Bank's asset/liability strategies for managing interest rate risk must also accommodate customer demands for particular types of deposit and loan products. The Bank uses asset/liability management techniques in an attempt to maintain a profitable mix of financial assets and liabilities, provide deposit and loan products that meet the needs of its market area, and maintain control over interest rate risk resulting from changes in interest rates.

Net interest income, the primary component of the Bank's net income, is derived from the difference or "spread" between the yield on interest-earning assets and the cost of interest-bearing liabilities. The Bank has sought to reduce its exposure to changes in interest rates by matching more closely the effective maturities and repricings of its interest-sensitive assets and liabilities. At the same time, the Bank's asset/liability management strategies must also accommodate customer demands for particular types of deposit and loan products.

While much of the Bank's asset/liability management efforts involve strategies that manage the rate sensitivity of its loans and investments, such as the sale of long-term fixed rate loans, originations of adjustable rate loans and purchases of adjustable rate mortgage-backed securities or relatively short average life fixed-rate investments, it also uses techniques to manage the rate sensitivity of its deposits and borrowed money. Those techniques include attracting longer-term certificates of deposit at rates lower than borrowing rates, when the market will permit. The Bank emphasizes core deposits, which are less sensitive to changes in interest rates, and borrowing through long-term FHLB advances or brokered certificates of deposit. The Bank's asset/liability management strategy adjusts, when market interest rates and customer demand change.

The Bank measures its exposure to interest rate fluctuations primarily by using a computer modeling software designed for financial institutions, such as the Bank. The model uses assumptions which Management believes are reasonable for the analysis. These assumptions include (but are not limited to) prepayment and decay rates. Because of the Bank's smaller loan population, these assumptions are based on national statistics and may not reflect the Bank's own experience. It allows the Bank to simulate its asset-liability sensitivity based on the interest rate risk identified. The analysis estimates the changes in the market value of the Bank's equity using immediate and permanent interest rate change scenarios ranging from +4% to –4%, in 1% increments from current market rates. The software also allows simulation for unlimited additional market interest rate scenarios. At December 31, 2010, the following table illustrates the interest rate sensitivity of the Bank's consolidated equity to immediate and permanent changes in market interest rates.

(in Thousands of Dollars)	
Book value of Bank's equity	$29,781
4% increase in market rates	34,442
3% increase in market rates	31,414
2% increase in market rates	30,948
1% increase in market rates	27,843
No change (current market value of equity)	24,974
1% decrease in market rates	N/A
2% decrease in market rates	N/A
3% decrease in market rates	N/A
4% decrease in market rates	N/A

As the table shows, the Bank's estimated market value of equity increases when interest rates rise. Market rate decreases are not relevant because resulting rates would be below 0%. That indicates that the Bank is able to withstand fluctuations in market interest rates without posing a significant threat to either the Bank's stockholders' equity or the federal deposit insurance system, and therefore, the Bank can be deliberate in its actions to adjust the asset-liability mix. The Bank would meet the regulatory minimum capital requirements in all of the interest-rate scenarios.

The Bank has an Asset-Liability Management Committee (ALCO) that meets as needed. The purpose of this Committee is to communicate, coordinate, and monitor asset-liability management procedures. The Committee establishes and monitors the volume and mix of both assets and funding sources. The objective is to manage assets and funding sources to produce results consistent with the Bank's liquidity requirements, capital adequacy, growth, and profitability goals. To accomplish this objective, the ALCO uses internal budget variance reports, forecasts for changes in interest rates and consumer deposit activity, as well as forecasts of loan demand in each of the Bank's loan types, investment maturities and new investment alternatives, and various other internal and external reports.

Effect of Interest Rate Fluctuations

Bancorp's consolidated results of operations depend, to a large extent, on the Bank's level of net interest income, which is the difference between interest income earned on its loan and investment portfolios versus the interest paid on deposits and borrowed funds. If the cost of funds increases faster than the yield on its interest-earning assets, net interest income will be reduced.

Bancorp measures its interest rate risk primarily using simulation analysis. This analysis is prepared by the Chief Financial Officer and reviewed by the ALCO. ALCO is comprised of the Chief Executive Officer, Chief Financial Officer, Executive Vice President and Senior Officers of the Bank. Bancorp's Board of Directors reviews quarterly reports that estimate Bancorp's sensitivity to changes in interest rates. Sensitivity is estimated for net interest income and market value of portfolio equity.

While Bancorp uses various tools to monitor interest rate risk, it is unable to predict future fluctuations in interest rates or the specific impact thereof. The market value of most of Bancorp's financial assets is sensitive to fluctuations in market interest rates. Fixed-rate investments and mortgage loans decline in value as interest rates rise. Adjustable-rate investments and loans generally have less market value volatility than fixed-rate assets.

Liquidity

Bancorp maintains certain levels of liquid assets (the most liquid of which are cash and investment securities) in order to meet demands from loan commitments, deposit withdrawals and other obligations. Bancorp manages liquidity by maintaining a portion of its liquid assets in overnight accounts and by staggering maturities in its portfolio of investment securities. The primary sources of liquidity are loan repayments, loan sales, maturing investments, deposit accounts, and other borrowed funds, such as FHLB borrowings.

As equity markets were volatile through 2009 and 2010, deposit customers have been attracted to Bank deposits from uninsured alternatives, such as money market accounts or other investments. If market interest rates remain historically low, Management expects depositors might unwisely look to more risky investments than Bank deposits to increase their return.

Contractual Obligations

The long-term debt obligations consist of certificates of deposit and advances from the Federal Home Loan Bank. The following schedule represents only scheduled principal payments as of December 31, 2010.

	Payments Due by Period (in thousands)				
	Total	Less than 1 year	1 – 3 years	4 – 5 Years	After 5 years
Certificates of deposit	$ 95,880	$48,213	$23,547	$13,481	$ 10,639
FHLB advances	48,500	-	-	25,500	23,000
Total contractual obligations	$144,380	$48,213	$23,547	$38,981	$33,639

Off-balance Sheet Activities

Other Commercial Credits – The Bank is a party to credit related financial instruments with off-balance sheet risks in the normal course of business to meet the financing needs of its customers. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet of the Bank.

Commitments to extend credit are agreements to lend to a customer, as long as there are no violations of any condition established in the contract. Commitments for equity lines of credit or overdraft protection may expire without being drawn. Therefore, total commitments do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on Management's credit evaluation of the customer and the related loans. 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, may not contain a specified maturity date and may be drawn to the total extent of the Bank's commitment.

Commercial and standby letters of credit are a conditional commitment issued by the Bank to guarantee the performance of a customer to a third party. The letters of credit are primarily used to support public and private borrowing arrangements. All letters of credit have expiration dates within one year.

At December 31, 2010, the Bank had total commitments to originate loans of $1.7 million and $44.3 million on fixed rate and variable rate loans, respectively.

All of the commercial credits are underwritten using the commercial loan underwriting guidelines.

Collateral Requirements – To reduce credit risks related to the use of credit-related financial instruments, the Bank might deem it necessary to obtain collateral. The amount and nature of the collateral obtained are based on the Bank's credit evaluation of the borrower and related loans. Collateral secured varies, but may include cash, investment securities, accounts receivable, inventory, property, plant and equipment and real estate. Although these items are used to secure loans, they are not included on the balance sheet of Bancorp.

Legal Contingencies – Various legal claims arise from time to time in the normal course of business which, in the opinion of Management, will have no material effect on Bancorp's consolidated financial statements.

Impact of Inflation

The majority of assets and liabilities of financial institutions are monetary in nature. Generally, changes in interest rates have a more significant impact on earnings of the Bank than inflation. Although influenced by inflation, changes in rates do not necessarily move in either the same magnitude or direction as changes in the price of goods and services. Inflation could impact the growth of total assets, creating a need to increase equity capital at a higher rate to maintain an adequate equity to assets ratio, which in turn reduces the amount of earnings available for cash dividends. Through 2010 and 2009, inflation did not have a material impact on the Bancorp.

DIRECTORS OF BANCORP – December 31, 2009

John R. Dresser	Dresser, Dresser, Haas & Caywood, P.C. Retained Counsel
Eric L. Eishen	President and Chief Executive Officer, Sturgis Bancorp, Inc and Sturgis Bank & Trust Company
Leonard L, Eishen	Chairman of the Board Retired President and Chief Executive Officer, Sturgis Bank & Trust Company
David L. Franks	President and COO, Oak Press Solutions
Donald L. Frost	Chief Executive Officer, LTI Printing, Inc.
James A. Goethals	Vice Chairman of the Board Retired President – Sturgis Foundry Corporation
Jeffrey M. Mohney	Owner, A. W. Ayres Agency, Inc.
John T. Wiedlea	President, Automation Plus, Inc.

OFFICERS OF BANCORP

Eric L. Eishen	President, Chief Executive Officer
Ronald W. Scheske	Vice President
Brian P. Hoggatt	Chief Financial Officer, Secretary/Treasurer

DIRECTORS OF THE BANK – DECEMBER 31, 2009

John R. Dresser	Dresser, Dresser, Haas & Caywood, P.C. Retained Counsel
Eric L. Eishen	President and Chief Executive Officer
Leonard L. Eishen	Retired President and Chief Executive Officer
David L. Franks	President and COO, Oak Press Solutions
Donald L. Frost	Chief Executive Officer, LTI Printing, Inc.
James A. Goethals	Chairman of the Board President, Sturgis Foundry Corporation – Retired
Jeffrey M. Mohney	Owner, A. W. Ayres Agency, Inc.
John T. Wiedlea	President, Automation Plus, Inc.

OFFICERS OF THE BANK – DECEMBER 31, 2009

Eric L. Eishen	President, Chief Executive Officer
Steven G. Gage	Senior Vice President, Commercial Lending
Brian P. Hoggatt	Senior Vice President, Chief Financial Officer, Treasurer, Corporate Secretary
Tracey L. Parker	Senior Vice President, Retail Lending
Ronald W. Scheske	Executive Vice President
Donald G. Baldwin	First Vice President, Operations, Compliance Officer
Christine M. Moline	First Vice President, Private Banking
Jose D. Albarran	Vice President
Sandra J. Cagle	Vice President
Debora L. Capman	Vice President, Trust Officer
Emily D. Haller	Vice President, Human Resources
Steven A. Haller	Vice President, Loss Mitigation
Kurt A. Inman	Vice President, Director of Marketing
Jason J. Hyska	Vice President
John D. Johnson	Vice President
Gary E. Metz	Vice President
Heather J. Myers	Corporate Secretary
Janet M. Stahl	Vice President
Matthew D. Scheske	Vice President
Jason A. Wagner	Vice President
David E. Watters	Vice President, Senior Trust Officer
Camille M. Wilson	Vice President
Marilee I. Yoder	Controller
Robby S. Beachy	Assistant Vice President
Tami J. De Mara	Assistant Vice President
Trudy R. Gloy	Assistant Vice President
Stephen E. Merchant	Assistant Vice President
Elizabeth M. Weinberg	Assistant Vice President
Cindy L. Woolner	Assistant Vice President

BANK CORPORATE INFORMATION

Location	Address	City, ST ZIP	Telephone	Fax
Sturgis (Main Office)	113-125 East Chicago Road	Sturgis, MI 49091	(269) 651-9345	(269) 651-5512 (269) 651-8263 (269) 865-5902
Sturgis–Trust Dept.	113-125 East Chicago Road	Sturgis, MI 49091	(269) 651-1380	(269) 659-6848
Branch Offices				
Bronson	863 West Chicago Road	Bronson, MI 49028	(517) 369-7322	(517) 369-2347
Centreville	158 West Main	Centreville, MI 49032	(269) 467-8525	(269) 467-4180
Climax	125 North Main	Climax, MI 49034	(269) 746-4256	(269) 746-4108
Colon	110 South Blackstone Street	Colon, MI 49040	(269) 432-3229	(269) 432-2971
South Haven	1121 LaGrange Street	South Haven, MI 49090	(269) 637-8444	(269) 637-5560
South Haven	365 Center Street	South Haven, MI 49090	(269)-637-6644	(269) 637-6645
Sturgis	1001 South Centerville Road	Sturgis, MI 49091	(269) 651-9379	(269) 651-1514
Sturgis	1501 East Chicago Road	Sturgis, MI 49091	(269) 651-9345	(269) 651-5609
Three Rivers	115 North Main Street	Three Rivers, MI 49093	(269) 273-8481	(269) 273-1732
White Pigeon	122 West Chicago Road	White Pigeon, MI 49099	(269) 483-9668	(269) 483-2725

Oakleaf Financial Services	113-125 East Chicago Road	Sturgis, MI 49091	(269) 651-2475	(269) 651-7273

MARKET INFORMATION

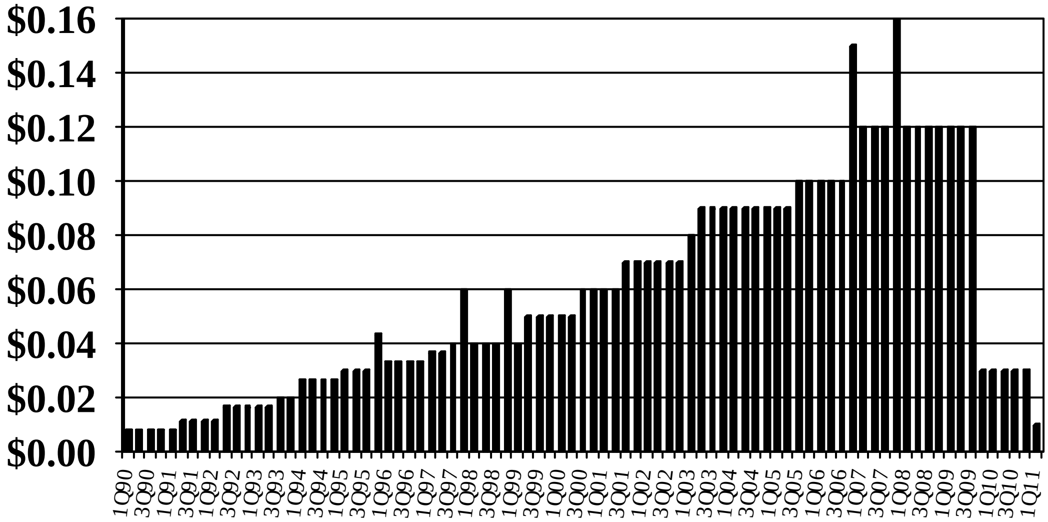
Shares of common stock of Bancorp were held by approximately 152 shareholders as of December 31, 2010. Bancorp's shares are traded on the OTC Bulletin Board under the symbol of "STBI". Trading activity has been infrequent.

The range of high and low trade prices for each quarterly period during the past two years is presented below:

	Year ended December 31,			
	2010		2009	
	High	Low	High	Low
First quarter	$7.40	$6.52	$9.00	$7.00
Second quarter	15.00	6.51	8.00	6.88
Third quarter	8.25	6.62	7.75	6.50
Fourth quarter	8.70	6.50	7.80	7.05

The trade prices listed above are based on actual transactions obtained from public Internet sources obtained by Bancorp.

Cash Dividends Per Share



On December 11, 2001, the shareholders of the Bank approved the reorganization of the Bank to become a wholly owned subsidiary of Sturgis Bancorp, Inc., a financial holding company. Sturgis Bancorp, Inc. is a financial holding company under the Bank Holding Company Act of 1956, as amended (the "Bancorp"). This reorganization was approved at a special meeting of the shareholders of the Bank on December 11, 2001. Bancorp received all of the various federal and state regulatory approvals for this reorganization.

This reorganization became effective as of the opening of business on January 1, 2002. Bancorp is a legal entity separate and distinct from its subsidiaries. Substantially all of Bancorp's revenues result from dividends paid to it by the Bank and from earnings on investments. There are statutory and regulatory requirements applicable to the payment of dividends by the Bank to Bancorp, as well as by Bancorp to its shareholders.

Under the Michigan Savings Bank Act, Bancorp may not declare a cash dividend or a dividend of any kind except out of net income then on hand after deducting all losses and bad debts, and then only if it will have a surplus amounting to not less than 20% of its capital after the payment of the dividend. Moreover, the Bank may not declare or pay any cash dividend or dividend in kind until the cumulative dividends on its preferred stock, if any, have been paid in full. Further, if the surplus of the Bank is at any time less than the amount of its capital, before the declaration of a cash dividend or dividend in kind, it must transfer to surplus not less than 10% of its net income for the preceding 6 months (in the case of quarterly or semi-annual dividends) or the preceding two consecutive 6 month periods (in the case of annual dividends).

Pursuant to the Michigan Business Corporation Act, Bancorp may not make distributions to its shareholders if, after giving effect to the distribution, the corporation would not be able to pay its debts as they become due in the usual course of business, or the corporation's total assets would be less than the sum of it total liabilities plus, unless the corporation's articles of incorporation permit otherwise, the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution.

The payment of dividends by Bancorp and its subsidiaries may also be affected or limited by other factors, such as the requirements to maintain adequate capital above regulatory guidelines. In addition, if, in the opinion of the applicable regulatory authority, a bank under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice (which, depending on the financial condition of the Bank, could include the payment of dividends), such authority may require, after notice and hearing, that such bank cease and desist from such practice or prohibit the payment of future dividends. The Federal Reserve has indicated that paying dividends that deplete a bank's capital base to an inadequate level would be an unsafe and unsound banking practice. The Federal Reserve, the FDIC and the Division of Financial Institutions of the Michigan Department of Consumer & Industry Services Office of Financial and Insurance Services have issued policy statements which provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.

INDEPENDENT AUDITORS

Bancorp employed the accounting firm of Crowe Horwath LLP as Independent Auditors for the years ended December 31, 2010 and December 31, 2009. There have been no disagreements on accounting or financial disclosure matters within these time periods.

REPORT OF INDEPENDENT AUDITORS

Board of Directors and Shareholders
Sturgis Bancorp, Inc.
Sturgis, Michigan

We have audited the accompanying consolidated balance sheets of Sturgis Bancorp, Inc. as of December 31, 2010 and 2009 and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sturgis Bancorp. Inc, as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

Grand Rapids, Michigan
March 23, 2011

STURGIS BANCORP, INC.

CONSOLIDATED BALANCE SHEETS

December 31, 2010 and 2009

(Amounts in thousands, except share and per share data)

	2010	2009
ASSETS		
Cash and due from banks	$ 16,146	$ 8,448
Other short-term investments	10,338	528
Total cash and cash equivalents	26,484	8,976
Interest-earning deposits in banks	10,376	7,565
Securities - Available for sale	27,669	31,908
Securities – Held to maturity (fair value $6,578 and $7,551)	6,452	7,607
Federal Home Loan Bank stock, at cost	4,424	4,784
Loans held for sale	2,191	595
Loans, net of allowance of $6,691 and $3,983	261,416	278,227
Premises and equipment, net	7,739	8,010
Premises and equipment held for sale, net	-	317
Goodwill	5,109	5,109
Originated mortgage servicing rights	1,381	1,277
Real estate owned	1,730	2,086
Bank-owned life insurance	8,696	8,401
Accrued interest receivable	1,602	1,795
Prepaid FDIC assessment	1,175	1,619
Other assets	3,517	1,645
Total assets	$ 369,961	$ 369,921
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Deposits		
Noninterest-bearing	$ 29,609	$ 24,855
Interest-bearing	236,342	234,296
Total deposits	265,951	259,151
Federal Home Loan Bank advances and other borrowings	53,000	57,942
Repurchase agreements	25,000	25,000
Accrued interest payable	466	687
Other liabilities	2,229	1,714
Total liabilities	346,646	344,494
Stockholders' equity		
Preferred stock - $1 par value: authorized - 1,000,000 shares issued and outstanding – 0 shares		
Common stock – $1 par value: authorized – 9,000,000 shares issued and outstanding 2,017,245 shares at December 31, 2010 and 2009	2,017	2,017
Additional paid-in capital	6,872	6,872
Retained earnings	15,646	16,598
Accumulated other comprehensive income (loss)	(1,220)	(60)
Total stockholders' equity	23,315	25,427
Total liabilities and stockholders' equity	$ 369,961	$ 369,921

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME

Years ended December 31, 2010 and 2009

(Amounts in thousands, except share and per share data)

	2010	2009
Interest income		
Loans	$ 14,275	$ 15,384
Investment securities:		
Taxable	1,334	1,702
Tax-exempt	63	55
Dividends	107	155
Total interest income	15,779	17,296
Interest expense		
Deposits	3,422	4,184
Borrowed funds	2,304	3,374
Total interest expense	5,726	7,558
Net interest income	10,053	9,738
Provision for loan losses	5,385	2,534
Net interest income after provision for loan losses	4,668	7,204
Noninterest income:		
Service charges and other fees	1,457	1,550
Investment brokerage commission income	1,224	1,091
Mortgage banking activities	1,055	1,089
Trust fee income	338	319
Increase in value of bank owned life insurance	295	329
Gain on sale of securities	1,134	1,244
Gain (loss) on sale of real estate owned	11	(52)
Other income	147	54
Total noninterest income	5,661	5,624
Noninterest expenses:		
Salaries and employee benefits	6,690	6,365
Occupancy and equipment	1,432	1,488
Data processing	670	735
Professional services	373	301
Real estate owned expense	693	440
Advertising	138	132
FDIC premiums	480	644
Other	1,342	1,515
Total noninterest expenses	11,818	11,620
Income (loss) before income tax expense (benefit)	(1,489)	1,208
Provision for income tax	(780)	293
Net income (loss)	$ (709)	$ 915
Basic earnings (loss) per share	$ (0.34)	$ 0.45
Diluted earnings (loss) per share	(0.34)	0.45

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years ended December 31, 2010 and 2009
(Amounts in thousands, except share and per share data)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance – January 1, 2009	$ 2,017	$ 6,872	$ 16,470	$ 391	$ 25,750
Net income for the year ended December 31, 2009	-	-	915	-	915
Other comprehensive income (loss)	-	-	-	(451)	(451)
Total comprehensive income	-	-	-	-	464
Cash dividends ($.39 per share)	-	-	(787)	-	(787)
Balance – December 31, 2009	2,017	6,872	16,598	(60)	25,427
Net income (loss) for the year ended December 31, 2010	-	-	(709)	-	(709)
Other comprehensive income (loss)	-	-	-	(1,160)	(1,160)
Total comprehensive income (loss)	-	-	-	-	(1,869)
Cash dividends ($0.12 per share)	-	-	(243)	-	(243)
Balance – December 31, 2010	$ 2,017	$ 6,872	$ 15,646	$ (1,220)	$ 23,315

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2010 and 2009
(Amounts in thousands)

	2010	2009
Cash flows from operating activities		
Net income (loss)	$ (709)	$ 915
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation	520	561
Amortization of mortgage servicing rights	179	692
Provision for loan losses	5,385	2,534
Deferred income taxes	294	(478)
Gain on sale of fixed assets	(110)	-
Accretion and amortization of securities	669	640
Gain on sale of loans held for sale	(722)	(1,253)
Proceeds from the sale of loans held for sale	29,904	65,501
Loans originated for sale	(31,057)	(63,809)
Loss (gain) on real estate owned	(11)	52
Write-down of real estate owned	470	265
Loss of equity in limited partnership	108	107
(Gain) loss on sale of available for sale securities	(1,134)	(1,244)
Increase in cash value of bank-owned life insurance	(295)	(329)
Changes in assets and liabilities:		
Decrease (increase) in accrued interest and other assets	(1,044)	(1,177)
(Decrease) increase in accrued interest and other liabilities	633	(115)
Net cash provided by operating activities	3,080	2,862
Cash flows from investing activities		
Net change in interest-earning deposits in banks	(2,811)	1,769
Proceeds from maturities of securities held to maturity	235	415
Principal reductions of mortgage-backed securities held to maturity	1,037	1,412
Principal reductions of mortgage-backed securities available for sale	4,096	7,254
Purchase of securities held-to-maturity	(275)	(881)
Purchase of securities available-for-sale	(38,723)	(62,560)
Proceeds from sales of securities available-for-sale	37,695	65,326
Purchase of loans	-	(325)
Net increase in loans	9,309	(912)
Proceeds from repurchase of Federal Home Loan Bank stock	361	-
Proceeds from sale of real estate owned	1,711	853
Proceeds from sale of premises and equipment	427	-
Additions to premises and equipment, net	(249)	(178)
Net cash used in investing activities	12,813	12,173

(Continued)

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2010 and 2009
(Amounts in thousands)

	2010	2009
Cash flows from financing activities		
Net increase in deposits	$ 6,800	$ 21,634
Repayment of FHLB advances and other borrowings	(51,000)	(50,845)
Proceeds from FHLB advances and other borrowings	46,058	22,500
Net change in repurchase agreements	-	(5,500)
Cash dividends paid on common stock	(243)	(787)
Net cash provided by financing activities	1,615	(12,998)
Net change in cash and cash equivalents	17,508	2,037
Cash and cash equivalents - beginning of year	8,976	6,939
Cash and cash equivalents - end of year	$ 26,484	$ 8,976
Supplemental information		
Cash paid for:		
Interest	$ 5,947	$ 7,739
Income taxes	145	445
Noncash investing and financing activities		
Loans transferred to real estate owned	$ 2,117	$ 1,343
Premises and equipment transferred to held for sale	-	317

See accompanying notes to consolidated financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation: The consolidated financial statements include the accounts of Sturgis Bancorp, Inc. (Bancorp), Sturgis Bank & Trust Company (Bank) and the Bank's wholly owned subsidiaries. The Bank's wholly owned subsidiaries include Oakleaf Financial Services, Inc., and First Michiana Development Corporation of Sturgis, Inc. Accounts of Oak Mortgage, LLC, a subsidiary jointly owned by the Bank and Oakleaf Financial Services, Inc., are also consolidated. All significant intercompany transactions and balances have been eliminated in consolidation.

The Bank, which has been in continuous operation since 1905, formed Bancorp on January 1, 2002 via an equal exchange of common stock of Bank for common stock of Bancorp.

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 these estimates and assumptions. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the fair values of securities and other financial instruments, valuation of real estate owned, deferred tax assets, mortgage servicing rights, and the carrying value of goodwill.

Nature of Operations: Bancorp operates predominantly in the southwestern portion of Michigan's Lower Peninsula. Its primary services include accepting deposits, making commercial and mortgage loans, engaging in mortgage banking activities, and providing investment brokerage advisory services.

Significant Group Concentrations of Credit Risk: Most of Bancorp's activities are with customers located within southwestern Michigan. Note 2 discusses the types of securities in which Bancorp invests. Note 3 discusses the types of lending in which Bancorp engages. Bancorp's loan portfolio is concentrated in residential and commercial mortgage loans. Bancorp does not have any significant concentrations to any one industry or customer.

Subsequent Events: The Company has evaluated subsequent events for recognition and disclosure through March 23, 2011, which is the date the financial statements were available to be issued.

Cash Flows: For the purpose of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, federal funds sold, and other short-term time and investment accounts at the Federal Home Loan Bank, all of which mature within 90 days. Net cash flows are reported for customer loan and deposit transactions, interest bearing deposits in banks, other short term investment, and repurchase agreements.

Interest-Earning Deposits in Banks: Interest-earning deposits in banks mature within eighteen years and are carried at cost.

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 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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment (“OTTI”) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Refer to Note 2 for further discussion.

Federal Home Loan Bank Stock: Bancorp’s minimum investment in the stock of the Federal Home Loan Bank of Indianapolis (FHLB) is an amount equal to at least 1.0% of the unpaid principal balances of Bancorp’s residential mortgage loans or 0.3% of its total assets, whichever is greater. Purchases and sales of stock are made directly with the FHLB at par value. The stock is recorded at cost.

Loans Held for Sale: Loans originated and intended for sale in the secondary market are carried at fair value. Net unrealized losses, if any, are recognized in a valuation allowance by charges to income.

Mortgage loans held for sale are generally sold with servicing rights retained. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loans sold. The carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right.

Loans: Bancorp grants mortgage, commercial, and consumer loans to customers. Loans are reported at their outstanding unpaid principal balances, adjusted for amounts charged off, nonaccrual interest paid, 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 to the related loan yield using the interest method. Recorded investment in loans includes unpaid principal balances, adjusted for amounts charged off, nonaccrual interest paid, unamortized deferred fees and costs, accrued interest receivable, and negative escrow balances.

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 the process of collection. Past due status is based on the contractual terms of the loan. In all cases, if collection of principal and interest is considered doubtful, loans are placed on nonaccrual, charged off, or charged down to the fair value of collateral.

When a loan is placed in nonaccrual status, all interest accrued but not collected is reversed against interest income. Interest payments received on loans in nonaccrual status are accounted as reductions to the carrying value of the principal. 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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 with any new information.

The allowance consists of specific, general and unallocated components. The specific components relate to generally commercial and commercial real estate loans that are classified as substandard. 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 non-classified loans and is based on historical loss experience adjusted for quantitative 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, based on current information and events, when it is probable Bancorp will be unable to collect the scheduled payments of principal or interest in accordance with 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 are not generally 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, reasons for the delay, the borrower's prior payment history, and the amount of the shortfall in relation to the amount due and collateral value. Impairment on a loan is measured on a loan-by-loan basis for commercial and construction loans.

Large groups of homogenous loans, such as consumer and residential mortgages, are collectively evaluated for impairment. Accordingly, Bancorp does not separately identify individual consumer and residential mortgage loans for impairment disclosures.

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

Commercial - Loans to businesses that are sole proprietorships, partnerships, limited liability companies and corporations. These loans are for commercial, industrial, or professional purposes.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Commercial Real Estate - Loans to individuals or businesses that are secured by improved and unimproved vacant land, farmland, commercial real property, multifamily residential properties, and all other conforming, nonresidential properties. Proceeds may be used for land acquisition, development or construction. The commercial real estate portfolio is separated by class between general commercial real estate loans and commercial construction loans.

Residential - Loans to purchase or refinance single family residences. Within the residential segment, historical loss experience is segregated into three classes; general residential loans, home equity loans, and residential construction.

Consumer - Term loans or lines of credit for the purchase of consumer goods, vehicles or home improvement.

For the commercial and commercial real estate portfolio segments, the historical loss is tracked by year of charge off and segregated by a grading system. Grades are assigned to each commercial and commercial real estate loan by assessing information about the specific borrower's situation and the estimated collateral values. The description of the loan grade criteria is included in Note 3.

Loans, for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Bancorp determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

Servicing: Servicing rights are recognized separately when they are acquired through sales of loans. When mortgage loans are sold, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. The Company compares the valuation model inputs and results to published industry data in order to validate the model results and assumptions. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for individual groupings, to the extent that fair value is less than the carrying amount. Changes in valuation allowances are reported with mortgage banking activities on the income statement. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Servicing fee income, which is reported on the income statement as mortgage banking activities, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income. Servicing fees totaled $508 and $511 for the years ended December 31, 2010 and 2009 respectively. Late fees and ancillary fees related to loan servicing were not material for presentation.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from Bancorp, 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 Bancorp does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Premises and Equipment: Land is carried at cost. Premises and equipment are carried at cost, less accumulated depreciation computed on the straight-line method over the estimated useful lives of the assets. Buildings and related components are depreciated with useful lives ranging from 5 to 50 years. Furniture, fixtures and equipment are depreciated with useful lives ranging from 3 to 15 years.

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 foreclosure, less costs to sell when acquired, 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 costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in real estate owned expense.

Bank-Owned Life Insurance: Bancorp has purchased life insurance policies on certain key officers. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Goodwill: Generally, intangible assets that meet certain criteria are recognized and subsequently amortized over their estimated useful lives. Goodwill with indefinite lives are not amortized. However, such assets are tested for impairment at least annually thereafter. The impairment test is generally performed as of October 31st of each year. There has been no impairment of goodwill.

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

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

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Repurchase Agreements: Bancorp enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, Bancorp transfers legal control over the assets but still retains effective control through an agreement that both entitles and obligates Bancorp to repurchase the assets. As a result, repurchase agreements are accounted for as financing arrangements and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the consolidated balance sheet while the dollar amount of securities underlying the agreements remains in the respective asset accounts as pledged 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 the tax bases of the various balance sheet assets and liabilities. This method gives current recognition to changes in tax rates and laws. When necessary, valuation allowances are established to reduce deferred tax assets to the amount expected to be realized.

Bancorp is qualified under provisions of the Internal Revenue Code to deduct from taxable income a provision for bad debts in excess of such provision charged to income in the consolidated financial statements. Accordingly, retained earnings at December 31, 2010 and 2009 include approximately $918 for which no provision for federal income taxes has been made. Unrecognized deferred taxes on this amount are approximately $312. In the future, if this portion of retained earnings is used for any purpose other than to absorb bad debt losses, federal income taxes would be imposed at the then applicable rates.

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

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

Stock Compensation Plans: Compensation cost is recognized for stock options issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. Future stock option grants will be recognized as described, although there are currently no active stock option plans under which options may be granted.

Earnings Per Share: Basic earnings per share represents income available to common stockholder divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share includes outstanding additional common shares that would have been outstanding, if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential shares that may be issued by Bancorp relate solely to outstanding stock options, and are determined using the treasury stock method.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings per share have been computed based on the following:

	2010	2009
Net income	$ (709)	$ 915
Weighted average number of common shares outstanding	2,017,245	2,017,245
Effect of dilutive options	-	-
Weighted average number of common shares outstanding used to calculate diluted earnings per share	2,017,245	2,017,245

Comprehensive Income (Loss): Comprehensive income (loss) consists of net income (loss) and other comprehensive income. Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale and changes in post retirement benefit obligation, which are also recognized as separate components of equity.

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

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

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

Adoption of New Accounting Standards: In June 2009, the FASB issued guidance on accounting for transfers of financial assets. This guidance amends previous guidance relating to the transfers of financial assets and eliminates the concept of a qualifying special purpose entity. This guidance must be applied as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. This guidance must be applied to transfers occurring on or after the effective date. Additionally, on and after the effective date, the concept of a qualifying special-purpose entity is no longer relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities should be evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. Additionally, the disclosure provisions of this guidance were also amended and apply to transfers that occurred both before and after the effective date of this Statement. The effect of adopting this new guidance was not significant to Bancorp.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In July 2010, the FASB issued an Accounting Standards Update, "Receivables: Disclosure about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." The objective of this update is for an entity to provide disclosures that facilitate financial statement users' evaluation of the nature of credit risk inherent in the entity's portfolio of financing receivables, how that risk is analyzed and assessed in arriving at the allowance for credit losses, and the changes and reasons for those changes in the allowance for credit losses. An entity should provide disclosures on a disaggregated basis on two defined levels: (1) portfolio segment; and (2) class of financing receivable. The update makes changes to existing disclosure requirements and includes additional disclosure requirements about financing receivables, including credit quality indicators of financing receivables at the end of the reporting period by class of financing receivables and the aging of past due financing receivables at the end of the reporting period by class of financing receivables. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010 and have been added to Note 3. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The effect of adopting this new guidance on December 31, 2010 was disclosure-related only and had no impact on its results of operations.

NOTE 2 – SECURITIES

The amortized cost and fair value of securities with gross unrealized (unrecognized) gains and losses follow:

	Amortized Cost	Gross Unrealized (Unrecognized) Gains	Gross Unrealized (Unrecognized) Losses	Fair Value
2010				
Available-for-sale securities:				
Mortgage-backed securities – residential	$ 2,166	$ 108	$ -	$ 2,274
Collateralized mortgage obligations	27,221	-	(1,826)	25,395
	$ 29,387	$ 108	$ (1,826)	$ 27,669
Held-to-maturity securities:				
Obligations of states and political subdivisions	$ 1,220	$ 88	$ -	$ 1,308
Mortgage-backed securities – residential	143	3	-	146
Mortgage-backed securities – commercial	5,089	55	(20)	5,124
	$ 6,452	$ 146	$ (20)	$ 6,578
2009				
Available-for-sale securities:				
Mortgage-backed securities – residential	$ 15,011	$ 148	$ -	$ 15,159
Collateralized mortgage obligations	16,250	62	(137)	16,175
Other securities	574	-	-	574
	$ 31,835	$ 210	$ (137)	$ 31,908
Held-to-maturity securities:				
Obligations of states and political subdivisions	$ 1,182	$ 35	$ -	$ 1,217
Mortgage-backed securities – residential	166	3	-	169
Mortgage-backed securities – commercial	6,259	43	(137)	6,165
	$ 7,607	$ 81	$ (137)	$ 7,551

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 2 – SECURITIES (Continued)

Securities with a carrying value of $35,357 (fair value of $33,760) and $37,681 (fair value of $37,662) were pledged at December 31, 2010 and 2009, respectively, to secure U.S. Treasury tax and loan payments, FHLB advances, and repurchase agreements.

The amortized cost and fair value of securities by contractual maturity at December 31, 2010 are shown below. Actual and 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.

	Held-to-Maturity		Available-for-Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 75	$ 76	$ -	$ -
Due after one through five years	40	40	-	-
Due after five through ten years	60	60	-	-
Due after ten years	1,045	1,132	-	-
	1,220	1,308	-	-
Mortgage-backed securities - residential	143	146	2,166	2,274
Collateralized mortgage obligations	-	-	27,221	25,395
Mortgage-backed securities – commercial	5,089	5,124	-	-
Other securities	-	-	-	-
	$ 6,452	$ 6,578	$ 29,387	$ 27,669

For the years ended December 31, 2010 and 2009, proceeds from sales of securities available for sale amounted to $37,695 and $65,326, respectively. Realized losses, net of applicable tax benefits, amounted to $0 and $30 for the years ended December 31, 2010 and 2009, respectively. Gross realized gains, net of applicable tax expense, amounted to $748 and $841 for the years ended December 31, 2010 and 2009, respectively.

Information pertaining to securities with gross unrealized losses at December 31, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less than 12 months		12 months or More		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
2010						
Available-for-sale securities:						
Collateralized mortgage obligations	$ (1,826)	$25,395	$ -	$ -	$ (1,826)	$25,395
Held-to-maturity securities:						
Obligations of states and political subdivisions	$ -	$ -	$ -	$ -	$ -	$ -
Mortgage-backed securities – residential	-	-	-	-	-	-
Mortgage-backed securities - commercial	-	-	(20)	3,637	(20)	3,637
	$ -	$ -	$ (20)	$ 3,637	$ (20)	$ 3,637

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 2 – SECURITIES (Continued)

	Less than 12 months		12 months or More		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
2009						
Available-for-sale securities:						
Collateralized mortgage obligations	$ (137)	$ 4,758	$ -	$ -	$ (137)	$ 4,758
Held-to-maturity securities:						
Obligations of states and political subdivisions	-	-	-	-	-	-
Mortgage-backed securities – residential	(1)	36	-	-	(1)	36
Mortgage-backed securities - commercial	-	-	(136)	5,195	(136)	5,195
	$ (138)	$ 4,794	$ (136)	$ 5,195	$ (274)	$ 9,989

Unrealized losses on securities have not been recognized into income, because the issuers' bonds are of high credit quality, Bancorp does not intend to sell and it is not more likely than not that management would be required to sell the securities prior to their anticipated recovery, and the decline in fair value is primarily due to changes in market interest rates. The fair value is expected to recover as the securities approach the maturity date.

In determining OTTI for debt securities, management considers many factors, including: (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, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Bancorp has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

At December 31, 2010, 100% of the mortgage-backed securities and collateralized mortgage obligations held by the Bancorp were issued by U.S. government-sponsored entities and agencies, primarily Ginnie Mae and the Small Business Administration, institutions which the government has affirmed its commitment to support. Because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, and because Bancorp does not have the intent to sell these mortgage-backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery, Bancorp does not consider these securities to be other-than-temporarily impaired at December 31, 2010.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 3 – LOANS

A summary of the balances of loans follows:

	2010	2009
Residential loans:		
Residential	$ 85,304	$ 86,379
Home equity	51,296	52,980
Residential construction	1,949	5,236
Total residential loans	138,549	144,595
Commercial real estate loans:		
Commercial real estate	87,798	90,687
Commercial construction	4,326	4,756
Total commercial real estate loans	92,124	95,443
Commercial loans	31,711	34,582
Consumer loans	5,456	7,291
	267,840	281,911
Less:		
Allowance for loan losses	6,691	3,983
Add:		
Deferred loan origination and other costs, net of fees	267	299
Loans, net	$ 261,416	$ 278,227

An analysis of the allowance for loan losses follows:

	2010	2009
Balance – Beginning of year	$ 3,983	$ 2,838
Provision for loan losses	5,385	2,534
Loans charged off	(2,839)	(1,408)
Recoveries of loans previously charged off	162	19
Balance – End of year	$ 6,691	$ 3,983

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 3 – LOANS (Continued)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and class and based on impairment method as of December 31, 2010:

	Residential	Home Equity	Commercial Real Estate	Residential Construction	Commercial Construction	Commercial	Consumer	Total
Allowance for loan losses:								
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	$ 469	$ -	$ 1,293	$ 268	$ 586	$ 195	$ 1	$ 2,812
Collectively evaluated for impairment	1,198	765	1,383	19	30	412	72	3,879
Total ending allowance balance	$ 1,667	$ 765	$ 2,676	$ 287	$ 616	$ 607	$ 73	$ 6,691
Loans:								
Loans individually evaluated for impairment	$ 5,753	$ 317	$ 13,133	$ 686	$ 2,704	$ 684	$ 5	$ 23,282
Loans collectively evaluated for impairment	80,149	51,410	75,075	1,271	1,635	31,158	5,463	246,161
Total ending recorded investment in loans	$ 85,902	$ 51,727	$ 88,208	$ 1,957	$ 4,339	$ 31,842	$ 5,468	$ 269,443

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 3 – LOANS (Continued)

Impaired loans were as follows:

	2010	2009
Impaired loans with a valuation allowance	$ 21,046	$ 3,627
Impaired loans without a valuation allowance	2,026	2,302
Total impaired loans	$ 23,072	$ 5,929
Valuation allowance related to impaired loans	$ 2,808	$ 605
Average investment in impaired loans	14,075	7,339
Interest income recognized on impaired loans	673	88
Interest income recognized on a cash basis on impaired loans	673	88

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2010:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
With no related allowance recorded:			
Residential	$ 1,013	$ 1,036	$ -
Home equity	313	318	-
Commercial real estate	616	654	-
Residential construction	-	-	-
Commercial construction	-	-	-
Commercial	84	84	-
Consumer	-	-	-
	2,026	2,092	-
With an allowance recorded:			
Residential	4,708	4,717	469
Home equity	-	-	-
Commercial real estate	12,358	12,479	1,293
Residential construction	684	686	268
Commercial construction	2,695	2,704	586
Commercial	596	599	195
Consumer	5	5	1
	21,046	21,190	2,812
	$ 23,072	$ 23,282	$ 2,812

No additional funds are committed to be advanced in connection with impaired loans.

Nonperforming loans were as follows:

	2010	2009
Total non-accrual loans	$ 5,258	$ 6,886
Total loans past due 90 days or more and still accruing	1,245	1,306

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 3 – LOANS (Continued)

Nonperforming loans include both smaller balance homogenous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following table presents the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of December 31, 2010:

	Nonaccrual	Loans Past Due Over 90 Days Still Accruing
Residential	$ 2,489	$ 898
Home equity	313	344
Commercial real estate	1,150	-
Residential construction	-	-
Commercial construction	1,340	-
Commercial	27	-
Consumer	37	30
Total	$ 5,356	$ 1,272

The following table presents the aging of the recorded investment in past due loans as of December 31, 2010 by class of loans:

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans not Past Due	Total
Residential	$ 1,757	$ 820	$ 3,158	$ 5,735	$ 80,167	$ 85,902
Home equity	171	205	657	1,033	50,694	51,727
Commercial real estate	414	1,812	484	2,710	85,498	88,208
Residential construction	-	-	-	-	1,957	1,957
Commercial construction	-	31	-	31	4,308	4,339
Commercial	168	182	-	350	31,492	31,842
Consumer	67	22	67	156	5,312	5,468
Total recorded investment	2,577	3,072	4,366	10,015	259,428	269,443
Less:						
Accrued interest receivable	29	50	24	103	1,233	1,336
Total loans	$ 2,548	$ 3,022	$ 4,342	$ 9,912	$ 258,195	$ 268,107

Troubled Debt Restructurings:

Bancorp has allocated $1,761 and $109 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2010 and 2009. Bancorp has not committed to lend additional amounts as of December 31, 2010 and 2009 to customers with outstanding loans that are classified as troubled debt restructurings.

(Amounts in thousands, except share and per share data)

NOTE 3 – LOANS (Continued)

Credit Quality Indicators:

Bancorp categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. Bancorp analyzes loans individually by classifying the loans as to credit risk. This analysis includes loans with an outstanding balance greater than $250 and non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed on a quarterly basis. Bancorp uses the following definitions for risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, condition, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. Loans listed as not rated are either less than $250 or are included in groups of homogeneous loans. Management monitors loans reported to be not rated by segregating between performing and nonperforming loans, which generally uses delinquency statistics. As of December 31, 2010, and based on the most recent analysis performed, the risk category of loans (recorded investment) is as follows:

	Pass	Special Mention	Substandard	Doubtful	Not Rated	Total
Residential 1-4 family	$ 18,377	$ 7,732	$ 772	$ -	$ 59,021	$ 85,902
Home equity	3,950	171	-	-	47,606	51,727
Commercial real estate	72,436	9,080	6,692	-	-	88,208
Residential construction	82	63	686	-	1,126	1,957
Commercial construction	1,635	2,704	-	-	-	4,339
Commercial	29,704	1,981	157	-	-	31,842
Consumer	714	-	5	-	4,749	5,468
Total	$ 126,898	$ 21,731	$ 8,312	$ -	$ 112,502	$ 269,443

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 4 – PREMISES AND EQUIPMENT

A summary of the cost and accumulated depreciation of premises and equipment follows:

	2010	2009
Land	$ 1,722	$ 1,722
Land improvements	159	159
Office buildings	8,020	8,008
Furniture, fixtures and equipment	4,834	4,777
Construction in progress	165	-
Total premises and equipment	14,900	14,666
Less accumulated depreciation	(7,161)	(6,656)
Net carrying amount	$ 7,739	$ 8,010

Premises and equipment held for sale had a balance of $317 at December 31, 2009, and consisted of primarily an office building of $159 and land of $124. These assets were sold during 2010 at a gain, net of taxes of $71. There were no such assets held for sale at December 31, 2010.

Depreciation expense for the years ended December 31, 2010 and 2009 amounted to $520 and $561, respectively.

NOTE 5 – SERVICING

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balance of mortgages and other loans serviced for others approximated $201,300 and $204,300 at December 31, 2010 and 2009, respectively.

The fair values of the rights to service these loans were $1,901 and $1,912 at December 31, 2010 and 2009. The fair value of servicing rights at December 31, 2010 was determined using a discount rate of 8% and prepayment speeds ranging from 139 PSA to 516 PSA. The fair value of servicing rights at December 31, 2009 was determined using a discount rate of 8% and prepayment speeds ranging from 176 PSA to 361 PSA.

The following summarizes the activity in mortgage servicing rights and the related valuation allowance:

	2010	2009
Mortgage servicing rights:		
Balance at beginning of year	$ 1,277	$ 1,409
Mortgage servicing rights capitalized	280	543
Mortgage servicing rights amortized	(179)	(692)
Change in valuation allowance	3	17
Balance at end of year	$ 1,381	$ 1,277
Valuation allowance:		
Balance at beginning of year	$ 18	$ 35
Additions	39	29
Reductions	(42)	(46)
Write-downs	-	-
Balance at end of year	$ 15	$ 18

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 6 – REAL ESTATE INVESTMENT – LIMITED PARTNERSHIP

In February 2003, Bancorp acquired 24.75% interest in a limited partnership operating in Elkhart County, Indiana. The limited partnership was formed to construct and operate multi-family housing units. All income, expenses and tax credits will be allocated to Bancorp based upon ownership percentage. As an investor, Bancorp is able to exercise influence over operating and financial policies of the management through provisions of the partnership agreement that require a majority approval of the limited partners. At such time as the project is sold, the limited partners will receive a share of the net proceeds proportionate to each limited partner's outstanding capital balance. Under the terms of the limited partnership agreement, Bancorp contributed $1,050 in cash, and is allocated tax losses and affordable housing federal income tax credits.

In December 2010, Bancorp acquired 4.878% interest in a limited partnership operating in St. Joseph County, Michigan. The limited partnership was formed to rehabilitate and operate multi-family housing units. Bancorp committed $500 in cash, of which $22 was paid in 2010. All income, expenses and tax credits will be allocated to Bancorp based upon ownership percentage. As an investor, Bancorp is able to exercise influence over operating and financial policies of the management through provisions of the partnership agreement that require a majority approval of the limited partners. At such time as the project is sold, the limited partners will receive a share of the net proceeds proportionate to each limited partner's outstanding capital balance. Under the terms of the limited partnership agreement, Bancorp is allocated tax losses and affordable housing federal income tax credits.

Bancorp's share of tax credits generated by the investee partnerships totaled $108 in both 2010 and 2009.

NOTE 7 – DEPOSITS

Interest-bearing deposit balances at December 31 are summarized as follows:

	2010	2009
Savings accounts	$ 77,220	$ 68,515
NOW accounts	63,242	56,050
Time:		
$100,000 and over	25,305	30,215
Under $100,000	70,575	79,516
	$ 236,342	$ 234,296

At December 31, 2010, the scheduled maturities of time deposits are as follows:

Maturing in the Year Ending December 31,	Under $100,000	$100,000 and Over
2011	$ 34,523	$ 13,689
2012	9,740	3,293
2013	8,197	2,318
2014	8,203	1,501
2015	2,561	1,216
Thereafter	7,351	3,288
	$ 70,575	$ 25,305

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 8 – FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS

The Bank had advances from the Federal Home Loan Bank of Indianapolis (FHLB) of $48,500 and $53,500 at December 31, 2010 and 2009, respectively, which mature through 2017. At December 31, 2010 and 2009, the interest rates ranged from 2.56% to 5.24% and from 2.46% to 5.24%, respectively. The advances are subject to prepayment penalties as defined in the credit policy of FHLB.

The advances are collateralized by securities held in safekeeping at FHLB, performing residential and commercial non-employee mortgage loans. The unpaid principal balance of pledged loans was approximately $94,308 and $105,772 at December 31, 2010 and 2009, respectively. Mortgage-backed securities with a carrying value of $5,089 (fair value $5,124) were held in safekeeping at FHLB and were pledged at December 31, 2010. Mortgage-backed securities with a carrying value of $6,259 (fair value $6,166) were held in safekeeping at FHLB and were pledged at December 31, 2009.

Annual payments of FHLB advances are as follows:

2011	$ -
2012	-
2013	-
2014	-
2015	25,500
2016 and thereafter	23,000
	$ 48,500

In 2010, Bancorp modified six FHLB advances for $41 million with weighted average maturity of October 21, 2011 and weighted average interest rate of 3.91% into two FHLB advances with weighted average maturity of October 28, 2016 and weighted average interest rate of 2.77%.

During 2009, Bancorp obtained an open-end line of credit with another financial institution for $5.0 million to refinance a $3.0 million closed-end line of credit with another financial institution, which had been obtained in 2008. The outstanding balance on the line of credit was $4.5 million and $4.4 million at December 31, 2010 and 2009, respectively. The line of credit matures in April 2013. The variable interest rate on the lines of credit was 4.00% at December 31, 2010 and 2009.

NOTE 9 – REPURCHASE AGREEMENTS

Repurchase agreements are secured by available for sale mortgage-backed securities held by a third-party trustee with a fair value of $27,669 and $31,334 at December 31, 2010 and 2009, respectively.

These agreements at December 31, 2010 are variable rate financing arrangements that mature in 2013. At maturity, the securities underlying the agreements are returned to Bancorp.

Information concerning repurchase agreements is summarized as follows:

	2010	2009
Average daily balance during the year	$ 25,000	$ 25,799
Average interest rate during the year	0.51%	0.73%
Maximum month-end balance during the year	25,000	30,500
Weighted average interest rate at year end	0.49%	0.46%

(Amounts in thousands, except share and per share data)

NOTE 9 – REPURCHASE AGREEMENTS (Continued)

If the fair values of the pledged available for sale securities decline, either through principal reductions or market value fluctuations, so that the aggregate fair values are insufficient collateral for the repurchase agreements, additional alternative collateral will be pledged.

NOTE 10 – FEDERAL INCOME TAXES

Sturgis Bancorp, Inc. and Subsidiaries file a consolidated federal income tax return. The following is a summary of the provision for income taxes for the two years ended December 31:

	2010	2009
Current expense	$ 245	$ 488
Deferred expense	(1,025)	(195)
	$ (780)	$ 293

A reconciliation of the difference between total federal income tax expense and the amount computed by applying the statutory tax rates to income before income taxes is as follows:

	2010	2009
Amount computed at statutory rate	$ (511)	$ 411
Tax-exempt income from Bank-owned life insurance	(100)	(112)
Tax-exempt interest income	(72)	(66)
Low-income housing tax credits	(108)	(108)
Other, net	11	168
	$ (780)	$ 293

The components of the net deferred tax asset (liability) are as follows:

	2010	2009
Deferred tax assets:		
Allowance for loan losses	$ 2,075	$ 1,206
Unfunded pension liability	44	55
Deferred compensation	185	156
Unrealized loss on available-for-sale securities	584	-
Low-Income housing tax credits	108	-
Other	257	172
	3,253	1,589
Deferred tax liabilities:		
Deferred loan fees	(139)	(132)
Mortgage servicing rights	(473)	(431)
Amortization	(1,298)	(1,131)
Depreciation	(252)	(265)
FHLB stock dividends	(140)	(139)
Unrealized gain on available-for-sale securities	-	(25)
Other	(133)	(271)
	(2,435)	(2,394)
Net deferred tax liability	$ 818	$ (805)

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 10 – FEDERAL INCOME TAXES (Continued)

At December 31, 2010, the Company has a low income housing tax credit carryforward of $108 that will expire if unused in the year 2030.

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax of the states of Indiana and Florida. The Company is no longer subject to examination by taxing authorities for years before 2007.

There were no unrecognized tax benefits at December 31, 2010 and the Company does not expect the total amount of unrecognized tax benefits to significantly increase of decrease in the next twelve months.

For the years ended 2010 and 2009, interest and penalties related to income tax matters were not material.

NOTE 11 – RETIREMENT BENEFITS

During 2009 and 2010, Bancorp was a participant in the multi-employer Financial Institutions Retirement Fund (FIRF or the Plan), which covered substantially all of the officers and employees of the Bank and its subsidiaries. The defined benefit plan provided benefits to all full-time employees with one year of service, based on basic compensation and years of service. Bancorp contributions are determined by FIRF and generally represent the normal cost of the Plan. Specific Plan assets and accumulated benefit information for Bancorp's portion of the fund are not available. Under the Employee Retirement Income Security Act (ERISA), a contributor to a multi-employer pension plan may be liable in the event of complete or partial withdrawal for the benefit payments guaranteed under ERISA. Bancorp has no present intention to withdraw from the fund, although Bancorp froze future benefits to participants effective March 2, 2011. The expenses of the Plan allocated to Bancorp for the years ended December 31, 2010 and 2009 were $446 and $453, respectively.

The Bank sponsors a non-qualified defined benefit (DB) to provide supplemental retirement benefits for certain executives. These benefits include pre-retirement disability and death benefits, as well as post-retirement payments for 15 years. The following table sets forth the DB activity and other information as of and for the years ended December 31, 2010 and 2009.

	2010	2009
Plan assets at fair value	$ -	$ -
Projected benefit obligation	670	621
Underfunded status	$ (670)	$ (621)
Accumulated benefit obligation	$ 349	$ 300

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 11 – RETIREMENT BENEFITS (Continued)

Components of Net Periodic Benefit Cost:

	2010	2009
Service cost	$ 34	$ 34
Interest cost	39	35
Expected return on plan assets	-	-
Amortization of prior service cost	10	10
Amortization of net (gain) loss	-	1
Net periodic benefit cost	83	80
Prior service cost (credit)	-	-
Amortization of prior service cost	(23)	(76)
Total recognized in other comprehensive income	(23)	(76)
Total recognized in net periodic benefit cost and other comprehensive income	$ 60	$ 4

Amounts reported in accumulated other comprehensive income at December 31 consist of:

	2010	2009
Net actuarial loss (gain)	$ (30)	$ (6)
Prior service cost (credit)	159	169
Underfunded status	$ 129	$ 163
Actuarial assumptions:		
Weighted average discount rate	6.50%	6.50%
Increase in future compensation levels	4.00	4.00

The estimated net loss and prior service cost for the plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost during the year ending December 31, 2011 are not significant.

To fund the DB obligation and other employee benefits, the Bank has purchased insurance policies on the lives of certain officers of the Bank. The Bank is owner and beneficiary of these policies. At December 31, 2010 and 2009, the cash value of all bank-owned life insurance policies was $8,696 and $8,401, respectively. The cash value is available to fund future benefit obligations. There were no supplemental retirement benefits paid by the DB during 2010 or 2009. The Bank does not anticipate paying benefits in connection with this plan over the next 9 years, with $31 anticipated to be paid in 10 years.

(Amounts in thousands, except share and per share data)

NOTE 12 – COMMON STOCK AND OPTIONS

Bancorp had one stock option plan, the New Director Plan, under which grants were extended to directors. The Plan provided active directors with stock options that expire 10 years and one day after the grant date. If a grantee ceases to be a director prior to that time for reasons other than death or disability, the options expire 30 days after cessation of director status. If cessation of director status results from death or disability, the options expire 90 days after cessation of director status. Unexercised grants under the Plan all expired in 2009. Because the New Director Plan expired in December 1999, no new stock options will be granted under the New Director Plan.

NOTE 13 – MINIMUM REGULATORY CAPITAL REQUIREMENTS

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate 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. Prompt corrective action provisions are not applicable to bank holding companies such as Bancorp.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios, as set forth in the following table. Total capital, Tier 1 capital, risk-weighted assets and average assets are measures used to analyze capital adequacy. These measures are defined in federal banking regulations. Ratios must be met regarding total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. At December 31, 2010 and 2009, the Bank met all minimum capital requirements to which it was subject.

At December 31, 2010, the Federal Deposit Insurance Corporation categorized the Bank as well-capitalized 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 December 31, 2010 that management believes have changed the Bank's well-capitalized status.

The Bank's actual capital amounts and ratios at December 31, 2010 and 2009 were as follows:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2010						
Total capital (to risk weighted assets)	$ 28,593	12.2%	$ 18,684	8.0%	$ 23,355	10.0%
Tier 1 capital (to risk weighted assets)	25,628	11.0	9,342	4.0	14,012	6.0
Tier 1 capital (to adjusted total assets)	25,628	6.7	15,255	4.0	19,068	5.0
December 31, 2009						
Total capital (to risk weighted assets)	$ 29,465	12.0%	$ 19,566	8.0%	$ 24,452	10.0%
Tier 1 capital (to risk weighted assets)	26,396	10.8	9,783	4.0	14,674	6.0
Tier 1 capital (to adjusted total assets)	26,396	7.1	14,819	4.0	18,525	5.0

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 14 – OFF-BALANCE-SHEET ACTIVITIES

Credit-Related Financial Instruments: Bancorp 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. To various degrees, such commitments involve elements of credit and interest rate risk in excess of the amount recognized on the consolidated balance sheet.

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

At December 31, 2010 and 2009, the following financial instruments with credit risk were outstanding:

	2010	2009
Commitments to grant loans	$ 5,925	$ 953
Unfunded commitments under lines of credit	39,145	36,951
Commercial and standby letters of credit	995	835

Commitments to extend credit are agreements to lend to a customer, as long as there are no violations of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of fees. These commitments, especially related to equity lines of credit, may expire without being drawn. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral secured by Bancorp 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. The equity and commercial lines of credit are collateralized, may not have a specified maturity date, and may be drawn to the full extent of Bancorp's commitment.

Commercial and standby letters of credit are conditional commitments issued by Bancorp to guarantee the performance of a customer to a third party. The letters of credit are primarily used to support public and private borrowing arrangements. All letters of credit issued by Bancorp have expiration dates within one year.

NOTE 15 – RELATED PARTY TRANSACTIONS

In the ordinary course of business, Bancorp has granted loans to principal officers, directors and affiliates. A summary of the related party loan transactions for the years ended December 31, 2010 and 2009 is as follows:

	2010	2009
Related party loans - beginning of the year	$ 2,369	$ 2,361
Advances	-	544
Principal repayments	(177)	(536)
Related party loans – end of the year	$ 2,192	$ 2,369

(Continued)

NOTE 15 – RELATED PARTY TRANSACTIONS (Continued)

Deposits from related parties held by the Bank at December 31, 2010 and 2009 approximated $876 and $1,897, respectively.

A director of Bancorp is a stockholder in a law firm that provides legal counsel to Bancorp and its subsidiaries. Legal fees and disbursements to the law firm totaled $180 and $98 for 2010 and 2009, respectively.

NOTE 16 – FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

> Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
>
> Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
>
> Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of securities available for sale are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

The fair value of loans held for sale is based upon binding quotes from 3rd party investors. (Level 2 inputs).

<u>Real Estate Owned</u>: Nonrecurring adjustments to certain commercial and residential real estate properties classified as real estate owned are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

<u>Impaired Loans</u>: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 16 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Assets and liabilities measured at fair value on a recurring basis, including financial assets and liabilities for which the Company has elected the fair value option, are summarized below:

		Fair Value Measurements at December 31, 2010 Using:		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Mortgage-backed securities - residential	$ 2,274	$ -	$ 2,274	$ -
Collateralized mortgage obligations	25,395	-	25,395	-
Other securities	-	-	-	-
Total investment securities available-for-sale	$ 27,669	$ -	$ 27,669	$ -
Loans held for sale	$ 2,191	$ -	$ 2,191	$ -

		Fair Value Measurements at December 31, 2009 Using:		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets				
Mortgage-backed securities - residential	$ 15,159	$ -	$ 15,159	$ -
Collateralized mortgage obligations	16,175	-	16,175	-
Other securities	574	-	574	-
Total investment securities available-for-sale	$ 31,908	$ -	$ 31,908	$ -
Loans held for sale	$ 595	$ -	$ 595	$ -

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 16 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Assets measured at fair value on a non-recurring basis are summarized below:

		Fair Value Measurements at December 31, 2010 Using:		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans:				
Residential	$ 1,013	$ -	$ -	$ 1,013
Home equity	313	-	-	313
Commercial real estate	4,324	-	-	4,324
Residential construction	-	-	-	-
Commercial construction	-	-	-	-
Commercial	288	-	-	288
Consumer	4	-	-	4
Total impaired loans	$ 5,942	$ -	$ -	$ 5,942
Real estate owned:				
Residential real estate	$ 539	$ -	$ -	$ 539

		Fair Value Measurements at December 31, 2009 Using:		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ 3,022	$ -	$ -	$ 3,022
Real estate owned, net	930	-	-	930

Assets and Liabilities Measured on a Non-Recurring Basis

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $6,668 at December 31, 2010, with a valuation allowance of $726, resulting in an additional provision for loan losses of $726 for the year ended December 31, 2010. At December 31, 2009, impaired loans had a carrying amount of $3,627, with a valuation allowance of $605, resulting in an additional provision for loan losses of $572 for the year ended December 31, 2009.

Real estate owned, which is measured at the lower of carrying or fair value less costs to sell, had a net carrying amount of $1,730, of which $539 is at fair value at December 31, 2010, resulting in a write-down of $215 for the year ended December 31, 2010. At December 31, 2009, real estate owned had a net carrying amount of $2,086, of which $930 is at fair value, at December 31, 2009, resulting in a write-down of $154 for the year ending December 31, 2009.

(Continued)

NOTE 16 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Other 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 Bancorp'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.

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

Cash and Cash Equivalents: The carrying amounts of cash and short-term instruments approximate fair values.

Interest-earning Deposits in Banks: The carrying amounts of interest-earning deposits maturing within 90 days approximate their fair values. Fair values of other interest-earning deposits are estimated using discounted cash flow analyses based on current rates for similar types of deposits.

FHLB stock: It was not practicable to estimate the fair value of FHLB stock due to restrictions on its transferability.

Loans Receivable: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values, as adjusted for estimated credit losses. Fair values for other loans (e.g., commercial real estate and investment property mortgage loans, commercial and industrial 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 for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Deposit Liabilities: The fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings, and certain types of money market accounts) 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.

FHLB Advances and Other Borrowings: The carrying amount of short-term FHLB advances, federal funds purchased, and other borrowings is a reasonable estimate of their fair value due to their variable interest rates and short-term maturities. The estimated fair value of long-term FHLB is determined by discounting the future cash flows of outstanding advances using rates currently available on advances from the FHLB with similar characteristics.

Repurchase Agreements: The estimated fair value of repurchase agreements is determined by discounting the future cash flows of outstanding advances using rates currently available on similar instruments.

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

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 16 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Off-Balance-Sheet Instruments: Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of off-balance sheet items is not considered material.

The estimated fair values and related carrying or notional amounts of Bancorp's financial instruments that are not previously presented are as follows:

	2010		2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	$ 26,484	$ 26,484	$ 8,976	$ 8,976
Interest-earning deposits in banks	10,376	10,598	7,565	7,239
Held to maturity securities	6,452	6,578	7,607	7,551
FHLB stock	4,424	N/A	4,784	N/A
Loans in portfolio, net	261,416	275,028	278,227	293,135
Accrued interest receivable	1,602	1,602	1,795	1,795
Financial liabilities:				
Deposits	$ 265,951	$ 261,066	$ 259,151	$ 254,172
Accrued interest payable	466	466	687	687
FHLB advances and other borrowings	53,000	52,655	57,942	59,675
Repurchase agreements	25,000	24,279	25,000	21,797

NOTE 17 – GOODWILL

Impairments exist when a reporting unit's carrying value of goodwill exceeds its fair value, which is determined through a two-step impairment test. Step 1 includes the determination of the carrying value of a single reporting unit, including the existing goodwill and intangible assets, and estimating the fair value of the reporting unit. Bancorp determined the fair value of its reporting unit and compared it to its carrying amount. If the carrying amount of a reporting unit exceeds its fair value, a second test is required. The annual impairment analysis indicated that Step 2 analysis was not necessary.

NOTE 18 – RESTRICTIONS ON DIVIDENDS

Banking regulations place certain restrictions on dividends paid and loans or advances made by the Bank to Bancorp. The total amount of dividends that 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, 2010, the Bank's retained earnings available for the payment of dividends was $3,116. Accordingly, approximately $25,112 of Bancorp's investment in the Bank was restricted at December 31, 2010.

Loans or advances made by the Bank to Bancorp are generally limited to 10% of the Bank's capital stock and surplus and require the pledging of collateral.

(Continued)

(Amounts in thousands, except share and per share data)

NOTE 19 – OTHER COMPREHENSIVE INCOME (LOSS)

	2010	2009
Unrealized holding losses on available for sale securities	$ 2,925	$ 2,042
Reclassification adjustment for losses (gains) realized in income	(1,134)	(1,244)
Net unrealized losses	1,791	798
Tax effect	(608)	(271)
Net-of-tax amount	1,183	527
Change in funded status of postretirement benefit obligation	(35)	4
Tax effect	12	(80)
Net-of-tax amount	(23)	(76)
Other comprehensive loss	$ 1,160	$ 451

The following is a summary of the accumulated other comprehensive income balances, net of tax:

	2010	2009
Unrealized gains (losses) on securities available for sale	$ (1,135)	$ 48
Unrealized loss on pension benefits	(85)	(108)
	$ (1,220)	$ (60)