March 28, 2013

To My Fellow Stockholders,

On behalf of the Directors and employees of Sturgis Bancorp, Inc. and Sturgis Bank & Trust Company, I am pleased to provide a copy of our 2012 Annual Report. In this Annual Report you will find many key ratios and measures of performance. I encourage you to study this information and participate as a shareholder. If you do not understand information contained in this Annual Report, or have suggestions, do not hesitate to contact me or our CFO Brian Hoggatt at (269)651-9345.

The last several years have been focused on navigating one of the worst economic environments this management team has seen in our careers. The Bank has been fortunate to have a seasoned staff to deal with these challenges. It appears the worst is behind us and we are hopeful to refocus our efforts on strategic initiatives and increasing shareholder value. There are still economic challenges and our Federal Government needs to get its house in order. As we continue to work through these economic uncertainties, all signs point to better times. There continues to be great concern in the "un-winding" of the Federal Reserve's balance sheet and the impact on our financial systems. We also have concern on the Regulatory environment and uncertain expectations as it relates to bank capital standards. Hopefully 2013 will give us answers to some of these uncertainties.

Our Bank continues to be focused on growing shareholder value, being a responsible corporate citizen, and providing a work environment based on integrity and service. We look forward to our continuing role as the leading financial institution in St. Joseph County, Michigan and growing our presence in the Van Buren and Branch County markets.

I wish to thank the members of our Board of Directors for their guidance and counsel. I also wish to recognize the talented staff of Sturgis Bank & Trust Company for their hard work and dedication to you, our shareholders.

In closing I would ask each of you to consider our products and services when choosing your financial service provider. After all, you are contributing to your own success, while receiving top-notch service, when you do business with your community Bank. Thank you for your continuing support and investment in Sturgis Bancorp, Inc.

I hope to see you at our annual meeting.

Sincerely,

Eric L. Eishen President/CEO

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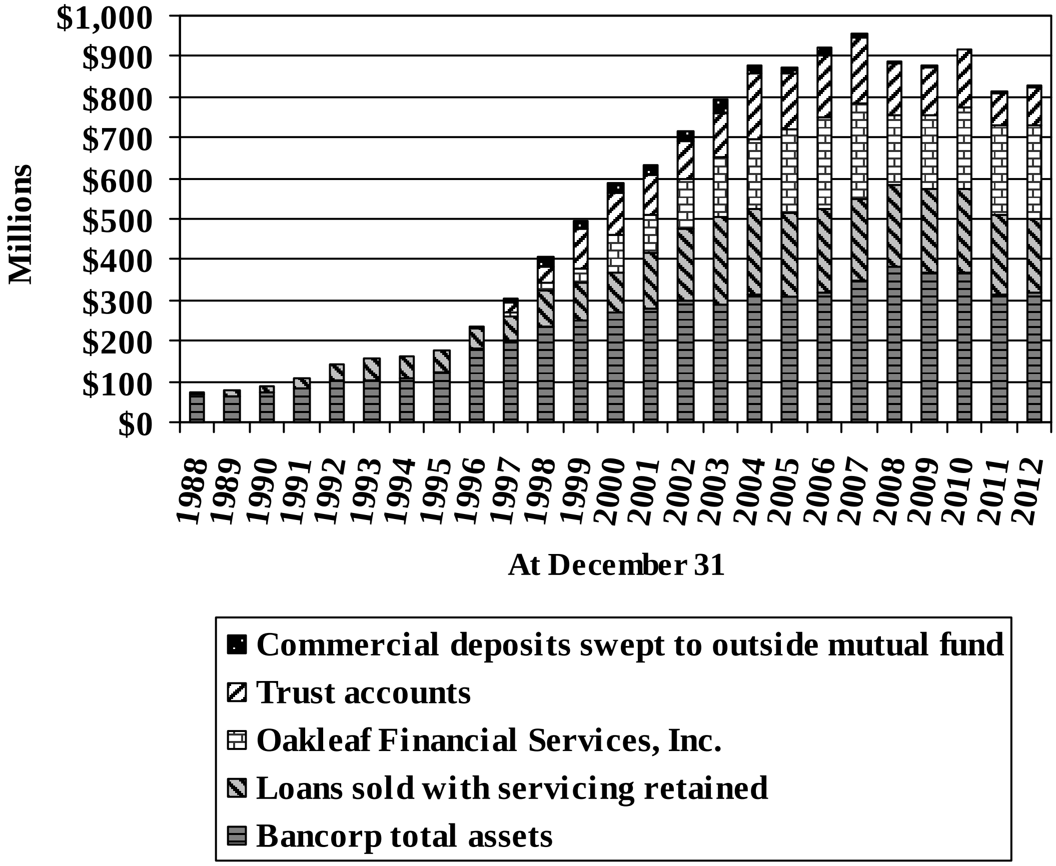
SELECTED FINANCIAL DATA

	(Dollars in Thousands) At December 31,				
	2012	2011	2010	2009	2008
Total assets	$317,045	$314,258	$369,961	$369,921	$383,394
Cash and investment securities	33,286	27,765	36,362	18,297	17,539
Loans and loans held for sale	250,781	252,987	263,607	278,822	282,445
Mortgage -backed securities (1)	-	-	34,619	37,759	49,407
Allowance for loan losses	5,138	5,875	6,691	3,983	2,838
Deposits	234,923	234,599	265,951	259,151	237,517
Short-term borrowings	-	75	-	4,442	7,287
Long-term borrowings	52,440	52,500	53,000	53,500	79,000
Repurchase agreements	-	-	25,000	25,000	30,500
Stockholders' equity	26,924	24,910	23,315	25,427	25,750
Book Value per share	13.21	12.34	11.56	12.60	12.76
Shares outstanding (actual number)	2,038,395	2,019,345	2,017,245	2,017,245	2,017,245

	(Dollars in Thousands) Year Ended December 31,				
	2012	2011	2010	2009	2008
Interest income	$12,679	$13,817	$15,779	$17,296	$20,483
Interest expense	3,035	4,036	5,726	7,558	10,239
Provision for loan losses	545	1,608	5,385	2,534	489
Noninterest income	4,728	4,546	5,661	5,624	4,733
Noninterest expense	11,457	12,415	11,818	11,620	11,584
Federal income tax	504	(197)	(780)	293	598
Net income (loss)	1,866	501	(709)	915	2,306
Earnings (loss) per share (basic)	0.92	0.25	(0.34)	0.45	1.13
Earnings (loss) per share (diluted)	0.92	0.25	(0.34)	0.45	1.13
Cash dividends per share	-	0.03	0.12	0.39	0.48
Dividend payout ratio	-	12.07%	(34.14%)	86.00%	42.48%
Equity/Assets ratio	8.49%	7.93%	6.30%	6.87%	6.72%
Return on assets	0.59%	0.14%	(0.19%)	0.24%	0.62%
Return on equity	7.18%	2.11%	(2.78%)	3.55%	9.14%
Weighted average shares outstanding (actual number):					
Basic	2,028,547	2,017,257	2,017,245	2,017,245	2,047,114
Diluted	2,028,547	2,017,257	2,017,245	2,017,245	2,047,114

(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



Despite decreases in total assets since 2010, this graph illustrates the stability 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. Most segments of the Bank's loan portfolio contracted in 2011.

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 net income for the year ended December 31, 2012 of $1.9 million, or $0.92 per share compared to net income of $501,000, or $0.25 per share, for the year ended December 31, 2011. The primary component of the increase in net income was provisions for loan losses of $545,000 in 2012, compared to $1.6 million in 2011. Net interest income decreased 1.4% to $9.6 million, from $9.8 million for 2011. The decrease is primarily due to the decrease in average earning assets to $276.4 million from $307.0 million in 2011. The tax equivalent net interest margin was 3.52% in 2012, compared to 3.22% in 2011.

Interest Income

Interest income decreased $1.1 million to $12.7 million from $13.8 million. This decrease is primarily due to the decrease in average interest-earning assets to $276.4 million in 2012 from $307.0 million in 2011. The average interest rate earned on loans decreased slightly to 4.91% in 2012 from 4.92% in 2011. This decrease in the average interest rate earned is primarily due to adjustable rate loans repricing lower through 2011 and 2012. 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 increased to 4.59% in 2012 from 4.50% in 2011.

Interest Expense

Interest expense decreased $1.0 million to $3.0 million in 2012 from $4.0 million in 2011. This was primarily due to the decrease in average interest-bearing liabilities to $250.8 million in 2012 from $293.5 million in 2011. The average interest rates on interest-bearing liabilities also decreased to 1.21% in 2012 from 1.38% in 2011. The average rate paid on interest-bearing deposits was 0.68% in 2012, compared to 1.00% in 2011. The average rate paid on borrowed funds increased to 3.22% in 2012 from 2.62% in 2011, primarily due to repayment of the low-rate repurchase agreements in 2011 at the same time as their related asset sales at gains.

Net Interest Income

Net interest income for the year ended December 31, 2012 was $9.6 million compared to $9.8 million for the year ended December 31, 2011, a decrease of $137,000. This decrease was caused primarily by a decrease in increase in interest-earning assets. The net interest margin increased to 3.49% in 2012 from 3.19% in 2011.

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 2012 and 2011 was, 3.49% and 3.19%, 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,

	2012			2011		
	Average Outstanding Balance	**Interest Earned/ Paid**	**Yield/ Rate**	**Average Outstanding Balance**	**Interest Earned/ Paid**	**Yield/ Rate**
Interest-Earning Assets:						
Loans (1)	$ 251,956	$ 12,362	4.91%	$ 258,796	$ 12,736	4.92%
Mortgage-backed securities	-	-	-.	20,726	727	3.51%
Investment securities (2)	4,970	173	3.49%	5,017	157	3.13%
Interest-bearing deposits	19,427	144	0.74%	22,415	197	0.88%
Total interest-earning assets	$ 276,353	$ 12,679	4.59%	$ 306,954	$ 13,817	4.50%
Interest-Bearing Liabilities:						
Deposits	$ 198,189	$ 1,341	1.00%	$ 226,200	$ 2,273	1.00%
FHLB advances and repurchase agreements	52,644	1,694	2.62%	67,332	1,763	2.62%
Total interest-bearing liabilities	$ 250,833	$ 3,035	1.38%	$ 293,532	$ 4,036	1.38%
Net interest income		$ 9,644			$ 9,781	
Interest rate spread			3.38%			3.12%
Net interest-earning assets	$ 25,520			$ 13,422		
Net interest margin			3.49%			3.19%

(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,	
	2012	**2011**
Weighted average rate:		
Loans	4.72%	4.89%
Mortgage-backed securities	-	-
Investments(1)	3.53%	2.70%
Interest-bearing deposits	0.84%	0.64%
All interest-earning assets	4.40%	4.56%
Weighted average cost:		
Deposits (interest-bearing)	0.50%	0.75%
FHLB advances other borrowings	3.14%	3.17%
All interest-bearing liabilities	0.98%	1.51%
Interest rate spread	3.42%	3.03%

(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, 2012 vs 2011 Increase (Decrease) Due To:			Year Ended December 31, 2011 vs 2010 Increase (Decrease) Due To:		
Interest Income:	Volume	Rate	Total	Volume	Rate	Total
Loans	$ (336)	$ (38)	$ (374)	$ (775)	$ (764)	$ (1,539)
Mortgage-backed securities	(727)	-	(727)	(491)	181	(310)
Investment securities	(2)	18	16	(40)	39	(1)
Interest-bearing deposits	(24)	(29)	(53)	2	(114)	(112)
Total interest-earning assets	(1,089)	(49)	(1,138)	(1,304)	(658)	(1,962)
Interest Expense:						
Deposits	(256)	(676)	(932)	(189)	(961)	(1,150)
FHLB advances and borrowings	(427)	358	(69)	(346)	(194)	(540)
Total interest-bearing liabilities	(683)	(318)	(1,001)	(535)	(1,155)	(1,690)
Net Interest Income	$ (406)	$ 269	$ (137)	$ (769)	$ 497	$ (272)

Provision for Loan Losses

The provision for loan losses was $545,000 for the year ended December 31, 2012 and $1.6 million for the year ended December 31, 2011, a decrease of $1.1 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 2012, net of recoveries, were $1.3 million, compared to $2.4 million during 2011.

Nonperforming loans decreased to $7.5 million at December 31, 2012 from $10.9 million at December 31, 2011. At December 31, 2012, the Bank had another $10.1 million of troubled debt restructured loans in addition to the nonperforming loans, compared to $9.1 million at December 31, 2011. The Bank restructures loans when such restructures are expected to minimize the Bank's losses on the loans.

The allowance for loan losses as a percentage of total (gross) loans increased to 2.03% in 2012 from 2.27% in 2011. This decrease is primarily due to Management's assessment of credit losses and exposure on loans specifically analyzed. Management monitors the increasing exposure to commercial lending and economic developments in the Bank's market area, among other factors, in determining appropriate provisions to the allowance for loan losses.

Noninterest Income

Noninterest income was $4.7 million in 2012, compared to $4.5 million in 2011. Mortgage banking activities increased $460,000 to $1.2 million, as proceeds from loan sales increased. Investment brokerage commission income also increased $359,000 to $1.5 million. The Company realized $0 of gains on sales of available-for-sale securities in 2012, compared to $536,000 in 2011.

Noninterest Expense

Noninterest expense was $11.5 million in 2012, compared to $12.4 million in 2011. The largest component of noninterest expense is salaries and employee benefits, which decreased $406,000. Real estate owned expense decreased $259,000, to $745,000. Management actively minimizes noninterest expense, although certain noninterest expenses are outside of Management's direct control.

The effective federal income tax rate was 20.9% in 2012 and (64.8%) in 2011.

Financial Condition

General. Bancorp's total assets at December 31, 2012 were $317.0 million compared to $314.3 million at December 31, 2011, an increase of $2.7 million. Most of the change was in interest-earning deposits in banks.

Loans. Net loans decreased to $248.5 million at December 31, 2012 from $252.0 million at December 31, 2011. Residential mortgages increased $9.6 million, as residential borrowers reacted to historically low interest rates. The Bank generally sells long-term, fixed rate, residential mortgages in the secondary market. The primary buyers of these loans are Federal Home Loan Mortgage Corporation (FHLMC) and FHLB. Commercial real estate loans and other commercial loans decreased to $109.7 million, or 43.3% of gross loans at December 31, 2012 from $119.1 million, or 46.4% of gross loans, at December 31, 2011. The proceeds from sales of loans (fixed-rate, residential mortgages) were $47.6 million and $24.4 million for the years ended December 31, 2012 and 2011, respectively. The mortgage loans originated for sale ($48.2 million in 2012 and $22.9 million in 2011) were primarily funded by the secondary mortgage market sales. The decision to sell most 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, 2012, outstanding commitments to originate loans were $2.2 million and $37.4 million on fixed and variable-rate loans, respectively. Of these loan commitments, Management expects $4.8 million to be disbursed for new loans during the first half of 2013. 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 required.

Loans serviced for others were $183.6 million and $195.6 million at December 31, 2012 and 2011, 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 $370,000 at December 31, 2012. 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,	
	2012	2011
Ratio of net charge-offs during the period to average loans outstanding during the period	0.50%	0.94%
Allowance for loan losses to total (gross) loans	2.03%	2.27%
Nonperforming assets to total assets	2.72%	3.46%
Allowance for loan losses to nonperforming assets	59.63%	54.04%

Loans in nonaccrual status at December 31, 2011 were $10.5 million, up from $5.3 million at December 31, 2010. The following table presents the aggregate amount of troubled asset categories as of the dates indicated:

	(Dollars in thousands) December 31, 2012	2011
Past due – 90 days or greater	$ 198	$ 366
Nonaccrual loans	7,166	10,505
Real estate owned	1,252	2,082
Total nonperforming assets	8,616	12,953
Restructured assets	10,096	5,200
Total troubled assets	$18,712	$18,153
Ratio of troubled assets to total loans	7.53%	6.38%
Ratio of troubled assets to total assets	5.90%	5.11%

Interest-earning Deposits in Banks. Interest-bearing deposits in banks were $12.2 million at December 31, 2012, compared to $4.8 million at December 31, 2011, an increase of $7.4 million.

Securities – Available for sale. Investment securities available for sale of $1.2 million at December 31, 2012 and $265,000 at December 31, 2011 consisted entirely of municipal securities. During 2011, the Bank transferred its entire held-to-maturity securities portfolio to available-for-sale, then sold most of the securities in the portfolio to fund the Bank's strategy to enhance capital ratios. The gain on sale of securities in 2011 was $536,000, before applicable taxes.

Securities – Held-to-maturity. At December 31, 2012 and 2011, the Bank had no held-to-maturity investment securities.

Deposits and Borrowed Funds. Deposits were $234.9 million at December 31, 2012 compared to $234.6 million at December 31, 2011, an increase of $300,000. Interest-bearing deposits decreased to $193.7 million at December 31, 2012 from $200.9 million at December 31, 2011. Certificates of deposit with balances greater than or equal to $100,000 (commonly referred to as jumbo certificates), which carry greater interest rate sensitivity, increased to $17.1 million at December 31, 2012 from $16.9 at December 31, 2011. Other certificates of deposit, including brokered certificates of deposit parsed into $1,000 increments, decreased to $45.5 million at December 31, 2012 from $52.0 million at December 31, 2011. Brokered certificates of deposit, mostly included in the certificates under $100,000, decreased to $13.3 million at December 31, 2012 from $14.9 million at December 31, 2011. The Bank uses brokered and jumbo certificates as sources of liquidity. Transaction savings accounts and checking accounts decreased $895,000, or 0.7%, from December 31, 2011 to December 31, 2012. Transaction savings accounts and checking accounts represent 55.82% of deposits at December 31, 2012, compared to 56.28% of deposits at December 31, 2011. Bank management is actively attempting to increase 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 May 2013. The Bank anticipates renewal of the line of credit at maturity. All borrowings from FHLB are collateralized by certain residential and commercial mortgage loans.

Long-term advances were $48.5 million at December 31, 2011 and 2010. At December 31, 2012, Bancorp had $3.9 million outstanding on an amortizing loan with another financial institution, compared to $4.0 million outstanding at December 31, 2011 on an open-end line of credit with another financial institution. The loan requires amortizing payments on a 10-year schedule, with final maturity in April 2015.

Capital Resources

The stockholders' equity of the Bancorp was $26.9 million at December 31, 2012 compared to $24.9 million at December 31, 2011, an increase of $2.0 million, or 8.09%. The primary component of this increase was retained earnings. No cash dividend was paid in 2012, and cash dividends of $60,000, or $0.03 per share, were paid in 2011, out of retained earnings. The stockholders' equity was 8.49% of total assets at December 31, 2012. 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, 2012	December 31, 2011
Equity to assets	8.5%	7.9%
Tier I leverage	7.5%	6.7%

Risk-based:	Tier I capital	10.7%	9.4%
	Total capital	11.9%	10.6%

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, 2011, 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	$30,884
4% increase in market rates	33,249
3% increase in market rates	33,475
2% increase in market rates	33,367
1% increase in market rates	33,561
No change (current market value of equity)	33,476
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 remains relatively stable 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.

Through recent volatile equity markets, 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, 2012.

	Payments Due by Period (in thousands)				
	Total	Less than 1 year	1 – 3 years	4 – 5 Years	After 5 years
Certificates of deposit	$ 62,529	$27,278	$18,449	$ 8,883	$ 7,919
FHLB advances	48,500	-	-	25,500	23,000
Total contractual obligations	$111,029	$27,278	$18,449	$34,383	$30,919

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, 2012, the Bank had total commitments to originate loans of $2.2 million and $37.4 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 2012 and 2011, inflation did not have a material impact on the Bancorp.

DIRECTORS OF BANCORP – December 31, 2012

John R. Dresser	President, Dresser, Dresser, Haas & Caywood, P.C. Retained Counsel
Eric L. Eishen	President and Chief Executive Officer, Sturgis Bancorp, Inc and Sturgis Bank & Trust Company
David L. Franks	President and COO, Oak Press Solutions
Donald L. Frost	Chairman of the Board Chief Executive Officer, LTI Printing, Inc.
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, 2012

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

OFFICERS OF THE BANK – DECEMBER 31, 2012

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
Tracey L. Parker	Senior Vice President, Chief Credit Officer
Ronald W. Scheske	Executive Vice President, Chief Operating Officer
Donald G. Baldwin	First Vice President, Operations, Compliance Officer
Christine M. Moline	First Vice President, Private Banking Officer
Jose D. Albarran	Vice President
Robby S. Beachy	Vice President
Sandra J. Cagle	Vice President
Debora L. Capman	Vice President, Trust Officer
Emily D. Frohriep	Vice President, Human Resources
Steven A. Haller	Vice President, Loss Mitigation
Jason J. Hyska	Vice President, Retail Lending
Kurt A. Inman	Vice President, Director of Marketing
John D. Johnson	Vice President, Business Development
Heather J. Myers	Corporate Secretary
Matthew D. Scheske	Vice President
Janet M. Stahl	Vice President
Jason A. Wagner	Vice President
Elizabeth M. Weinberg	Vice President
Camille M. Wilson	Vice President
Marilee I. Yoder	Comptroller
Tamera J. De Mara	Assistant Vice President
Trudy R. Gloy	Assistant Vice President
Stephen E. Merchant	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

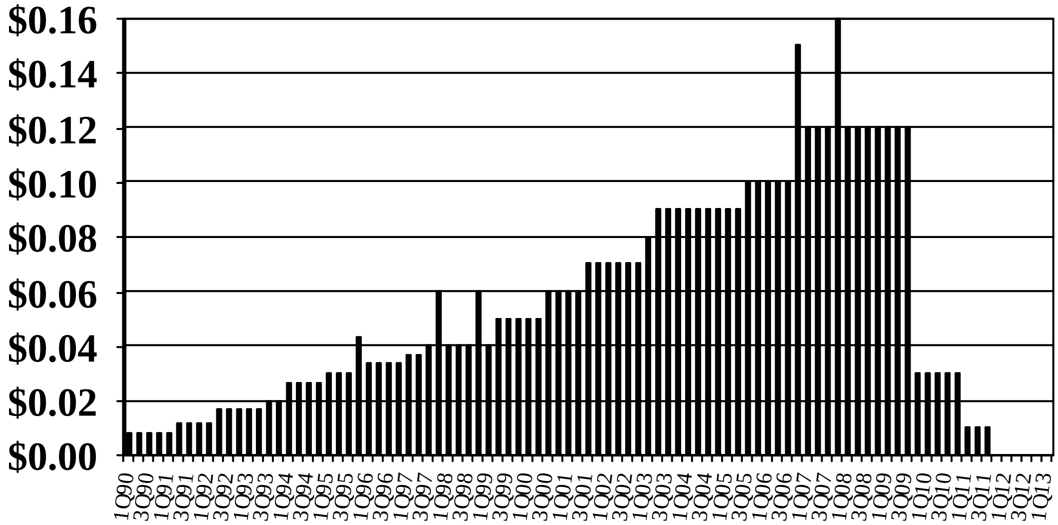
Shares of common stock of Bancorp were held by 139 holders of record as of December 31, 2012. Bancorp's shares are traded on the OTC Bulletin Board under the symbol of "STBI". Trading activity has been infrequent.

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

	Year ended December 31,			
	2012		2011	
	High	Low	High	Low
First quarter	$7.00	$4.20	$7.00	$6.50
Second quarter	7.60	5.55	6.55	5.51
Third quarter	7.35	5.97	6.00	5.51
Fourth quarter	8.05	6.50	9.00	4.55

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, 2012 and December 31, 2011. There have been no disagreements on accounting or financial disclosure matters within these time periods.

INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Sturgis Bancorp, Inc., which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sturgis Bancorp, Inc. as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

Grand Rapids, Michigan
March 22, 2013

STURGIS BANCORP, INC.

CONSOLIDATED BALANCE SHEETS

December 31, 2012 and 2011

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

	2012	2011
ASSETS		
Cash and due from banks	$ 10,237	$ 7,297
Other short-term investments	9,611	15,443
Total cash and cash equivalents	19,848	22,740
Interest-earning deposits in banks	12,196	4,760
Securities - available for sale	1,242	265
Federal Home Loan Bank stock, at cost	4,064	4,064
Loans held for sale, at fair value	2,261	986
Loans, net of allowance of $5,138 and $5,875	248,520	252,001
Premises and equipment, net	7,044	7,855
Goodwill	5,109	5,109
Originated mortgage servicing rights	1,273	1,279
Real estate owned	1,252	2,082
Bank-owned life insurance	9,259	8,976
Accrued interest receivable	861	943
Prepaid FDIC assessment	414	814
Other assets	3,702	2,384
Total assets	$ 317,045	$ 314,258
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Deposits		
Noninterest-bearing	$ 41,261	$ 33,642
Interest-bearing	193,662	200,957
Total deposits	234,923	234,599
Federal Home Loan Bank advances and other borrowings	52,440	52,575
Accrued interest payable	333	344
Other liabilities	2,425	1,830
Total liabilities	290,121	289,348
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 2,038,395 shares at December 31, 2012 and 2,019,345 at December 31, 2011	2,038	2,019
Additional paid-in capital	6,979	6,881
Retained earnings	17,953	16,087
Accumulated other comprehensive income (loss)	(46)	(77)
Total stockholders' equity	26,924	24,910
Total liabilities and stockholders' equity	$ 317,045	$ 314,258

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2012 and 2011
(Amounts in thousands, except share and per share data)

	2012	2011
Interest income		
Loans	$ 12,362	$ 12,736
Investment securities:		
Taxable	131	916
Tax-exempt	36	41
Dividends	150	124
Total interest income	12,679	13,817
Interest expense		
Deposits	1,341	2,273
Borrowed funds	1,694	1,763
Total interest expense	3,035	4,036
Net interest income	9,644	9,781
Provision for loan losses	545	1,608
Net interest income after provision for loan losses	9,099	8,173
Noninterest income:		
Service charges and other fees	1,344	1,379
Investment brokerage commission income	1,542	1,183
Mortgage banking activities	1,219	759
Trust fee income	310	322
Increase in cash value of bank owned life insurance	282	280
Gain on securities	-	536
Loss (gain) on sale of real estate owned	(24)	19
Other income	55	68
Total noninterest income	4,728	4,546
Noninterest expenses:		
Salaries and employee benefits	6,257	6,663
Occupancy and equipment	1,422	1,436
Data processing	707	690
Professional services	369	469
Real estate owned expense	745	1,004
Advertising	109	126
FDIC premiums	418	389
Other	1,430	1,638
Total noninterest expenses	11,457	12,415
Income before income tax expense (benefit)	2,370	304
Income tax expense (benefit)	504	(197)
Net income	$ 1,866	$ 501
Earnings per share	$ 0.92	$ 0.25

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years ended December 31, 2012 and 2011

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

	2012	2011
Net income	$ 1,866	$ 501
Other comprehensive income:		
Unrealized gains on securities:		
Unrealized holding gain arising during the period	12	2,254
Reclassification adjustment for losses (gains) included in net income	-	(536)
Tax effect	(4)	(584)
Net of tax	8	1,134
Change in post-retirement obligation	31	14
Tax effect	(8)	(5)
Net of tax	23	9
Total other comprehensive income	31	1,143
Comprehensive income	$ 1,897	$ 1,644

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years ended December 31, 2012 and 2011
(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, 2011	$ 2,017	$ 6,872	$ 15,646	$ (1,220)	$ 23,315
Net income for the year ended December 31, 2011	-	-	501	-	501
Other comprehensive income, net of tax effect of $589	-	-	-	1,143	1,143
Common stock issued (2,100 shares)	2	9	-	-	11
Cash dividends ($0.03 per share)	-	-	(60)	-	(60)
Balance – December 31, 2011	2,019	6,881	16,087	(77)	24,910
Net income for the year ended December 31, 2012	-	-	1,866	-	1,866
Other comprehensive income, net of tax effect of $12	-	-	-	31	31
Common stock issued (19,050 shares)	19	98	-	-	117
Balance – December 31, 2012	$ 2,038	$ 6,979	$ 17,953	$ (46)	$ 26,924

See accompanying notes to consolidated financial statements.

STURGIS BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2012 and 2011
(Amounts in thousands)

	2012	2011
Cash flows from operating activities		
Net income	$ 1,866	$ 501
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	473	487
Amortization of mortgage servicing rights	240	208
Provision for loan losses	545	1,608
Gain on sale of fixed assets	(9)	-
Accretion and amortization of securities	(3)	171
Gain on sale of loans	(1,215)	(590)
Proceeds from the sale of loans held for sale	47,644	24,448
Loans originated for sale	(48,169)	(22,883)
Impairment of mortgage servicing rights	231	124
Loss (gain) on sale of real estate owned	(24)	19
Write-down of real estate owned	471	581
Loss of equity in limited partnership	147	110
Gain on available for sale securities	-	(536)
Increase in cash value of bank-owned life insurance	(282)	(280)
Prepayment penalties on repurchase agreements	-	195
Changes in assets and liabilities:		
Decrease (increase) in accrued interest and other assets	(985)	2,522
(Decrease) increase in accrued interest and other liabilities	604	(1,576)
Net cash provided by operating activities	1,534	5,109
Cash flows from investing activities		
Net change in interest-earning deposits in banks	(7,436)	5,616
Proceeds from maturities of securities held to maturity	-	75
Principal reductions of mortgage-backed securities held to maturity	-	536
Principal reductions of mortgage-backed securities available for sale	10	188
Purchase of securities available-for-sale	(972)	(1,011)
Proceeds from sales of securities available-for-sale	-	36,152
Net increase in loans	360	4,397
Proceeds from repurchase of Federal Home Loan Bank stock	-	360
Proceeds from sale of real estate owned	2,959	2,458
Proceeds from sale of premises and equipment	575	-
Additions to premises and equipment, net	(228)	(603)
Net cash provided by investing activities	(4,732)	48,168

(Continued)

STURGIS BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2012 and 2011
(Amounts in thousands)

	2012	2011
Cash flows from financing activities		
Net increase (decrease) in deposits	$ 324	$ (31,352)
Repayment of FHLB advances and other borrowings	(5,135)	(500)
Proceeds from FHLB advances and other borrowings	5,000	75
Repayment of repurchase agreements	-	(25,195)
Issuance of common stock	117	11
Cash dividends paid on common stock	-	(60)
Net cash provided by (used in) financing activities	306	(57,021)
Net change in cash and cash equivalents	(2,892)	(3,744)
Cash and cash equivalents - beginning of year	22,740	26,484
Cash and cash equivalents - end of year	$ 19,848	$ 22,740
Supplemental information		
Cash paid (refunded) for:		
Interest	$ 3,046	$ 4,158
Income taxes	804	(171)
Noncash investing and financing activities		
Transfers of held to maturity securities to available for sale	$ -	$ 5,778
Loans transferred to real estate owned	2,509	3,409

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: Bancorp has evaluated subsequent events for recognition and disclosure through March 22, 2013, 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 five 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. 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.

<u>Federal Home Loan Bank Stock</u>: 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 and classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value.

<u>Loans Held for Sale</u>: Loans originated and intended for sale in the secondary market are carried at fair value. The fair value includes the servicing value of the loans as well as any accrued interest. 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.

<u>Loans</u>: 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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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 and general components. The specific components relate to loans that are classified as impaired. For such loans, 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 qualitative factors.

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 generally measured on a loan-by-loan basis for commercial, commercial real estate, and residential troubled debt restructurings.

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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 three 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. The risk characteristics of these loans vary based on the borrower's business and industry as repayment is typically dependent on cash flows generated from the underlying business.

Commercial Real Estate and Commercial Construction - 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. The risk characteristics are similar to commercial loans, but these loan segments may also be dependent on real estate sales or rental income. For commercial construction, proceeds may be used for land acquisition, development or construction.

Consumer - Term loans or lines of credit for the purchase of consumer goods, vehicles or home improvement. The risks characteristics of this loan segment vary depending on the type of collateral but general repayment is expected from an individual continuing to generate a cash flow that supports the calculated payment obligation.

Residential and Residential Construction - Loans to purchase or refinance single family residences. The risks associated with these segments are similar to the risks for consumer loans regarding individual payment obligations however the underlying collateral is the real estate. Real estate is subject to changes in market valuation and can be unstable for a variety of reasons. For residential construction, proceeds may be used for land acquisition, development, or construction of residential properties.

Home equity – Loans to purchase consumer goods or home improvements. The risks associated with this segment are similar to residential loans, however typically these loans are secured by second lien positions in real estate.

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 accessing 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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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. Bancorp 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.

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 $475 and $502 for the years ended December 31, 2012 and 2011 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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 in the fourth quarter of each year. There has been no impairment of goodwill.

Long-Term Assets: Premises and equipment 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.

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.

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.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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. As of December 31, 2012 and 2011, there were no dilutive common shares. As of December 31, 2012 and 2011 weighted average shares used in computing earnings per share were 2,028,547 and 2,017,257.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale and 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 April 2011, the FASB amended existing guidance for assisting a creditor in determining whether a restructuring is a troubled debt restructuring. The amendments clarify the guidance for a creditor's evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. With regard to determining whether a concession has been granted, the ASU clarifies that creditors are precluded from using the effective interest method to determine whether a concession has been granted. In the absence of using the effective interest method, a creditor must now focus on other considerations such as the value of the underlying collateral, evaluation of other collateral or guarantees, the debtor's ability to access other funds at market rates, interest rate increases and whether the restructuring results in a delay in payment that is insignificant. This guidance is effective for annual reporting periods ending after December 15, 2012, including interim reporting periods within those annual periods. The adoption of this guidance is not expected to materially impact the Bancorp.

In June 2011, the FASB amended existing guidance and eliminated the option to present the components of other comprehensive income as part of the statement of changes in shareholder's equity. The amendment requires that comprehensive income be presented in either a single continuous statement or in two separate consecutive statements. The amendments in this guidance are effective for annual reporting periods ending after December 15, 2012. The adoption of this amendment changed the presentation of comprehensive income to be presented in a separate statement.

(Continued)

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

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In September 2011, the FASB amended existing guidance relating to goodwill impairment testing. The amendment permits an assessment of qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing these events or circumstances, it is concluded that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. The amendments in this guidance are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The effect of adopting this standard did not have a material effect on the Bancorp's operating results or financial condition.

In May 2011, the FASB issued an amendment to achieve common fair value measurement and disclosure requirements between U.S. and International accounting principles. Overall, the guidance is consistent with existing U.S. accounting principles; however, there are some amendments that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The effect of adopting this standard did not have a material effect on the Bancorp's operating results or financial condition.

NOTE 2 – SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2012				
Available-for-sale securities:				
Obligations of states and political subdivisions	$ 1,230	$ 12	$ -	$ 1,242
	$ 1,230	$ 12	$ -	$ 1,242
2011				
Available-for-sale securities:				
Obligations of states and political subdivisions	$ 265	$ -	$ -	$ 265
	$ 265	$ -	$ -	$ 265

No securities were pledged at December 31, 2012 and 2011.

(Continued)

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

NOTE 2 – SECURITIES (Continued)

The amortized cost and fair value of securities by contractual maturity at December 31, 2012 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.

	Available-for-Sale	
	Amortized Cost	Fair Value
Due in one year or less	$ 10	$ 10
Due after one through five years	40	40
Due after five through ten years	85	85
Due after ten years	1,095	1,107
	$ 1,230	$ 1,242

For the years ended December 31, 2012 and 2011, proceeds from sales of securities available for sale amounted to $0 and $36,152, respectively. Realized losses, net of applicable tax benefits, amounted to $0 and $4 for the years ended December 31, 2012 and 2011, respectively. Gross realized gains, net of applicable tax expense, amounted to $0 and $358 for the years ended December 31, 2012 and 2011, respectively.

NOTE 3 – LOANS

A summary of the balances of loans follows:

	2012	2011
Residential loans:		
Residential	$ 95,027	$ 85,455
Home equity	43,820	46,662
Residential construction	227	1,546
Total residential loans	139,074	133,663
Commercial real estate loans:		
Commercial real estate	85,300	87,973
Commercial construction	-	2,494
Total commercial real estate loans	85,300	90,467
Commercial loans	24,432	29,067
Consumer loans	4,718	4,482
	253,524	257,679
Less:		
Allowance for loan losses	5,138	5,875
Add:		
Deferred loan origination and other costs, net of fees	134	197
Loans, net	$ 248,520	$ 252,001

(Continued)

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

NOTE 3 – LOANS (Continued)

The following table presents the activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2012 and 2011:

	Residential	Home Equity	Commercial Real Estate	Residential Construction	Commercial Construction	Commercial	Consumer	Total
December 31, 2012								
Allowance for loan losses:								
Beginning balance	$ 1,910	$ 896	$ 1,777	$ 160	$ 226	$ 857	$ 49	$ 5,875
Provision for loan losses	499	(114)	750	(142)	(226)	(198)	(24)	545
Loans charged-off	(563)	(132)	(593)	-	-	(90)	(32)	(1,410)
Recoveries	38	39	1	-	-	9	41	128
Total ending allowance balance	$ 1,884	$ 689	$ 1,935	$ 18	$ -	$ 578	$ 34	$ 5,138
December 31, 2011								
Allowance for loan losses:								
Beginning balance	$ 1,667	$ 765	$ 2,676	$ 287	$ 616	$ 607	$ 73	$ 6,691
Provision for loan losses	651	304	(31)	134	20	527	3	1,608
Loans charged-off	(448)	(183)	(929)	(262)	(410)	(277)	(34)	(2,543)
Recoveries	40	10	61	1	-	-	7	119
Total ending allowance balance	$ 1,910	$ 896	$ 1,777	$ 160	$ 226	$ 857	$ 49	$ 5,875

(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, 2012 and 2011:

	Residential	Home Equity	Commercial Real Estate	Residential Construction	Commercial Construction	Commercial	Consumer	Total
2012								
Allowance for loan losses:								
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	$ 132	$ 4	$ 615	$ -	$ -	$ 2	$ -	$ 753
Collectively evaluated for impairment	1,752	685	1,320	18	-	576	34	4,385
Total ending allowance balance	$ 1,884	$ 689	$ 1,935	$ 18	$ -	$ 578	$ 34	$ 5,138
Loans:								
Loans individually evaluated for impairment	$ 7,692	$ 148	$ 9,970	$ -	$ -	$ 190	$ 21	$ 18,021
Loans collectively evaluated for impairment	87,469	44,040	75,439	228	-	24,586	4,690	236,452
Total ending recorded investment in loans	$ 95,161	$ 44,188	$ 85,409	$ 228	$ -	$ 24,776	$ 4,711	$ 254,473
2011								
Allowance for loan losses:								
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	$ 420	$ 9	$ 549	$ -	$ 226	$ 36	$ -	$ 1,240
Collectively evaluated for impairment	1,490	887	1,228	160	-	821	49	4,635
Total ending allowance balance	$ 1,910	$ 896	$ 1,777	$ 160	$ 226	$ 857	$ 49	$ 5,875
Loans:								
Loans individually evaluated for impairment	$ 8,003	$ 239	$ 13,865	$ -	$ 2,495	$ 518	$ 5	$ 25,125
Loans collectively evaluated for impairment	77,783	46,841	74,406	1,552	-	28,737	4,354	233,673
Total ending recorded investment in loans	$ 85,786	$ 47,080	$ 88,271	$ 1,552	$ 2,495	$ 29,255	$ 4,359	$ 258,798

(Continued)

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

NOTE 3 – LOANS (Continued)

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2012 and 2011. For purposes of this disclosure, unpaid principal balance has been reduced by partial charge offs, if any.

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash basis Interest Income Recognized
2012						
With no related allowance recorded:						
Residential	$ 5,641	$ 5,687	$ -	$ 5,994	$ 227	$ 227
Home equity	91	91	-	87	5	5
Commercial real estate	6,582	6,675	-	7,574	267	267
Commercial	91	91	-	102	1	1
Consumer	21	21	-	5	-	-
	12,426	12,565	-	13,762	500	500
With an allowance recorded:						
Residential	2,001	2,005	132	1,970	66	66
Home equity	57	57	4	58	3	3
Commercial real estate	3,289	3,295	615	3,328	42	42
Commercial	98	99	2	100	6	6
Consumer	-	-	-	-	-	-
	5,445	5,456	753	5,456	117	117
	$ 17,871	$ 18,021	$ 753	$ 19,218	$ 617	$ 617
2011						
With no related allowance recorded:						
Residential	$ 2,398	$ 2,414	$ -	$ 2,584	$ 50	$ 50
Home equity	123	125	-	141	4	4
Commercial real estate	5,510	5,598	-	7,880	66	66
Commercial	119	119	-	127	8	8
Consumer	5	5	-	34	2	2
	8,155	8,261	-	10,766	130	130
With an allowance recorded:						
Residential	5,570	5,589	420	5,591	158	158
Home equity	114	114	9	95	2	2
Commercial real estate	8,243	8,267	549	8,490	400	400
Commercial construction	2,494	2,495	226	2,884	-	-
Commercial	396	399	36	316	13	13
Consumer	-	-	-	-	-	-
	16,817	16,864	1,240	17,376	573	573
	$ 24,972	$ 25,125	$ 1,240	$ 28,142	$ 703	$ 703

(Continued)

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

NOTE 3 – LOANS (Continued)

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, 2012 and 2011:

	2012		2011	
	Nonaccrual	Loans Past Due Over 90 Days Still Accruing	Nonaccrual	Loans Past Due Over 90 Days Still Accruing
Residential	$ 1,892	$ 103	$ 2,742	$ 331
Home equity	70	101	69	45
Commercial real estate	5,222	-	5,267	-
Commercial construction	-	-	2,494	-
Commercial	91	-	-	-
Consumer	-	1	26	-
Total	$ 7,275	$ 205	$ 10,598	$ 376

The following table presents the aging of the recorded investment in past due loans as of December 31, 2012 and 2011 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
2012						
Residential	$ 839	$ 777	$ 1,408	$ 3,024	$ 92,137	$ 95,161
Home equity	322	35	171	528	43,660	44,188
Commercial real estate	443	473	1,423	2,339	83,070	85,409
Residential construction	-	-	-	-	228	228
Commercial construction	-	-	-	-	-	-
Commercial	-	-	91	91	24,685	24,776
Consumer	102	24	1	127	4,584	4,711
Total recorded investment	1,706	1,309	3,094	6,109	248,364	254,473
Less:						
Accrued interest receivable	17	7	6	30	785	815
Total loans, including deferred fees and costs	$ 1,689	$ 1,302	$ 3,088	$ 6,079	$ 247,579	$ 253,658

(Continued)

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

NOTE 3 – LOANS (Continued)

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans not Past Due	Total
2011						
Residential	$ 1,188	$ 712	$ 1,400	$ 3,300	$ 82,486	$ 85,786
Home equity	137	167	106	410	46,670	47,080
Commercial real estate	-	1,136	1,451	2,587	85,684	88,271
Residential construction	-	-	-	-	1,552	1,552
Commercial construction	209	-	-	209	2,286	2,495
Commercial	-	-	-	-	29,255	29,255
Consumer	46	25	5	76	4,283	4,359
Total recorded investment	1,580	2,040	2,962	6,582	252,216	258,798
Less:						
Accrued interest receivable	15	8	7	30	892	922
Total loans, including deferred fees and costs	$ 1,565	$ 2,032	$ 2,955	$ 6,552	$ 251,324	$ 257,876

Troubled Debt Restructurings:

Bancorp has allocated $749 and $763 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2012 and 2011. Bancorp has committed to lend $0 as of December 31, 2012 and $11 as of December 31, 2011 to customers with outstanding loans that are classified as troubled debt restructurings.

During the years ended December 31, 2012 and 2011, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk.

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 2 years to 30 years. Modifications involving an extension of the maturity date were for periods ranging from 1 year to 30 years.

The following table presents loans by class modified as troubled debt restructurings that occurred during the years ended December 31, 2012 and 2011:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
2012			
Troubled Debt Restructurings:			
Residential	5	$ 3,396	$ 3,396
Home equity	2	23	23
Commercial real estate	7	5,663	5,663
Commercial	2	99	99
Consumer	1	22	22
Total	17	$ 9,203	$ 9,203

The troubled debt restructurings described above increased the allowance for loan losses by $436 and resulted in charge offs of $548 during the year ended December 31, 2012.

(Continued)

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

NOTE 3 – LOANS (Continued)

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
2011			
Troubled Debt Restructurings:			
Residential	3	$ 5,008	$ 5,008
Home equity	1	74	74
Commercial real estate	5	725	725
Commercial	2	101	101
Consumer	1	5	5
Total	12	$ 5,913	$ 5,913

The troubled debt restructurings described above increased the allowance for loan losses by $127 and resulted in charge offs of $13 during the year ended December 31, 2011.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within the twelve months following the modification during the years ended December 31, 2012 and 2011:

	2 0 1 2		2 0 1 1	
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Residential	1	39	3	$ 305
Home equity	-	-	1	74
Commercial real estate	3	420	6	859
Residential construction	-	-	-	-
Commercial construction	-	-	-	-
Commercial	-	-	1	151
Other	-	-	1	5
Total	4	$ 459	12	$ 1,394

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

The troubled debt restructurings that subsequently defaulted described above did not materially increase the allowance for loan losses during the year ended December 31, 2011 or 2012. These did not result in material charge offs during the year ended December 31, 2011 and there was one chargeoff for $100 during the year ended December 31, 2012.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under Bancorp's internal underwriting policy.

(Continued)

(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, 2012 and 2011, 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
2012						
Residential 1-4 family	$ 16,892	$ 1,017	$ 6,077	$ -	$ 71,175	$ 95,161
Home equity	4,073	35	-	-	40,080	44,188
Commercial real estate	65,397	6,970	9,916	-	3,126	85,409
Residential construction	27	117	-	-	84	228
Commercial construction	-	-	-	-	-	-
Commercial	16,523	735	141	-	7,377	24,776
Consumer	461	8	70	-	4,172	4,711
Total	$ 103,373	$ 8,882	$ 16,204	$ -	$ 126,014	$ 254,473

(Continued)

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

NOTE 3 – LOANS (Continued)

	Pass	Special Mention	Substandard	Doubtful	Not Rated	Total
2011						
Residential 1-4 family	$ 17,006	$ 5,438	$ 1,740	$ -	$ 61,602	$ 85,786
Home equity	3,610	74	-	-	43,396	47,080
Commercial real estate	68,645	6,778	11,898	-	950	88,271
Residential construction	109	-	-	-	1,443	1,552
Commercial construction	-	-	2,495	-	-	2,495
Commercial	18,004	2,467	519	-	8,265	29,255
Consumer	420	10	-	-	3,929	4,359
Total	$ 107,794	$ 14,767	$ 16,652	$ -	$ 119,585	$ 258,798

NOTE 4 – PREMISES AND EQUIPMENT

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

	2012	2011
Land	$ 1,312	$ 1,872
Land improvements	153	159
Office buildings	8,355	8,355
Furniture, fixtures and equipment	5,197	5,117
Total premises and equipment	15,017	15,503
Less accumulated depreciation	(7,973)	(7,648)
Net carrying amount	$ 7,044	$ 7,855

Depreciation expense for the years ended December 31, 2012 and 2011 amounted to $473 and $487, 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 $183,637 and $195,518 at December 31, 2012 and 2011, respectively.

The fair values of the rights to service these loans were $1,378 and $1,572 at December 31, 2012 and 2011. The fair value of servicing rights at December 31, 2012 was determined using a discount rate of 8% and prepayment speeds ranging from 173 PSA to 715 PSA. The fair value of servicing rights at December 31, 2011 was determined using a discount rate of 8% and prepayment speeds ranging from 176 PSA to 694 PSA.

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

NOTE 5 – SERVICING (Continued)

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

	2012	2011
Mortgage servicing rights:		
Balance at beginning of year	$ 1,279	$ 1,381
Mortgage servicing rights capitalized	466	230
Mortgage servicing rights amortized	(240)	(208)
Change in valuation allowance	(232)	(124)
Balance at end of year	$ 1,273	$ 1,279
Valuation allowance:		
Balance at beginning of year	$ 139	$ 15
Additions	231	150
Reductions	-	(26)
Write-downs	-	-
Balance at end of year	$ 370	$ 139

NOTE 6 – REAL ESTATE AND OTHER INVESTMENTS

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. The remaining asset at December 31, 2012 is $182.

During 2003, Bancorp committed to an investment for $250 in a venture capital limited partnership. Advances on this commitment totaled $10 and $10 during the years ended December 31, 2012 and 2011, respectively. At December 31, 2012, $30 remains committed to the purchases of this investment. There were no distributions from the venture capital limited partnership in 2012 and 2011. Bancorp owns approximately 1.23% of this venture capital limited partnership.

During 2008, Bancorp committed to purchase another investment for $250 in a venture capital limited partnership. Advances on this commitment totaled $39 and $19 during the years ended December 31, 2012 and 2011, respectively. At December 31, 2012, $143 remains committed to the purchases of this investment. There were no distributions from this venture capital limited partnership in 2012 and 2011. Bancorp owns approximately 0.95% of this venture capital limited partnership.

(Continued)

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

NOTE 6 – REAL ESTATE AND OTHER INVESTMENTS (Continued)

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 $515 in cash, of which $151 was paid in 2011 and $303 was paid in 2012. 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.

In November 2012, Bancorp acquired 4.546% 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 $61 was paid in 2012. 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 $150 in 2012 and $125 in 2011.

In May 2010, Bancorp funded an investment vehicle for a non-profit foundation located in Memphis, Tennessee for approximately $500. This investment, which is a loan collateralized by a foundation investment security, was formed to strengthen security for housing of retired military veterans and also earn Community Reinvestment Act credit for the Bank. Bancorp invested $500 in cash and will be repaid with accrued interest in 2017.

NOTE 7 – DEPOSITS

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

	2012	2011
Savings accounts	$ 70,562	$ 70,200
NOW accounts	60,571	61,828
Time:		
$100,000 and over	17,053	16,941
Under $100,000	45,476	51,988
	$ 193,662	$ 200,957

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

NOTE 7 – DEPOSITS (Continued)

At December 31, 2012, the scheduled maturities of time deposits are as follows:

Maturing in the Year Ending December 31,	Under $100,000	$100,000 and Over
2013	$ 18,647	$ 8,631
2014	9,973	3,098
2015	4,199	1,178
2016	3,046	231
2017	4,299	1,307
Thereafter	5,312	2,608
	$ 45,476	$ 17,053

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 at December 31, 2012 and 2011, which mature through 2017. At December 31, 2012 and 2011, the interest rates ranged from 2.56% to 5.24%. The advances are subject to prepayment penalties as defined in the credit policy of FHLB.

The advances are collateralized by performing non-employee residential and commercial mortgage loans. The unpaid principal balance of pledged loans was approximately $103,876 and $91,035 at December 31, 2012 and 2011, respectively.

Annual payments of FHLB advances are as follows:

2015	$ 25,500
2016	2,500
2017	20,500
	$ 48,500

During 2009, Bancorp obtained an open-end line of credit with a financial institution for $5,000 to refinance a $3,000 closed-end line of credit with another financial institution, which had been obtained in 2008. The outstanding balance on the line of credit was $3,000 at December 31, 2011, when the variable interest rate on the line of credit was 4.00%. During 2012, Bancorp refinanced the $3,000 line of credit and another $1,000 of short-term debt with a 10-year amortizing loan for $4,000, with a balloon payoff at maturity in July 2015. The outstanding balance of the loan was $3,940 at December 31, 2012. The fixed interest rate on the loan was 3.55% at December 31, 2012.

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

NOTE 9 – REPURCHASE AGREEMENTS

Bancorp had no repurchase agreements at December 31, 2012 and 2011. During 2011, repurchase agreements were secured by available for sale mortgage-backed securities held by a third-party trustee.

These agreements at December 31, 2010 were variable rate financing arrangements that were scheduled to mature in 2013. At maturity, the securities underlying the agreements were to be returned to Bancorp. During 2011, Bancorp elected early extinguishment of the repurchase agreement. The prepayment penalty on early extinguishment of debt in 2011 was $195.

Information concerning repurchase agreements is summarized as follows:

	2012	2011
Average daily balance during the year	$ -	$ 14,526
Average interest rate during the year	N/A	0.47%
Maximum month-end balance during the year	-	25,000
Weighted average interest rate at year end	N/A	N/A

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:

	2012	2011
Current expense	$ 215	$ (229)
Deferred expense	289	32
	$ 504	$ (197)

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:

	2012	2011
Amount computed at statutory rate	$ 805	$ 103
Tax-exempt income from Bank-owned life insurance	(96)	(95)
Tax-exempt interest income	(54)	(59)
Low-income housing tax credits	(150)	(125)
Other, net	(1)	(21)
	$ 504	$ (197)

(Continued)

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

NOTE 10 – FEDERAL INCOME TAXES (Continued)

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

	2012	2011
Deferred tax assets:		
Allowance for loan losses	$ 1,393	$ 1,696
Unfunded pension liability	28	39
Deferred compensation	247	215
Low-Income housing tax credits	304	108
Alternative minimum tax credits	20	20
Nonaccrual interest income	105	224
Other real estate	288	324
Other	104	96
	2,489	2,722
Deferred tax liabilities:		
Deferred loan fees	(64)	(96)
Mortgage servicing rights	(437)	(438)
Amortization	(1,557)	(1,431)
Depreciation	(288)	(301)
FHLB stock dividends	(138)	(138)
Unrealized gain on available-for-sale securities	(4)	-
Other	(107)	(120)
	(2,595)	(2,524)
Net deferred tax asset (liability)	$ (106)	$ 198

At December 31, 2012, Bancorp has a low income housing tax credit carryforward of $304 that begin to expire if unused in the year 2029.

Bancorp and its subsidiaries are subject to U.S. federal income tax as well as income tax to the state of Indiana. Bancorp is no longer subject to examination by taxing authorities for years before 2009.

There were no unrecognized tax benefits at December 31, 2012 and Bancorp does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months.

For the years ended 2012 and 2011, interest and penalties related to income tax matters were not material.

(Continued)

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

NOTE 11 – RETIREMENT BENEFITS

The Bancorp participates in the Pentegra Defined Benefit Plan for Financial Institutions (Pentegra DB Plan), which is a tax-qualified, multi-employer defined benefit pension plan, covering 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 the Plan 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 Pentegra DB Plan's Employee Identification Number is 13-5645888 and the Plan Number is 333.

The Pentegra DB Plan is a single plan under Internal Revenue Code Section 413(c) and, as a result, all of the assets stand behind all of the liabilities. Accordingly, under the Pentegra DB Plan, contributions made by a participating employer may be used to provide benefits to participants of other participating employers. Total contributions received by the Pentegra DB Plan, as reported on Form 5500, for the plan years ending June 30, 2011 and 2010 totaled $299,729 and $203,582, respectively.

Employer contributions and administrative expenses charged to operations for the years ended December 31, 2012 and 2011 totaled $166 and $365, respectively. Our contribution for 2012 and 2011 was not more than 5% of the total contributions made to the Pentegra DB Plan. There are no collective bargaining agreements in place that require contributions to the plan. The funded status of the plan as of July 1, 2012 and 2011 was 110% and 89%, respectively.

The Bancorp 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, 2012 and 2011.

	2012	2011
Plan assets at fair value	$ -	$ -
Projected benefit obligation	802	746
Underfunded status	$ (802)	$ (746)
Accumulated benefit obligation	$ 461	$ 402

(Continued)

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

NOTE 11 – RETIREMENT BENEFITS (Continued)

Components of Net Periodic Benefit Cost:

	2012	2011
Service cost	$ 37	$ 37
Interest cost	47	43
Amortization of prior service cost	10	10
Amortization of net (gain) loss	(2)	(2)
Net periodic benefit cost	92	88
Prior service cost (credit)	(29)	-
Amortization of prior service cost	-	(9)
Total recognized in other comprehensive income	(29)	(9)
Total recognized in net periodic benefit cost and other comprehensive income	$ 63	$ 79

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

	2012	2011
Net actuarial loss (gain)	$ (58)	$ (32)
Prior service cost (credit)	139	149
Underfunded status	$ 81	$ 117
Actuarial assumptions:		
Weighted average discount rate	6.50%	6.50%
Increase in future compensation levels	4.00	4.00

The Bancorp does not expect to contribute to the plan in 2013.

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, 2013 are not significant.

To fund the DB obligation and other employee benefits, Bancorp has purchased insurance policies on the lives of certain officers of the Bank. Bancorp is owner and beneficiary of these policies. At December 31, 2012 and 2011, the cash value of all bank-owned life insurance policies was $9,259 and $8,976, respectively. The cash value is available to fund future benefit obligations. There were no supplemental retirement benefits paid by the DB during 2012 or 2011. The Bancorp does not anticipate paying benefits in connection with this plan over the next 7 years, with $29 anticipated to be paid in 2020 and $50 anticipated to be paid in 2021.

(Continued)

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

NOTE 12 – 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.

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, 2012 and 2011, the Bank met all minimum capital requirements to which it was subject. During 2011, the Bank agreed with its primary regulator to maintain Tier 1 capital (to adjusted total assets) equal to or exceeding 8%.

At December 31, 2012 and 2011, 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, 2012 that management believes have changed the Bank's well-capitalized status.

The Bank's actual capital amounts and ratios at December 31, 2012 and 2011 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, 2012						
Total capital (to risk weighted assets)	$ 30,125	13.7%	$ 17,533	8.0%	$ 21,916	10.0%
Tier 1 capital (to risk weighted assets)	27,356	12.5	8,767	4.0	13,150	6.0
Tier 1 capital (to adjusted total assets)	27,356	8.8	12,412	4.0	15,515	5.0
December 31, 2011						
Total capital (to risk weighted assets)	$ 28,321	12.4%	$ 18,199	8.0%	$ 22,748	10.0%
Tier 1 capital (to risk weighted assets)	25,439	11.2	9,099	4.0	13,649	6.0
Tier 1 capital (to adjusted total assets)	25,439	8.0	12,664	4.0	15,830	5.0

NOTE 13 – 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.

(Continued)

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

NOTE 13 – OFF-BALANCE-SHEET ACTIVITIES (Continued)

At December 31, 2012 and 2011, the following financial instruments with credit risk were outstanding:

	2012	2011
Commitments to grant loans	$ 4,479	$ 300
Unfunded commitments under lines of credit	35,145	36,854
Commercial and standby letters of credit	-	920

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 14 – 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, 2012 and 2011 is as follows:

	2012	2011
Related party loans - beginning of the year	$ 2,176	$ 2,192
Advances	1,265	213
Principal repayments	(1,179)	(229)
Related party loans – end of the year	$ 2,262	$ 2,176

Deposits from related parties held by the Bank at December 31, 2012 and 2011 approximated $4,205 and $829, 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 $177 and $239 for 2012 and 2011, respectively.

NOTE 15 – 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).

Impaired Loans: 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 independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually. 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 independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

(Continued)

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

NOTE 15 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Appraisals for both collateral-dependent impaired loans and real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Bancorp. Once received, an officer reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, the Bancorp compares the actual selling price of collateral that has been sold to the most recent appraised value to determine what additional adjustment should be made to the appraisal value to arrive at fair value.

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

		Fair Value Measurements at December 31, 2012 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				
Obligations of states and political subdivisions	$ 1,242	$ -	$ 1,242	$ -
Total investment securities available-for-sale	$ 1,242	$ -	$ 1,242	$ -
Loans held for sale	$ 2,261	$ -	$ 2,261	$ -

		Fair Value Measurements at December 31, 2011 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				
Obligations of states and political subdivisions	$ 265	$ -	$ 265	$ -
Total investment securities available-for-sale	$ 265	$ -	$ 265	$ -
Loans held for sale	$ 986	$ -	$ 986	$ -

(Continued)

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

NOTE 15 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Financial Instruments Recorded Using Fair Value Option

The Bancorp has elected the fair value option for loans held for sale. These loans are intended for sale and the Bancorp believes the fair value is the best indicator of the resolution of these loans. Interest income is recorded based on the contractual terms of the loan and in accordance with the Bancorp's policy on loans held for investment. None of these loans are 90 days or more past due or on nonaccrual as of December 31, 2012 and 2011.

As of December 31, 2012 and 2011, the aggregate fair value, contractual balance (including accrued interest), and gain or loss was as follows:

	2012	2011
Aggregated fair value	$ 2,261	$ 986
Contractual balance	2,225	965
Gain (loss)	36	21

The total amount of gains and losses from changes in fair value included in earnings for the years ended December 31, 2012 and 2011 for loans held for sale were:

	2012	2011
Interest income	$ 57	$ 67
Interest expense	-	-
Change in fair value	15	26

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

		Fair Value Measurements at December 31, 2012 Using:		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Real estate owned:				
Residential	$ 830	$ -	$ -	$ 830
Commercial real estate	403	-	-	403

(Continued)

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

NOTE 15 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

		Fair Value Measurements at December 31, 2011 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	$ 121	$ -	$ -	$ 121
Home equity	36	-	-	36
Commercial real estate	1,590	-	-	1,590
Residential construction	-	-	-	-
Commercial construction	190	-	-	190
Commercial	205	-	-	205
Consumer	-	-	-	-
Total impaired loans	$ 2,142	$ -	$ -	$ 2,142
Real estate owned:				
Residential	$ 1,491	$ -	$ -	$ 1,491
Commercial real estate	315	-	-	315

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 $0 at December 31, 2012, with a valuation allowance of $0, resulting in an additional provision for loan losses of $0 for the year ended December 31, 2012. At December 31, 2011, impaired loans had a carrying amount of $2,616, with a valuation allowance of $237, resulting in an additional provision for loan losses of $65 for the year ended December 31, 2011.

Real estate owned, which is measured at the lower of carrying or fair value less costs to sell, had a net carrying amount of $1,252, of which $1,233 is at fair value at December 31, 2012, resulting in a write-down of $231 for the year ended December 31, 2012. At December 31, 2011, real estate owned had a net carrying amount of $2,082, of which $1,806 is at fair value at December 31, 2011, resulting in a write-down of $36 for the year ended December 31, 2011.

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.

NOTE 15 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

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.

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.

(Continued)

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

NOTE 15 – FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

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

	2012		2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	$ 19,848	$ 19,848	$ 22,740	$ 22,740
Interest-earning deposits in banks	12,196	12,501	4,760	4,910
FHLB stock	4,064	N/A	4,064	N/A
Loans in portfolio, net (including impaired)	248,520	250,686	252,001	253,190
Accrued interest receivable	1,328	1,328	1,191	1,191
Financial liabilities:				
Deposits	$ 234,923	$ 232,664	$ 234,599	$ 233,925
Accrued interest payable	333	333	344	344
FHLB advances and other borrowings	52,440	56,161	52,575	55,816

NOTE 16 – 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 17 – 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, 2012, the Bank's retained earnings available for the payment of dividends was $4,598. Accordingly, approximately $26,287 of Bancorp's investment in the Bank was restricted at December 31, 2012. The Bank has also agreed with its primary regulator not to pay dividends to the Bancorp without the regulator's consent.

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.