

# 2016

AUDITED  
FINANCIAL  
STATEMENTS

PSB Holdings, Inc.

Wausau, Wisconsin

Consolidated Financial Statements  
Years Ended December 31, 2016, 2015, and 2014





## Independent Auditor's Report

Board of Directors  
PSB Holdings, Inc.  
Wausau, Wisconsin

We have audited the accompanying consolidated financial statements of PSB Holdings, Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2016 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 financial statements in accordance with accounting principles generally accepted in the United States; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of 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 financial statements based on our audits. We conducted our audits of the December 31, 2016 and 2015 financial statements in accordance with auditing standards generally accepted in the United States. We conducted our audit of the December 31, 2014 financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). These standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 PSB Holdings, Inc. and Subsidiary as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2016 in accordance with accounting principles generally accepted in the United States.

A handwritten signature in black ink that reads "Wipfli LLP".

Wipfli LLP

February 24, 2017  
Madison, Wisconsin

**Consolidated Balance Sheets**  
**December 31, 2016 and 2015**  
(dollars in thousands except per share data)

<i>Assets</i>	<b>2016</b>	<b>2015</b>
Cash and due from banks	\$ 24,126	\$ 13,359
Interest-bearing deposits	1,051	1,084
Federal funds sold	9,817	33,604
Cash and cash equivalents	34,994	48,047
Securities available for sale (at fair value)	94,568	83,306
Securities held to maturity (fair value of \$70,947 and \$72,866, respectively)	71,436	71,545
Bank certificates of deposit (at cost)	3,472	9,178
Loans held for sale	802	-
Loans receivable, net of allowance for loan losses	586,109	535,325
Accrued interest receivable	2,189	2,072
Foreclosed assets	373	1,378
Premises and equipment, net	10,427	10,927
Mortgage servicing rights, net	1,943	1,757
Federal Home Loan Bank stock (at cost)	1,861	2,556
Cash surrender value of bank-owned life insurance	14,247	13,981
Other assets	5,107	4,338
<b>TOTAL ASSETS</b>	<b>\$ 827,528</b>	<b>\$ 784,410</b>
<i>Liabilities and Stockholders' Equity</i>		
Deposits:		
Non-interest-bearing	\$ 143,206	\$ 126,669
Interest-bearing	543,554	539,507
Total deposits	686,760	666,176
Federal Home Loan Bank advances	37,769	22,042
Other borrowings	14,860	11,527
Senior subordinated notes	2,500	3,500
Junior subordinated debentures	7,732	7,732
Accrued expenses and other liabilities	8,855	8,348
Total liabilities	758,476	719,325
Stockholders' equity:		
Preferred stock - No par value:		
Authorized - 30,000 shares; no shares issued or outstanding		
Common stock - No par value with a stated value of \$1 per share:		
Authorized - 6,000,000 shares		
Issued - 1,830,266 shares	1,830	1,830
Outstanding - 1,525,843 and 1,576,034 shares, respectively		
Additional paid-in capital	7,208	7,100
Retained earnings	71,025	63,968
Accumulated other comprehensive income (loss), net of tax	(741)	96
Treasury stock, at cost - 304,423 and 254,232 shares, respectively	(10,270)	(7,909)
Total stockholders' equity	69,052	65,085
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 827,528</b>	<b>\$ 784,410</b>

See accompanying notes to consolidated financial statements.

**Consolidated Statements of Income**  
**Years Ended December 31, 2016, 2015, and 2014**  
(dollars in thousands except per share data)

	2016	2015	2014
Interest and dividend income:			
Loans, including fees	\$24,839	\$23,240	\$22,634
Securities:			
Taxable	2,486	2,548	2,398
Tax-exempt	1,465	1,508	1,504
Other interest and dividends	127	76	82
<b>Total interest and dividend income</b>	<b>28,917</b>	<b>27,372</b>	<b>26,618</b>
Interest expense:			
Deposits	2,768	2,697	2,835
Federal Home Loan Bank advances	461	269	601
Other borrowings	245	242	560
Senior subordinated notes	103	141	150
Junior subordinated debentures	343	342	340
<b>Total interest expense</b>	<b>3,920</b>	<b>3,691</b>	<b>4,486</b>
Net interest income	24,997	23,681	22,132
Provision (credit) for loan losses	55	(530)	560
<b>Net interest income after provision (credit) for loan losses</b>	<b>24,942</b>	<b>24,211</b>	<b>21,572</b>
Noninterest income:			
Service fees	1,561	1,591	1,656
Residential mortgage banking, net	2,040	1,725	1,373
Investment and insurance sales commissions	953	1,000	946
Net gain on sale of securities	-	-	3
Increase in cash surrender value of bank-owned life insurance	401	401	404
Gain on life insurance death benefits received	380	-	-
Other operating income	1,634	1,431	1,312
<b>Total noninterest income</b>	<b>6,969</b>	<b>6,148</b>	<b>5,694</b>
Noninterest expense:			
Salaries and employee benefits	11,837	11,089	9,879
Occupancy and facilities	1,761	1,884	1,828
Loss on foreclosed assets	49	206	233
Data processing and other office operations	2,213	2,137	2,224
Advertising and promotion	371	363	376
FDIC insurance premiums	316	472	523
Other operating expense	2,958	2,730	2,857
<b>Total noninterest expense</b>	<b>19,505</b>	<b>18,881</b>	<b>17,920</b>
Income before income taxes	12,406	11,478	9,346
Provision for income taxes	3,970	3,729	2,906
<b>Net income</b>	<b>\$ 8,436</b>	<b>\$ 7,749</b>	<b>\$ 6,440</b>
<b>Basic earnings per share</b>	<b>\$ 5.48</b>	<b>\$ 4.83</b>	<b>\$ 3.90</b>
<b>Diluted earnings per share</b>	<b>\$ 5.48</b>	<b>\$ 4.83</b>	<b>\$ 3.90</b>

See accompanying notes to consolidated financial statements.

**Consolidated Statements of Comprehensive Income**  
**Years Ended December 31, 2016, 2015, and 2014**  
(dollars in thousands except per share data)

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Net income	\$8,436	\$7,749	\$6,440
Other comprehensive income (loss), net of tax:			
Unrealized gain (loss) on securities available for sale	(801)	(414)	420
Reclassification adjustment for net gain on sale of securities, included in net income	-	-	(2)
Amortization of unrealized gain on securities available for sale transferred to securities held to maturity	(114)	(189)	(200)
Unrealized loss on interest rate swap	(16)	(50)	(44)
Reclassification adjustment of interest rate swap settlements included in earnings	94	112	114
Other comprehensive income (loss)	(837)	(541)	288
Comprehensive income	\$7,599	\$7,208	\$6,728

See accompanying notes to consolidated financial statements.

**Consolidated Statements of Changes in Stockholders' Equity**  
**Years Ended December 31, 2016, 2015, and 2014**  
(dollars in thousands except per share data)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Totals
Balance, January 1, 2014	\$1,830	\$6,967	\$52,432	\$349	(\$4,825)	\$56,753
Net income			6,440			6,440
Other comprehensive income				288		288
Purchase of treasury stock					(913)	(913)
Grants of restricted stock		(173)			173	-
Vesting of restricted stock		203				203
Directors fees paid in grants of stock					6	6
Cash dividends declared \$.80 per share			(1,288)			(1,288)
Cash dividends declared on unvested restricted stock			(28)			(28)
<b>Balance, December 31, 2014</b>	<b>\$1,830</b>	<b>\$6,997</b>	<b>\$57,556</b>	<b>\$637</b>	<b>(\$5,559)</b>	<b>\$61,461</b>

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Totals
Balance, December 31, 2014 (brought forward)	\$1,830	\$6,997	\$57,556	\$637	(\$5,559)	\$61,461
Net income			7,749			7,749
Other comprehensive loss				(541)		(541)
Purchase of treasury stock					(2,490)	(2,490)
Grants of restricted stock		(157)			157	-
Vesting of restricted stock		216				216
Forfeiture of unvested restricted stock grants		38			(38)	-
Directors fees paid in grants of stock		6			21	27
Cash dividends declared \$.84 per share			(1,314)			(1,314)
Cash dividends declared on unvested restricted stock			(23)			(23)
<b>Balance, December 31, 2015</b>	<b>\$1,830</b>	<b>\$7,100</b>	<b>\$63,968</b>	<b>\$ 96</b>	<b>(\$7,909)</b>	<b>\$65,085</b>

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Totals
Balance, December 31, 2015 (brought forward)	\$1,830	\$7,100	\$63,968	\$96	(\$7,909)	\$65,085
Net income			8,436			8,436
Other comprehensive loss				(837)		(837)
Purchase of treasury stock					(2,554)	(2,554)
Grants of restricted stock		(155)			155	-
Vesting of restricted stock		249				249
Directors fees paid in grants of stock		14			38	52
Cash dividends declared \$.90 per share			(1,355)			(1,355)
Cash dividends declared on unvested restricted stock			(24)			(24)
<b>Balance, December 31, 2016</b>	<b>\$1,830</b>	<b>\$7,208</b>	<b>\$71,025</b>	<b>(\$741)</b>	<b>(\$10,270)</b>	<b>\$69,052</b>

See accompanying notes to consolidated financial statements.

**Consolidated Statements of Cash Flows**  
**Years Ended December 31, 2016, 2015, and 2014**  
(dollars in thousands except per share data)

	2016	2015	2014
Increase (decrease) in cash and cash equivalents:			
Cash flows from operating activities:			
Net income	\$ 8,436	\$ 7,749	\$ 6,440
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for depreciation and net amortization	2,448	2,477	2,262
Benefit for deferred income taxes	(293)	(342)	(93)
Provision (credit) for loan losses	55	(530)	560
Deferred net loan origination costs	(172)	(488)	(417)
Proceeds from sales of loans held for sale	66,345	65,780	41,591
Originations of loans held for sale	(65,978)	(64,742)	(40,882)
Gain on sale of loans	(1,771)	(1,564)	(1,047)
Provision for (recapture of) mortgage servicing rights valuation allowance	(75)	90	19
Net (gain) loss on sale of premises and equipment	(17)	18	57
Realized gain on sale of securities available for sale	-	-	(3)
Net loss on sale and provision for write-down of foreclosed assets	22	73	65
Increase in cash surrender value of bank-owned life insurance	(401)	(401)	(404)
Gain on life insurance death benefits received	(380)	-	-
Changes in operating assets and liabilities:			
Accrued interest receivable	(117)	2	50
Other assets	131	231	80
Accrued expenses and other liabilities	688	848	757
<b>Net cash provided by operating activities</b>	<b>8,921</b>	<b>9,201</b>	<b>9,035</b>
Cash flows from investing activities:			
Proceeds from maturities of securities available for sale	18,317	16,823	15,606
Proceeds from sale of securities available for sale	-	-	1,774
Proceeds from maturities of securities held to maturity	8,570	7,405	5,225
Payment for purchase of securities available for sale	(31,354)	(26,752)	(29,710)
Payment for purchase of securities held to maturity	(8,909)	(9,743)	(3,965)
Cash acquired on branch acquisition	-	-	17,741
Net redemption (net purchase) of bank certificates of deposit	5,706	(5,754)	(1,188)
Net redemption of FHLB stock	695	-	-
Net (increase) decrease in loans	(50,985)	(10,318)	4,339
Capital expenditures	(289)	(939)	(595)
Proceeds from sale of premises and equipment	19	57	7
Life insurance death benefits received	515	-	-
Proceeds from sale of foreclosed assets	1,030	1,439	782
Purchase of bank-owned life insurance	-	(350)	-
<b>Net cash provided by (used in) investing activities</b>	<b>(56,685)</b>	<b>(28,132)</b>	<b>10,016</b>



**Consolidated Statements of Cash Flows (Continued)**  
**Years Ended December 31, 2016, 2015, and 2014**  
(dollars in thousands except per share data)

	<b>2016</b>	<b>2015</b>	<b>2014</b>
<b>Cash flows from financing activities:</b>			
Net increase in non-interest-bearing deposits	\$ 16,537	\$ 11,866	\$ 8,269
Net increase (decrease) in interest-bearing deposits	4,047	31,359	(3,612)
Net increase (decrease) in Federal Home Loan Bank advances	15,727	1,771	(17,778)
Net increase (decrease) in other borrowings	3,333	1,203	(10,117)
Repayment of senior subordinated notes	(1,000)	(500)	-
Dividends declared	(1,379)	(1,337)	(1,316)
Purchase of treasury stock	(2,554)	(2,490)	(913)
<b>Net cash provided by (used in) financing activities</b>	<b>34,711</b>	<b>41,872</b>	<b>(25,467)</b>
Net increase (decrease) in cash and cash equivalents	(13,053)	22,941	(6,416)
Cash and cash equivalents at beginning	48,047	25,106	31,522
<b>Cash and cash equivalents at end</b>	<b>\$ 34,994</b>	<b>\$ 48,047</b>	<b>\$ 25,106</b>
<b>Supplemental cash flow information:</b>			
Cash paid during the year for:			
Interest	\$ 3,753	\$ 3,556	\$ 4,632
Income taxes	3,849	3,995	2,560
<b>Noncash investing and financing activities:</b>			
Loans charged off	\$ 360	\$ 809	\$ 969
Loans transferred to foreclosed assets	594	1,309	801
Loans originated on sale of foreclosed properties	547	80	43
Grants of unvested restricted stock at fair value	220	200	200
Vesting of restricted stock grants	249	216	203
Amortization of unrealized gain on securities held to maturity transferred from securities available for sale	188	312	330

See accompanying notes to consolidated financial statements.

## **Notes to Consolidated Financial Statements (dollars in thousands except per share data)**

### **NOTE 1            Summary of Significant Accounting Policies**

#### **Principal Business Activity**

PSB Holdings, Inc. operates Peoples State Bank (the “Bank”), a full-service financial institution chartered as a Wisconsin commercial bank with nine locations in a primary service area including Marathon, Oneida, and Vilas counties in Wisconsin in addition to one loan production office serving the Milwaukee, Wisconsin area. PSB operates as a community bank and provides a full range of traditional retail consumer and commercial banking products, including uninsured investment and insurance products, long-term fixed-rate residential mortgages, and commercial treasury management services.

#### **Principles of Consolidation**

The consolidated financial statements include the accounts of PSB Holdings, Inc. and its subsidiary, Peoples State Bank. Peoples State Bank owns and operates a Nevada subsidiary, PSB Investments, Inc., to manage the Bank’s investment securities. All significant intercompany balances and transactions have been eliminated. The accounting and reporting policies of PSB conform to accounting principles generally accepted in the United States (GAAP) and to the general practices within the banking industry. Any reference to “PSB” refers to the consolidated or individual operations of PSB Holdings, Inc. and its subsidiary, Peoples State Bank.

#### **Use of Estimates in Preparation of Financial Statements**

The preparation of the consolidated financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Estimates that are susceptible to significant change include the determination of the allowance for loan losses, mortgage servicing rights assets, and the valuation of investment securities.

#### **Cash Equivalents**

For purposes of reporting cash flows in the consolidated financial statements, cash and cash equivalents include cash and due from banks, interest-bearing deposits, money market funds, and federal funds sold, all of which have original maturities of three months or less.

#### **Securities**

Securities are assigned an appropriate classification at the time of purchase in accordance with management’s intent. 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. Amortization of the net unrealized gain on securities held to maturity that were transferred from securities available for sale is recognized in other comprehensive income using the interest method over the estimated lives of the securities. Securities not classified as securities held to maturity are considered available for sale and reported at fair value determined from estimates of brokers or other sources. Unrealized gains and losses are excluded from earnings but are reported as other comprehensive income, net of income tax effects. Amortization of premiums and accretion of discounts is recognized in interest income using the interest method over the estimated lives of the securities.

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

Declines in fair value of securities that are deemed to be other than temporary, if applicable, are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers the length of time and the extent to which fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of PSB to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

#### **Loans Held for Sale**

PSB sells substantially all 20- and 30-year long-term fixed-rate single-family mortgage loans and most 15-year fixed-rate mortgage loans it originates to the secondary market. The gain or loss associated with sales of single-family mortgage loans is recorded as a component of residential mortgage banking revenue.

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net unrealized losses are recognized through a valuation allowance by charges to income. Gains and losses on the sale of loans held for sale are determined using the specific identification method using quoted market prices.

## **Notes to Consolidated Financial Statements (dollars in thousands except per share data)**

For sales of mortgage loans to the Federal Home Loan Bank (FHLB) prior to 2009, PSB retained a secondary portion of the credit risk on the underlying loans in exchange for a credit enhancement fee. When applicable, PSB records a recourse liability to provide for potential credit losses. PSB also provides representations and warranties regarding all originated loans sold to secondary market buyers including the FHLB and the Federal National Mortgage Association (FNMA). These representations and warranties can lead to additional credit risk for which PSB records a recourse liability. Because the loans involved in these transactions are similar to those in PSB's loans held for investment, the review of the adequacy of the recourse liability is similar to the review of the adequacy of the allowance for loan losses (refer to "Allowance for Loan Losses").

### **Loans**

Loans that management has the intent to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest on loans is credited to income as earned. Interest income is not accrued on loans where management has determined collection of such interest is doubtful or those loans which are past due 90 days or more as to principal or interest payments. When a loan is placed on nonaccrual status, previously accrued but unpaid interest deemed uncollectible is reversed and charged against current income. After being placed on nonaccrual status, additional income is recorded only to the extent that payments are received and the collection of principal becomes reasonably assured. Interest income recognition on loans considered to be impaired is consistent with the recognition on all other loans.

Loan origination fees and certain direct loan origination costs are deferred and recognized as an adjustment of the related loan yield using the interest method.

### **Allowance for Loan Losses**

The allowance for loan losses is a valuation allowance for probable incurred credit losses. 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. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that PSB will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings (TDRs) and classified as impaired.

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

Loans that are not collectively evaluated for impairment are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan net of the specific allocation equals the present value of estimated future cash flows using the loan's existing rate or the fair value of underlying collateral less applicable estimated selling costs if repayment is expected solely from the collateral.

TDRs are individually evaluated for impairment and included in the separately identified impairment disclosures. TDRs are measured at the present value of estimated future cash flows using the loan's original effective rate. If a TDR is considered to be a collateral dependent loan, the loan is measured at the fair value of the collateral less applicable estimated selling costs. For TDRs that subsequently default, PSB determines the amount of the allowance on that loan in accordance with the accounting policy for the allowance for loan losses on loans individually identified as impaired.

The general component covers loans that are collectively evaluated for impairment. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment and, accordingly, they are not included in the separately identified impairment disclosures. The general allowance component also includes loans that are not individually identified for impairment evaluation, such as commercial loans below the individual evaluation threshold, as well as those loans that are individually evaluated but are not considered impaired.

## **Notes to Consolidated Financial Statements (dollars in thousands except per share data)**

The general component is based on historical loss experience adjusted for current qualitative factors. The historical loss experience is determined by portfolio segment or loan class and is based on the actual loss history experienced by PSB. This actual loss experience is supplemented with other external, economic, and internal factors based on the risks present for each portfolio segment or loan class. These additional factors include: national and local economic trends and conditions; trends in volume and terms of loans; trends in collateral fair values; changes in regulatory requirements; trends and changes in industry and peer credit performance; effects of any changes in risk selection and underwriting standards; other changes in lending policies, loan review, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; and effects of changes in credit concentrations.

Due to the added risks associated with loans which are graded as special mention or substandard that are not classified as impaired, an additional analysis is performed to determine whether an allowance is needed that is not fully captured by the historical loss experience. Historical loss experience by portfolio segment or loan class and migration of loans into higher risk classifications are considered, as well as the historical loss rates (or severity) of loans specifically classified as special mention, substandard, or doubtful and the trends in the underlying collateral included within these classifications.

Management considers the following when assessing risk in PSB's loan portfolio segments:

Commercial and industrial loans and agricultural loans are primarily for working capital, physical asset expansion, and asset acquisition loans. These loans are made based primarily on historical and projected cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not behave as forecasted and collateral securing loans may fluctuate in value due to economic or individual performance factors. Financial information is obtained from the borrowers to evaluate cash flows sufficiency to service debt and are periodically updated during the life of the loan. Municipal loans are primarily for equipment purchases or development infrastructure to be repaid out of applicable tax collections and usually represent general obligations of the municipality.

Commercial and agricultural real estate loans are dependent on the industries tied to these loans. Commercial real estate loans are primarily secured by owner and non-owner occupied office and industrial buildings, warehouses, small retail shopping facilities and various special purpose properties, including hotels and restaurants. Agricultural real estate loans are primarily for land acquisition. Financial information is obtained from the borrowers and/or the individual project to evaluate cash flow sufficiency to service debt and is periodically updated during the life of the loan. Loan performance may be adversely affected by factors impacting the general economy or conditions specific to the real estate market such as geographic location and/or property type. Commercial real estate loans also include multifamily loans to finance non-farm properties with five or more units in structures primarily to accommodate households on a temporary or permanent basis. Such credits are typically originated to finance the acquisition of an apartment or condominium building/complex. Multifamily loans are made based primarily on the historical and projected cash flow of the subject multifamily property, with assumptions made for vacancy rates. Cash flows and ultimate loan performance rely on the receipt of rental income from the tenants of the property who are themselves subject to fluctuations in national and local economic and unemployment trends.

Construction and land development loans are secured by vacant land and/or property that are in the process of improvement, including (a) land development preparatory to erecting vertical improvements or (b) the on-site construction of industrial, commercial, residential, or farm buildings. Repayment of these loans can be dependent on the sale of the property to third parties or the successful completion of the improvements by the builder for the end user. In the event a loan is made on property that is not yet improved for the planned development, there is the risk that necessary approvals will not be granted or will be delayed. Construction loans also run the risk that improvements will not be completed on time or in accordance with specifications and projected costs.

Residential real estate loans, including home equity lines of credit, are affected by the local residential real estate market, the local economy, and, for variable rate mortgages, movement in indices tied to these loans. At the time of origination, the Company evaluates the borrower's repayment ability through a review of debt to income and credit scores. Appraisals are obtained to support the loan amount. Financial information is obtained from the borrowers and/or the individual project to evaluate the sufficiency of cash flows to service debt at the time of origination.

Consumer and other loans may take the form of installment loans, demand loans, or single payment loans and are extended to individuals for household, family, and other personal expenditures. At the time of origination, the Company evaluates the borrower's repayment ability through a review of debt to income and credit scores.

### **Foreclosed Assets**

Real estate and other property acquired through, or in lieu of, loan foreclosure are initially recorded at fair value (after deducting estimated costs to sell) at the date of foreclosure, establishing a new cost basis. Costs related to development and improvement of property are capitalized, whereas costs related to holding property are expensed. After foreclosure, valuations are periodically performed by management, and the real estate or other property is carried at the lower of carrying amount or fair value less

## **Notes to Consolidated Financial Statements (dollars in thousands except per share data)**

estimated costs to sell. Revenue and expenses from operations and changes in any valuation allowance are included in loss on foreclosed assets.

### **Premises and Equipment**

Premises and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed principally on the straight-line method and is based on the estimated useful lives of the assets primarily from 15 to 40 years on buildings, 5 to 10 years on furniture and equipment, and 3 years on computer hardware and software. Maintenance and repair costs are charged to expense as incurred. Gains or losses on disposition of property and equipment are reflected in income.

### **Mortgage Servicing Rights**

PSB services the single-family mortgages it sells to the FHLB and FNMA. Servicing mortgage loans includes such functions as collecting monthly payments of principal and interest from borrowers, passing such payments through to third-party investors, maintaining escrow accounts for taxes and insurance, and making such payments when they are due. When necessary, servicing mortgage loans also includes functions related to the collection of delinquent principal and interest payments, loan foreclosure proceedings, and disposition of foreclosed real estate. PSB generally earns a servicing fee of 25 basis points (.25% annually) on the outstanding loan balance for performing these services as well as fees and interest income from ancillary sources such as delinquency charges and payment float. Servicing fee income is recorded as a component of mortgage banking revenue, net of the amortization and charges described in the following paragraphs.

PSB records originated mortgage servicing rights (OMSR) as a component of mortgage banking income when the obligation to service such loans has been retained. The initial value recorded for OMSR is based on the fair values of the servicing fee adjusted for expected future costs to service the loans, as well as income and fees expected to be received from ancillary sources, as previously described. The carrying value of OMSR is amortized against service fee income in proportion to estimated gross servicing revenues, net of estimated costs of servicing, adjusted for expected prepayments. In addition to this periodic amortization, the carrying value of OMSR associated with loans that actually prepay is also charged against servicing fee income as amortization. During periods of falling long-term interest rates, prepayments would likely accelerate, increasing amortization of existing OMSR against servicing fee income, and impair the value of OMSR as described below.

The carrying value of OMSR recorded in PSB's consolidated balance sheets ("mortgage servicing rights" or MSRs) is subject to impairment because of changes in loan prepayment expectations and in market discount rates used to value the future cash flows associated with such assets. In valuing MSRs, PSB stratifies the loans by year of origination, term of the loan, and range of interest rates within each term. If, based on a periodic evaluation, the estimated fair value of the MSRs related to a particular stratum is determined to be less than its carrying value, a valuation allowance is recorded against such stratum and against PSB's loan servicing fee income, which is included as a component of mortgage banking revenue. If the periodic evaluation of impairment calls for a valuation allowance less than currently recorded, the decrease in the valuation allowance is recaptured, offsetting amortization from loan prepayments during the period and increasing mortgage banking revenue. The valuation allowance is calculated using the current outstanding principal balance of the related loans, long-term prepayment assumptions as provided by independent sources, a market-based discount rate, and other management assumptions related to future costs to service the loans, as well as ancillary sources of income.

### **Federal Home Loan Bank Stock**

As a member of the FHLB system, PSB is required to hold stock in the FHLB of Chicago. The minimum stock investment is determined as a percentage of the amount of mortgage assets held on the balance sheet or the amount of advances borrowed from the FHLB. The stock is recorded at cost, which approximates the fair value. The stock is evaluated for impairment on an annual basis. Transfer of the stock is substantially restricted.

### **Bank-Owned Life Insurance**

PSB has purchased life insurance policies on certain officers. Bank-owned life insurance is recorded at its cash surrender value. Changes in cash surrender value and life insurance death benefits received in excess of policy cash surrender value are recorded in noninterest income.

### **Goodwill and Intangible Assets**

Intangible assets attributable to the value of core deposits are stated at cost less accumulated amortization. Intangible assets are amortized over the estimated lives of the assets using a double declining balance method. The excess of purchase price over fair value of net assets acquired (goodwill) is not amortized. PSB evaluates whether goodwill and other intangible assets may be impaired at least annually and whenever events or changes in circumstances indicate it is more likely than not the fair value of the asset is less than its carrying amount.

## **Notes to Consolidated Financial Statements (dollars in thousands except per share data)**

### **Retirement Plans**

PSB maintains a defined contribution 401(k) profit sharing plan which covers substantially all full-time employees.

### **Income Taxes**

Deferred income taxes have been provided under the liability method. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates which will be in effect when these differences are expected to reverse. Deferred tax expense is the result of changes in the deferred tax asset and liability and is a component of the provision for income taxes.

PSB may also recognize a liability for unrecognized tax benefits from uncertain tax positions. Unrecognized tax benefits represent the difference between a tax position taken or expected to be taken in a tax return and the benefit recognized and measured in the financial statements. Interest and penalties related to unrecognized benefits are recorded as additional income tax expense.

### **Advertising and Promotional Costs**

Costs relating to PSB's advertising and promotion are generally expensed when paid.

### **Derivative Instruments and Hedging Activities**

All derivative instruments are recorded at their fair values. If derivative instruments are designated as hedges of fair values, both the change in the fair value of the hedge and the hedged item are included in current earnings. Fair value adjustments related to cash flow hedges are recorded in other comprehensive income and reclassified to earnings when the hedged transaction is reflected in earnings. Ineffective portions of hedges are reflected in income. The fair value of derivative instruments is not offset against cash collateral paid to secure those instruments but is reflected as gross amounts outstanding on the consolidated balance sheets.

### **Rate Lock Commitments**

PSB enters into commitments to originate loans whereby the interest rate on the loan is determined prior to funding (rate lock commitments). Rate lock commitments on mortgage loans that are intended to be sold are considered to be derivatives. Rate lock commitments are recorded at fair value at period-end and classified as other assets on the consolidated balance sheets. Changes in the fair value of rate lock commitments during the period are reflected in the current period's income statement as mortgage banking income. The fair value of rate lock commitments includes the estimated gain on sale of the loan to the secondary market agency and the estimated value of OMSR on loans expected to be closed.

### **Fair Values of Financial Instruments**

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 22. 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. The fair value estimates of existing on- and off-balance-sheet financial instruments do not include the value of anticipated future business or the values of assets and liabilities not considered financial instruments.

### **Stock-Based Compensation**

PSB uses the fair value based method of accounting for employee stock compensation plans, whereby compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the service period, which is normally the vesting period.

### **Accumulated Other Comprehensive Income (Loss)**

PSB's accumulated other comprehensive income (loss) is composed of the unrealized gain (loss) on securities available for sale, net of tax, unrealized gain (loss) on interest rate swaps used for cash flow hedges after reclassification of settlements of the hedged item, net of tax, and unamortized unrealized gain on securities transferred to securities held to maturity from securities available for sale, net of tax, and is shown on the consolidated statements of changes in stockholders' equity.

## Notes to Consolidated Financial Statements (dollars in thousands except per share data)

### **Current Accounting Changes**

**FASB ASC Topic 310, *Receivables*.** In January 2014, new authoritative accounting guidance was issued that defined when a lender has obtained physical possession of residential real estate collateral, requiring charge-off of the loan and recognition as foreclosed property. In addition, additional disclosures on the amount of residential real estate included in foreclosed assets as well as the amount of residential loans in the process of foreclosure are required for each period end. These new rules became effective on January 1, 2015. Adoption of this new guidance did not have a significant impact on PSB's results of operations or financial statements.

### **Future Accounting Changes**

**FASB ASC Topic 718, *Improvements to Employee Share-Based Payment Accounting*.** In October 2016, new authoritative accounting guidance was issued that will simplify various aspects of the accounting for PSB's restricted stock plan. PSB intends to adopt this standard effective January 1, 2017. As a result of adopting this standard, PSB (1) will recognize current and future excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement; and (2) will make an accounting policy election to account for forfeitures when they occur. PSB does not believe this will have a significant impact on its financial statements.

**FASB ASC Topic 606, *Revenue from Contracts with Customers*.** In May 2014, new authoritative accounting guidance was issued that provides guidance on when it is appropriate to recognize customer sales agreements as revenue. This large standard has limited impact on PSB as loans, deposits, and other financial instruments are excluded from the scope of the standard. However, sales of foreclosed property and certain noninterest income from contracts with customers, such as insurance contracts, are subject to new rules applied on an individual transaction basis. During 2015, authoritative guidance deferred the effective date of the new standard by one year, to quarterly periods beginning January 1, 2018. Adoption of this new guidance is not expected to have a significant impact on PSB's results of operations or financial statements.

**FASB ASC Topic 825, *Recognition and Measurement of Financial Assets and Financial Liabilities*.** In January 2016, new authoritative accounting guidance was issued that makes a number of changes to the recognition and measurement standards of financial instruments, including the following changes: (1) equity securities with a readily determinable fair value will have to be measured at fair value with changes in fair value recognized in net income; (2) PSB will no longer be required to disclose the methods and significant assumptions used to estimate the fair value disclosed for financial instruments measured at amortized cost; and (3) PSB will be required to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The new standard is effective beginning January 1, 2018. PSB does not believe adoption of the standard will have a significant impact on its financial statements except that it will no longer disclose the methods and significant assumptions used to estimate the fair value disclosed for instruments measured at amortized cost.

**FASB ASC Topic 842, *Leases*.** In April 2016, new authoritative accounting guidance was issued that will require lessees to recognize right of use assets and lease obligation liabilities for most operating leases as well as finance leases. The new standard is effective beginning January 1, 2019. PSB currently leases two branch locations and is evaluating what impact adoption of this new standard will have on its financial statements.

**FASB ASC Topic 326, *Measurement of Credit Losses on Financial Instruments*.** This standard issued in October 2016 will significantly change how financial assets measured at amortized cost are presented. Such assets, which include most loans and securities held to maturity, will be presented at the net amount expected to be collected over their remaining contractual lives. Estimated credit losses will be based on relevant information about historical experience, current conditions, and reasonable and supportable forecasts that affect the collectibility of the reported amounts. The standard will also change the accounting for credit losses related to securities available for sale and purchased financial assets having a more-than-insignificant amount of credit deterioration since origination. This new accounting standard is effective for PSB financial statements issued for interim and annual periods beginning January 1, 2021. PSB is evaluating what impact this new standard will have on its financial statements.

### **Reclassifications**

Certain prior year balances have been reclassified to conform to the current year presentation.

### **Subsequent Events**

Subsequent events have been evaluated through February 24, 2017, which is the date the consolidated financial statements were available to be issued.

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

**NOTE 2 Merger and Acquisition Activity**

**Purchase of the Northwoods National Bank of Rhinelander, Wisconsin, a branch of The Baraboo National Bank**

On April 11, 2014, Peoples State Bank, subsidiary of PSB Holdings, Inc., purchased the following assets and assumed liabilities of the Northwoods National Bank, Rhinelander, Wisconsin, branch:

Fair value of assets acquired:

Cash and due from banks	\$17,741
Loans receivable, including accrued interest	21,365
Premises and equipment	1,368
Core deposit intangible	231
Goodwill	113
<hr/>	
Total fair value of assets acquired	\$40,818

Fair value of liabilities assumed:

Non-interest-bearing deposits	\$ 3,890
Interest-bearing deposits, including accrued interest	36,912
Other liabilities	16
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Fair value of liabilities assumed	\$40,818

In the transaction, net cash received by PSB from the seller was reduced by the purchase premium of \$654. During 2014, PSB incurred and expensed \$371 of non-recurring branch merger and conversion costs with integration of the purchased Northwoods branch, including \$224 of data processing conversion costs. The core deposit intangible acquired is being amortized over a five-year period using a double declining balance method with amortization expense totaling \$39, \$65, and \$69 during the three years ended December 31, 2016, 2015, and 2014 respectively.

**NOTE 3 Cash and Cash Equivalents**

PSB is required to maintain a certain reserve balance, in cash or on deposit with the Federal Reserve Bank, based upon a percentage of transactional deposits. As of December 31, 2016, PSB had a required reserve of \$1,516, which was satisfied by cash balances of \$1,873.

PSB is also required to provide collateral on interest rate swap agreement liabilities with counterparties. The total required collateral on deposit with counterparties before any offset against related swap liabilities was \$230 at December 31, 2016, and \$430 at December 31, 2015.

In the normal course of business, PSB maintains cash and due from bank balances with correspondent banks. Such balances are not insured. Total uninsured cash and cash equivalent balances totaled \$22,534 and \$11,989 at December 31, 2016 and 2015, respectively.



**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)**NOTE 4**            **Securities**

The amortized cost and estimated fair value of investment securities are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<u>December 31, 2016</u>				
<u>Securities available for sale</u>				
U.S. agency issued residential mortgage-backed securities	\$52,227	\$ 244	\$ 902	\$51,569
U.S. agency issued commercial mortgage-backed securities	2,722	-	96	2,626
U.S. agency issued residential collateralized mortgage obligations	36,983	64	621	36,426
Privately issued residential collateralized mortgage obligations	10	-	-	10
Negotiable FDIC insured bank certificates of deposit	2,940	-	-	2,940
Nonrated SBA loan fund	950	-	-	950
Other equity securities	47	-	-	47
<b>Totals</b>	<b>\$95,879</b>	<b>\$ 308</b>	<b>\$ 1,619</b>	<b>\$94,568</b>
<u>Securities held to maturity</u>				
Obligations of states and political subdivisions	\$69,456	\$ 616	\$ 827	\$69,245
Nonrated trust preferred securities	1,580	-	290	1,290
Nonrated senior subordinated notes	400	12	-	412
<b>Totals</b>	<b>\$71,436</b>	<b>\$ 628</b>	<b>\$ 1,117</b>	<b>\$70,947</b>
<u>December 31, 2015</u>				
<u>Securities available for sale</u>				
U.S. agency issued residential mortgage-backed securities	\$53,028	\$ 502	\$ 295	\$53,235
U.S. agency issued residential collateralized mortgage obligations	27,290	126	312	27,104
Privately issued residential collateralized mortgage obligations	18	-	-	18
Negotiable FDIC insured bank certificates of deposit	1,960	-	8	1,952
Nonrated SBA loan fund	950	-	-	950
Other equity securities	47	-	-	47
<b>Totals</b>	<b>\$83,293</b>	<b>\$ 628</b>	<b>\$ 615</b>	<b>\$83,306</b>
<u>Securities held to maturity</u>				
Obligations of states and political subdivisions	\$69,584	\$1,620	\$ 32	\$71,172
Nonrated trust preferred securities	1,561	-	283	1,278
Nonrated senior subordinated notes	400	16	-	416
<b>Totals</b>	<b>\$71,545</b>	<b>\$1,636</b>	<b>\$ 315</b>	<b>\$72,866</b>

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

Fair values of securities are estimated based on financial models or prices paid for similar securities. It is possible future interest rates could change considerably resulting in a material change in the estimated fair value.

Nonrated trust preferred securities at December 31, 2016 and 2015, consist of separate obligations issued by three holding companies headquartered in Wisconsin. Nonrated senior subordinated notes at December 31, 2016 and 2015, consist of one obligation issued by a Wisconsin state chartered bank. All issues of nonrated trust preferred securities or senior subordinated notes were current as to principal and interest payments as of December 31, 2016 and 2015.

The following table indicates the number of months securities that are considered to be temporarily impaired have been in an unrealized loss position at December 31:

<b>Description of Securities</b>	<b>Less Than 12 Months</b>		<b>12 Months or More</b>		<b>Total</b>	
	<b>Fair Value</b>	<b>Unrealized Loss</b>	<b>Fair Value</b>	<b>Unrealized Loss</b>	<b>Fair Value</b>	<b>Unrealized Loss</b>
<u>2016</u>						
<u>Securities available for sale</u>						
U.S. agency issued residential mortgage-backed securities	\$ 42,212	\$ 902	\$ -	\$ -	\$ 42,212	\$ 902
U.S. agency issued commercial mortgage-backed securities	2,626	96	-	-	2,626	96
U.S. agency issued residential collateralized mortgage obligations	27,994	528	3,217	93	31,211	621
<b>Totals</b>	<b>\$ 72,832</b>	<b>\$ 1,526</b>	<b>\$3,217</b>	<b>\$ 93</b>	<b>\$76,049</b>	<b>\$ 1,619</b>
<u>Securities held to maturity</u>						
Obligations of states and political subdivisions	\$ 28,935	\$ 815	\$ 855	\$ 12	\$ 29,790	\$ 827
Nonrated trust preferred securities	-	-	1,290	290	1,290	290
<b>Totals</b>	<b>\$ 28,935</b>	<b>\$ 815</b>	<b>\$ 2,145</b>	<b>\$ 302</b>	<b>\$ 31,080</b>	<b>\$ 1,117</b>

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

Description of Securities	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
<u>2015</u>						
<u>Securities available for sale</u>						
U.S. agency issued residential mortgage-backed securities	\$ 21,797	\$ 228	\$ 3,804	\$ 67	\$25,601	\$ 295
U.S. agency issued residential collateralized mortgage obligations	13,202	185	4,357	127	17,559	312
Negotiable FDIC insured bank certificates of deposit	1,952	8	-	-	1,952	8
<b>Totals</b>	<b>\$ 36,951</b>	<b>\$ 421</b>	<b>\$ 8,161</b>	<b>\$ 194</b>	<b>\$45,112</b>	<b>\$ 615</b>
<u>Securities held to maturity</u>						
Obligations of states and political subdivisions	\$ 1,746	\$ 3	\$ 2,007	\$ 29	\$ 3,753	\$ 32
Nonrated trust preferred securities	-	-	1,278	283	1,278	283
<b>Totals</b>	<b>\$ 1,746</b>	<b>\$ 3</b>	<b>\$ 3,285</b>	<b>\$ 312</b>	<b>\$ 5,031</b>	<b>\$ 315</b>

At December 31, 2016, 203 debt securities had unrealized losses with aggregate depreciation of 2.49% from the amortized cost basis, compared to 54 debt securities which had unrealized losses with aggregate depreciation of 1.82% from the amortized cost basis at December 31, 2015. These unrealized losses relate principally to an increase in interest rates relative to interest rates in effect at the time of purchase or reclassification from available-for-sale to held-to-maturity classification and are not due to changes in the financial condition of the issuers. However, the unrealized loss on nonrated trust preferred securities is due to an increase in credit spreads for risk on such investments demanded in the market at period-end. In analyzing an issuer's financial condition, management considers whether the securities are issued by a government body or agency, whether a rating agency has downgraded the securities, industry analysts' reports, and internal review of issuer financial statements. Since management does not intend to sell and has the ability to hold debt securities until maturity (or the foreseeable future for securities available for sale), no declines are deemed to be other than temporary.

The amortized cost and estimated fair value of debt securities, negotiable bank certificates of deposit, nonrated trust preferred securities, and senior subordinated notes at December 31, 2016, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale		Held to Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 735	\$ 735	\$ 4,916	\$ 4,912
Due after one year through five years	2,205	2,205	23,945	24,466
Due after five years through ten years	-	-	38,075	37,543
Due after ten years	-	-	4,500	4,026
<b>Subtotals</b>	<b>2,940</b>	<b>2,940</b>	<b>71,436</b>	<b>70,947</b>
Mortgage-backed securities and collateralized mortgage obligations	91,942	90,631	-	-
<b>Totals</b>	<b>\$ 94,882</b>	<b>\$ 93,571</b>	<b>\$ 71,436</b>	<b>\$ 70,947</b>

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

Securities with a fair value of \$53,279 and \$53,315 at December 31, 2016 and 2015, respectively, were pledged to secure public deposits, other borrowings, and for other purposes required by law.

PSB had no sales of securities available for sale during 2016 or 2015. During 2014, PSB realized a gain of \$3 (\$2 after tax expense) from proceeds totaling \$1,774 on the sale of securities available for sale.

During 2014, PSB reclassified \$3 (\$2 after tax impacts) to reduce comprehensive net income following a gain on sale of securities available for sale. The reduction to comprehensive net income was recognized as a \$3 (\$2 after tax impacts) gain on sale of securities on the statement of income during the year.

During 2010, PSB transferred all its municipal, trust preferred, and senior subordinated note securities from the available-for-sale classification to the held-to-maturity classification to better reflect its intent and practice to hold these long-term debt securities until maturity. Fair value of the securities was \$54,130 at the time of the transfer, which included a \$2,552 unrealized gain over the existing amortized cost basis. The original unrealized gain on the transfer date is being amortized against the new cost basis (equal to transfer date fair value) over the remaining life of the securities which is recorded as a reduction to other comprehensive income. Amortization of the unrealized gain reduced comprehensive income by \$188 (\$114 after tax impacts), \$312 (\$189 after tax impacts), and \$330 (\$200 after tax impacts) during the years ended December 31, 2016, 2015, and 2014, respectively.

Scheduled amortization (accretion) at December 31, 2016, of the remaining unrealized gain is as follows:

2017	\$115
2018	68
2019	22
2020	(5)
Thereafter	4
<hr/>	
Total	\$204

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

**NOTE 5           Loans**

The composition of loans at December 31 categorized by the type of the loan is as follows:

	<b>2016</b>	<b>2015</b>
Commercial, industrial, municipal and agricultural	\$133,990	\$120,313
Commercial real estate mortgage	266,721	239,583
Commercial construction and development	33,007	35,309
Residential real estate mortgage	121,572	117,912
Residential construction and development	17,681	17,786
Residential real estate home equity	24,651	23,083
Consumer and individual	2,992	3,419
Subtotals – Gross loans	600,614	557,405
Loans in process of disbursement	(8,685)	(16,092)
Subtotals – Disbursed loans	591,929	541,313
Net deferred loan origination costs	263	362
Allowance for loan losses	(6,083)	(6,350)
Net loans receivable	\$586,109	\$535,325

PSB, in the ordinary course of business, grants loans to its executive officers and directors, including their families and firms in which they are principal owners. All loans to executive officers and directors are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others and, in the opinion of management, did not involve more than the normal risk of collectability or present other unfavorable features. Activity in such loans is summarized below:

	<b>2016</b>	<b>2015</b>
Loans outstanding at beginning	\$13,364	\$6,980
New loans	12,919	9,844
Repayments	(12,131)	(3,460)
Loans outstanding at end	\$14,152	\$13,364

At December 31, 2016 and 2015, PSB had total loans receivable of approximately \$11,349 and \$11,253, respectively, from one related party.

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

Allowance for loan losses activity for the years ended December 31, 2016, 2015, and 2014, follows:

	2016					Total
	Commercial & Industrial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	
<b>Allowance for loan losses:</b>						
Beginning balance	\$ 1,780	\$ 2,566	\$ 1,918	\$ 86	\$ -	\$ 6,350
Provision (credit)	(366)	615	(182)	(12)	-	55
Recoveries	8	7	23	-	-	38
Charge-offs	(28)	(79)	(253)	-	-	(360)
Ending balance	\$ 1,394	\$ 3,109	\$ 1,506	\$ 74	\$ -	\$ 6,083
Individually evaluated for impairment	\$ 141	\$ 316	\$ 360	\$ 44	\$ -	\$ 861
Collectively evaluated for impairment	\$ 1,253	\$ 2,793	\$ 1,146	\$ 30	\$ -	\$ 5,222
<b>Loans receivable (gross):</b>						
Individually evaluated for impairment	\$ 3,200	\$ 4,558	\$ 1,713	\$ 56	\$ -	\$ 9,527
Collectively evaluated for impairment	\$130,790	\$295,170	\$162,191	\$2,936	\$ -	\$591,087
<b>2015</b>						
	Commercial & Industrial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
<b>Allowance for loan losses:</b>						
Beginning balance	\$ 1,901	\$ 2,294	\$ 2,112	\$ 102	\$ -	\$ 6,409
Provision (credit)	(1,362)	452	394	(14)	-	(530)
Recoveries	1,243	14	16	7	-	1,280
Charge-offs	(2)	(194)	(604)	(9)	-	(809)
Ending balance	\$ 1,780	\$ 2,566	\$ 1,918	\$ 86	\$ -	\$ 6,350
Individually evaluated for impairment	\$ 815	\$ 537	\$ 534	\$ 48	\$ -	\$ 1,934
Collectively evaluated for impairment	\$ 965	\$ 2,029	\$ 1,384	\$ 38	\$ -	\$ 4,416
<b>Loans receivable (gross):</b>						
Individually evaluated for impairment	\$ 5,166	\$ 4,711	\$ 2,291	\$ 86	\$ -	\$ 12,254
Collectively evaluated for impairment	\$115,147	\$270,181	\$156,490	\$3,333	\$ -	\$545,151

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

	2014					
	Commercial & Industrial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
<b>Allowance for loan losses:</b>						
Beginning balance	\$ 2,828	\$ 2,653	\$ 1,223	\$ 79	\$ -	\$ 6,783
Provision (credit)	(716)	(321)	1,564	33	-	560
Recoveries	4	3	19	9	-	35
Charge-offs	(215)	(41)	(694)	(19)	-	(969)
Ending balance	\$ 1,901	\$ 2,294	\$ 2,112	\$ 102	\$ -	\$ 6,409
Individually evaluated for impairment	\$ 976	\$ 511	\$ 746	\$ 25	\$ -	\$ 2,258
Collectively evaluated for impairment	\$ 925	\$ 1,783	\$ 1,366	\$ 77	\$ -	\$ 4,151
<b>Loans receivable (gross):</b>						
Individually evaluated for impairment	\$ 10,542	\$ 5,378	\$ 3,203	\$ 25	\$ -	\$ 19,148
Collectively evaluated for impairment	\$124,226	\$229,487	\$162,372	\$3,602	\$ -	\$519,687

During 2015, PSB recorded a loan-charge off recovery totaling \$1,230 of a former commercial loan to a grain storage and marketing company which had been secured by inventory and related collateral on which the entire relationship of \$3,340 was charged off during 2013.

PSB maintains an independent credit administration staff that continually monitors aggregate commercial loan portfolio and individual borrower credit quality trends. All commercial purpose loans are assigned a credit grade upon origination, and credit grades for nonproblem borrowers with aggregate credit more than \$500 are reviewed annually. In addition, all past due, restructured, or identified problem loans, both commercial and consumer purpose, are reviewed and assigned an up-to-date credit grade quarterly.

PSB uses a seven-point grading scale to estimate credit risk with risk rating 1, representing the high credit quality, and risk rating 7, representing the lowest credit quality. The assigned credit grade considers several credit quality components which are assigned a weight and blended into the composite grade. The factors considered and their assigned weight for the final composite grade is as follows:

**Cash flow** (30% weight) – Considers earnings trends and debt service coverage levels.

**Collateral** (25% weight) – Considers loan-to-value and other measures of collateral coverage.

**Leverage** (15% weight) – Considers balance sheet debt and capital ratios compared to Robert Morris & Associates (RMA) industry medians.

**Liquidity** (10% weight) – Considers the balance sheet current, quick, and other working capital ratios compared to RMA industry medians.

**Management** (5% weight) – Considers the past performance, character, and depth of borrower management.

**Guarantor** (5% weight) – Considers the existence of a guarantor, the bank's past experience with the guarantor, and the guarantor's related liquidity and credit score.

**Financial reporting** (5% weight) – Considers the relative level of independent financial review obtained by the borrower on its financial statements, from audited financial statements down to existence of only tax returns or potentially unreliable financial information.

**Industry** (5% weight) – Considers the borrower's industry and whether it is stable or subject to cyclical or seasonal factors.

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

Nonclassified loans are assigned a risk rating of 1 to 4 and have credit quality that ranges from well above average to some inherent industry weaknesses that may present higher than average risk due to conditions affecting the borrower, the borrower's industry, or economic development.

Special mention and watch loans are assigned a risk rating of 5 when potential weaknesses exist that deserve management's close attention. If left uncorrected, the potential weaknesses may result in deterioration of repayment prospects or in credit position at some future date. Substandard loans are assigned a risk rating of 6 and are inadequately protected by the current worth and borrowing capacity of the borrower. Well-defined weaknesses exist that may jeopardize the liquidation of the debt. There is a possibility of some loss if the deficiencies are not corrected. At this point, the loan may still be performing and accruing.

Impaired and other doubtful loans assigned a risk rating of 7 have all the weaknesses of a substandard credit plus the added characteristic that the weaknesses make collection or liquidation in full based on current facts, conditions, and collateral values questionable and improbable. Impaired loans include all nonaccrual loans and all restructured loans including restructured loans performing according to the restructured terms. In special situations, an impaired loan with a risk rating of 7 could still be maintained on accrual status such as in the case of restructured loans performing according to restructured terms.

The commercial credit exposure based on internally assigned credit grade at December 31, 2016 and 2015, follows:

	2016					
	Commercial & Industrial	Commercial Real Estate	Construction & Development	Agricultural	Municipal	Total
High quality (risk rating 1)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Minimal risk (2)	31,569	34,058	613	1,206	22	67,468
Average risk (3)	57,101	158,306	28,163	2,814	7,289	253,673
Acceptable risk (4)	20,059	64,417	3,422	3,339	130	91,367
Watch risk (5)	5,031	4,903	758	82	-	10,774
Substandard risk (6)	2,142	536	-	-	-	2,678
Impaired loans (7)	710	4,501	51	6	2,490	7,758
Totals	\$116,612	\$266,721	\$33,007	\$7,447	\$9,931	\$433,718

	2015					
	Commercial & Industrial	Commercial Real Estate	Construction & Development	Agricultural	Municipal	Total
High quality (risk rating 1)	\$ -	\$ 79	\$ -	\$ -	\$ -	\$ 79
Minimal risk (2)	25,337	31,503	410	2,591	41	59,882
Average risk (3)	45,214	142,713	28,715	2,602	7,776	227,020
Acceptable risk (4)	22,942	56,706	4,779	553	226	85,206
Watch risk (5)	7,217	3,921	1,293	89	-	12,520
Substandard risk (6)	559	62	-	-	-	621
Impaired loans (7)	2,526	4,599	112	-	2,640	9,877
Totals	\$103,795	\$239,583	\$35,309	\$5,835	\$10,683	\$395,205

The consumer credit exposure based on performance classification at December 31, 2016 and 2015, follows:

	2016				
	Residential-Prime	Construction and Development	Residential-HELOC	Consumer	Total
Performing	\$120,096	\$17,652	\$22,443	\$2,936	\$165,127
Impaired loans	1,476	29	208	56	1,769
Totals	\$121,572	\$17,681	\$24,651	\$2,992	\$166,896



**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

	2015				
	Residential- Prime	Construction and Development	Residential- HELOC	Consumer	Total
Performing	\$115,991	\$17,769	\$22,730	\$3,333	\$159,823
Impaired loans	1,921	17	353	86	2,377
<b>Totals</b>	<b>\$117,912</b>	<b>\$17,786</b>	<b>\$23,083</b>	<b>\$3,419</b>	<b>\$162,200</b>

The payment age analysis of loans receivable disbursed at December 31, 2016 and 2015, follows:

Loan Class	2016						
	30-59 Days	60-89 Days	90+ Days	Total Past Due	Current	Total Loans	90+ and Accruing
Commercial:							
Commercial and industrial	\$ 600	\$ 29	\$ 108	\$ 737	\$115,875	\$116,612	\$ -
Agricultural	6	-	-	6	7,441	7,447	-
Municipal	-	-	130	130	9,801	9,931	-
Commercial real estate:							
Commercial real estate	706	130	421	1,257	265,464	266,721	-
Construction and development	588	38	-	626	26,848	27,474	-
Residential real estate:							
Residential – Prime	609	254	293	1,156	120,416	121,572	-
Construction and development	16	-	-	16	14,513	14,529	-
Residential – HELOC	39	102	28	169	24,482	24,651	-
Consumer	7	-	7	14	2,978	2,992	-
<b>Totals</b>	<b>\$2,571</b>	<b>\$553</b>	<b>\$987</b>	<b>\$4,111</b>	<b>\$587,818</b>	<b>\$591,929</b>	<b>\$ -</b>

Loan Class	2015						
	30-59 Days	60-89 Days	90+ Days	Total Past Due	Current	Total Loans	90+ and Accruing
Commercial:							
Commercial and industrial	\$ 39	\$ 35	\$ 215	\$ 289	\$103,506	\$103,795	\$ -
Agricultural	-	-	-	-	5,835	5,835	-
Municipal	-	-	-	-	10,683	10,683	-
Commercial real estate:							
Commercial real estate	166	-	546	712	238,871	239,583	-
Construction and development	-	-	-	-	22,959	22,959	-
Residential real estate:							
Residential – Prime	732	58	855	1,645	116,267	117,912	-
Construction and development	-	-	-	-	14,044	14,044	-
Residential – HELOC	120	23	111	254	22,829	23,083	-
Consumer	4	2	10	16	3,403	3,419	-
<b>Totals</b>	<b>\$1,061</b>	<b>\$118</b>	<b>\$1,737</b>	<b>\$2,916</b>	<b>\$538,397</b>	<b>\$541,313</b>	<b>\$ -</b>

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

The following is a summary of information pertaining to impaired loans and nonperforming loans:

	<b>December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Impaired loans without a valuation allowance	\$ 6,295	\$ 6,220	\$ 9,021
Impaired loans with a valuation allowance	3,232	6,034	10,127
Total impaired loans before valuation allowances	9,527	12,254	19,148
Valuation allowance related to impaired loans	861	1,934	2,258
Net impaired loans	\$8,666	\$10,320	\$16,890

  

	<b>Years Ended December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Average recorded investment, net of allowance for loan losses	\$10,893	\$15,704	\$17,465
Interest income recognized	\$ 285	\$ 351	\$ 586
Interest income recognized on a cash basis on impaired loans	\$ -	\$ -	\$ -

At December 31, 2016, \$3 of funds were committed to be advanced on remaining available lines of credit in connection with impaired loans, while \$289 of funds were committed to be advanced on remaining available lines of credit in connection with impaired loans at December 31, 2015.

At December 31, 2016, residential mortgage loans in the process of foreclosure and residential real estate included in foreclosed assets totaled \$357 and \$0, respectively. At December 31, 2015, residential mortgage loans in the process of foreclosure and residential real estate included in foreclosed assets totaled \$996 and \$468, respectively.

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

Detailed information on impaired loans by loan class at December 31, 2016 and 2015, and during the years then ended, follows:

	<b>2016</b>				
	<b>Unpaid Principal Balance</b>	<b>Related Allowance</b>	<b>Recorded Investment</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>
<b>With no related allowance recorded:</b>					
Commercial and industrial	\$ 153	\$ -	\$ 139	\$294	\$ -
Commercial real estate	3,455	-	3,073	2,784	106
Commercial construction and development	-	-	-	-	-
Agricultural	-	-	-	-	-
Municipal	2,490	-	2,490	2,565	128
Residential – Prime	610	-	593	604	21
Residential – HELOC	-	-	-	11	-
Residential construction and development	-	-	-	-	-
Consumer	-	-	-	-	-
<b>With an allowance recorded:</b>					
Commercial and industrial	\$ 805	\$141	\$571	\$1,325	\$ 7
Commercial real estate	1,706	299	1,428	1,766	4
Commercial construction and development	65	11	51	82	-
Agricultural	6	6	6	3	-
Municipal	-	-	-	-	-
Residential – Prime	983	270	883	1,095	13
Residential – HELOC	233	73	208	270	2
Residential construction and development	31	17	29	23	1
Consumer	56	44	56	71	3
<b>Totals:</b>					
Commercial and industrial	\$952	\$141	\$710	\$1,619	\$ 7
Commercial real estate	5,161	299	4,501	4,550	110
Commercial construction and development	65	11	51	82	-
Agricultural	6	6	6	3	-
Municipal	2,490	-	2,490	2,565	128
Residential – Prime	1,593	270	1,476	1,699	34
Residential – HELOC	233	73	208	281	2
Residential construction and development	31	17	29	23	1
Consumer	56	44	56	71	3

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

	2015				
	Unpaid Principal Balance	Related Allowance	Recorded Investment	Average Recorded Investment	Interest Income Recognized
<b>With no related allowance recorded:</b>					
Commercial and industrial	\$ 464	\$ -	\$ 448	\$1,342	\$ 22
Commercial real estate	2,963	-	2,495	2,536	75
Commercial construction and development	-	-	-	-	-
Agricultural	-	-	-	-	-
Municipal	2,640	-	2,640	2,708	128
Residential – Prime	624	-	615	948	21
Residential – HELOC	22	-	22	88	2
Residential construction and development	-	-	-	-	-
Consumer	-	-	-	-	-
<b>With an allowance recorded:</b>					
Commercial and industrial	\$2,314	\$815	\$2,078	\$3,744	\$ 45
Commercial real estate	2,337	515	2,104	2,387	35
Commercial construction and development	120	22	112	122	3
Agricultural	-	-	-	61	-
Municipal	-	-	-	-	-
Residential – Prime	1,977	350	1,306	1,169	11
Residential – HELOC	351	172	331	289	6
Residential construction and development	18	12	17	254	1
Consumer	87	48	86	56	2
<b>Totals:</b>					
Commercial and industrial	\$2,778	\$815	\$2,526	\$5,086	\$ 67
Commercial real estate	5,300	515	4,599	4,923	110
Commercial construction and development	120	22	112	122	3
Agricultural	-	-	-	61	-
Municipal	2,640	-	2,640	2,708	128
Residential – Prime	2,601	350	1,921	2,117	32
Residential – HELOC	373	172	353	377	8
Residential construction and development	18	12	17	254	1
Consumer	87	48	86	56	2

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

The loans on nonaccrual status at December 31, follows:

	2016	2015
Commercial:		
Commercial and industrial	\$ 474	\$ 813
Agricultural	6	-
Commercial real estate:		
Commercial real estate	1,980	2,817
Construction and development	51	60
Residential real estate:		
Residential – Prime	848	1,289
Construction and development	20	5
Residential - HELOC	208	270
Consumer	24	44
Totals	\$3,611	\$5,298

There were no loans past due 90 days or more but still accruing income at December 31, 2016 and 2015.

The following table presents information concerning modifications of troubled debt made during 2016:

<b>As of December 31, 2016</b>	<b>Number of contracts</b>	<b>Premodification Outstanding Recorded Investment</b>	<b>Postmodification Outstanding Recorded Investment at Period-End</b>
Commercial and industrial	2	\$ 132	\$ 132
Commercial real estate	3	1,252	1,216

During the year ended December 31, 2016, \$1,246, or 90%, of the modified loan principal was restructured to change payments to that of interest only, and \$138, or 10%, was modified for other factors. No loan principal was charged off or forgiven in connection with the modifications. At December 31, 2016, specific loan loss reserves maintained on loans modified or restructured during 2016 totaled \$0.

There were no past troubled debt restructurings that subsequently defaulted during 2016 when the default occurred within 12 months of the last restructuring date. For purposes of this determination, default is defined as 90 days or more past due on restructured payments.

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

The following table presents information concerning modifications of troubled debt made during 2015:

<b>As of December 31, 2015</b>	<b>Number of contracts</b>	<b>Premodification Outstanding Recorded Investment</b>	<b>Postmodification Outstanding Recorded Investment at Period-End</b>
Commercial and industrial	1	\$903	\$850
Commercial real estate	1	89	79
Residential real estate - Prime	1	118	-
Consumer	2	30	30

During the year ended December 31, 2015, \$903, or 79%, of the modified loan principal was restructured to lower the interest rate and \$237, or 21%, was modified for other factors. No loan principal was charged off or forgiven in connection with the modifications. At December 31, 2015, specific loan loss reserves maintained on loans modified or restructured during 2015 totaled \$197.

The following table outlines past troubled debt restructurings that subsequently defaulted during 2015 when the default occurred within 12 months of the last restructuring date. For purposes of this table, default is defined as 90 days or more past due on restructured payments.

	<b>Number of Contracts</b>	<b>Recorded Investment at Period-End</b>
Commercial and industrial	1	\$12

The contract noted above was originally restructured primarily to lower the interest rate and payments in bankruptcy. Specific loan loss reserves of \$6 were maintained on this impaired loan at December 31, 2015.

Under a secondary market loan servicing program with the FHLB, in exchange for a monthly fee, PSB provides a credit enhancement guarantee to reimburse the FHLB for foreclosure losses more than 1% of original loan principal sold to the FHLB. At December 31, 2016, PSB serviced payments on \$11,460 of first lien residential loan principal under these terms for the FHLB. At December 31, 2016, the maximum PSB obligation for such guarantees would be approximately \$924 if total foreclosure losses on the entire pool of loans exceed approximately \$1,218. Management believes the likelihood of reimbursement for credit loss payable to the FHLB on loans underwritten according to program requirements beyond the monthly credit enhancement fee is remote. PSB recognizes the credit enhancement fee as mortgage banking income when received in cash and does not maintain any recourse liability for possible credit enhancement losses.

PSB had originated and sold \$13,787 and \$10,043 of commercial and commercial real estate loans to other participating financial institutions at December 31, 2016 and 2015, respectively, to accommodate customer credit needs, maintain compliance with internal and external large borrower limits, and as part of the sale and servicing of government guaranteed loans. Likewise, PSB had purchased \$24,540 and \$21,379 of commercial and commercial real estate loans originated by other Wisconsin-based financial institutions at December 31, 2016 and 2015, respectively, as part of informal reciprocal relationships that allow the originating bank to meet the needs of their large credit customers. PSB generally does not charge servicing fees to the participating institutions on these traditional loan participations sold by PSB, and no servicing right asset or liability has been recognized on these relationships or associated with the servicing of government guaranteed loans. Any credit losses incurred on purchased or sold participation loans upon liquidation are shared pro-rata among the participants based on principal owned.

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)**NOTE 6 Foreclosed Assets**

A summary of activity in foreclosed assets for the period ended December 31 is as follows:

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Balance at beginning of year	\$1,378	\$1,661	\$1,750
Transfer of loans at net realizable value to foreclosed assets	594	1,309	801
Sale proceeds	(1,030)	(1,439)	(782)
Loans made on sale of foreclosed assets	(547)	(80)	(43)
Net gain (loss) from sale of foreclosed assets	226	61	(10)
Provision for write-down charged to operations	(248)	(134)	(55)
<b>Balance at end of year</b>	<b>\$373</b>	<b>\$1,378</b>	<b>\$1,661</b>

Net gain and loss from the sale of foreclosed assets as well as the provision for the partial write-down of foreclosed assets prior to sale are recorded as loss on foreclosed assets. Loss on foreclosed assets also includes periodic holding costs related to foreclosed assets. The total loss on foreclosed assets was \$49, \$206, and \$233 during the years ended 2016, 2015, and 2014, respectively.

**NOTE 7 Mortgage Servicing Rights**

Residential mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of residential mortgage loans serviced for FHLB and FNMA were \$309,614 and \$290,777 at December 31, 2016 and 2015, respectively. The following is a summary of changes in the balance of mortgage servicing rights (MSR):

	<b>Originated MSR</b>	<b>Valuation Allowance</b>	<b>Total</b>
Balance at January 1, 2014	\$ 1,717	\$ (21)	\$ 1,696
Additions from originated servicing	339	-	339
Amortization charged to earnings	(278)	-	(278)
Change in valuation allowance credited to earnings	-	(19)	(19)
<b>Balance at December 31, 2014</b>	<b>1,778</b>	<b>(40)</b>	<b>1,738</b>
Additions from originated servicing	520	-	520
Amortization charged to earnings	(411)	-	(411)
Change in valuation allowance charged to earnings	-	(90)	(90)
<b>Balance at December 31, 2015</b>	<b>1,887</b>	<b>(130)</b>	<b>1,757</b>
Additions from originated servicing	500	-	500
Amortization charged to earnings	(389)	-	(389)
Change in valuation allowance charged to earnings	-	75	75
<b>Balance at December 31, 2016</b>	<b>\$ 1,998</b>	<b>\$ (55)</b>	<b>\$ 1,943</b>

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

The table below summarizes the components of residential mortgage banking income for the three years ended December 31.

	<b>Years Ending December 31,</b>		
	<b>2016</b>	<b>2015</b>	<b>2014</b>
Cash gain on sale of mortgage loans	\$1,037	\$936	\$659
Originated mortgage servicing rights	500	520	339
Increase (decrease) in accrued mortgage rate lock commitments	102	43	(7)
<b>Gain on sale of mortgage loans</b>	<b>1,639</b>	<b>1,499</b>	<b>991</b>
Mortgage servicing fee income	746	709	691
(Provision) credit for representation and warranty losses	(22)	40	(8)
Foreclosure servicing losses	(9)	(22)	(4)
Amortization of mortgage servicing rights	(389)	(411)	(278)
Decrease (increase) in servicing right valuation allowance	75	(90)	(19)
<b>Loan servicing fee income, net</b>	<b>401</b>	<b>226</b>	<b>382</b>
<b>Residential mortgage banking income, net</b>	<b>\$2,040</b>	<b>\$1,725</b>	<b>\$1,373</b>

**NOTE 8 Premises and Equipment**

The composition of premises and equipment at December 31 follows:

	<b>2016</b>	<b>2015</b>
Land	\$2,853	\$ 2,856
Buildings and improvements	11,007	10,966
Furniture and equipment	2,678	2,679
Computer hardware and software	1,999	1,962
<b>Total cost</b>	<b>18,537</b>	<b>18,463</b>
Less – Accumulated depreciation and amortization	8,110	7,536
<b>Totals</b>	<b>\$10,427</b>	<b>\$10,927</b>

Depreciation and amortization charged to operating expenses amounted to \$787 in 2016, \$778 in 2015, and \$727 in 2014.

**Lease Commitments**

PSB leases various pieces of equipment under cancelable leases and office space for two locations under noncancelable leases. The first noncancelable branch location lease expires in August 2020 followed by one optional 5-year renewal period. The second noncancelable location lease expires in July 2019 followed by one optional 6-month renewal period. Both leases are classified as operating leases. Future minimum payments under the noncancelable leases include:

2017	\$ 40
2018	41
2019	37
2020	20
<b>Total</b>	<b>\$138</b>

Rental expense for all operating leases was \$53, \$67, and \$78, for the years ended December 31, 2016, 2015, and 2014, respectively. Remaining undepreciated net book value of leasehold improvements included in premises and equipment totaled \$508 at December 31, 2016, and \$492 at December 31, 2015.



**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

**NOTE 9            Deposits**

The distribution of deposits at December 31 is as follows:

	<b>2016</b>	<b>2015</b>
Non-interest-bearing demand	\$143,206	\$126,669
Interest-bearing demand (NOWs)	151,554	136,552
Savings	74,530	69,106
Money market	141,963	150,463
Retail and local time	116,858	115,890
Wholesale market and national time	58,649	67,496
<b>Total deposits</b>	<b>\$686,760</b>	<b>\$666,176</b>

The scheduled maturities of time deposits at December 31, 2016, are summarized as follows:

2017	\$77,631
2018	42,001
2019	30,528
2020	19,533
2021	5,814
Thereafter	-
<b>Total</b>	<b>\$175,507</b>

Time deposits with individual balances of \$100 and over totaled \$109,627 and \$115,463 at December 31, 2016 and 2015, respectively.

Deposits from PSB directors, executive officers, and related parties at December 31, 2016 and 2015, totaled \$21,367 and \$8,728, respectively.

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

**NOTE 10 Federal Home Loan Bank Advances**

FHLB advances at December 31 consist of the following:

	<b>Scheduled Maturity</b>	<b>Range of Rates</b>	<b>Weighted Average Rate</b>	<b>Amount</b>
<u>2016</u>				
Fixed rate, interest only	2017	0.77%-1.17%	0.91%	\$2,638
Fixed rate, interest only	2018	0.95%-1.92%	1.22%	8,237
Fixed rate, interest only	2019	1.21%-1.89%	1.64%	8,171
Fixed rate, interest only	2020	1.74%-1.81%	1.79%	4,246
Fixed rate, interest only	2021	1.10%-1.56%	1.27%	14,477
<b>Totals</b>			<b>1.37%</b>	<b>\$37,769</b>
<u>2015</u>				
Fixed rate, interest only	2016	0.29%	0.29%	\$5,000
Fixed rate, interest only	2017	0.77%-1.17%	0.91%	2,638
Fixed rate, interest only	2018	1.18%-1.92%	1.64%	3,238
Fixed rate, interest only	2019	1.66%-1.89%	1.72%	6,921
Fixed rate, interest only	2020	1.74%-1.81%	1.79%	4,245
<b>Totals</b>			<b>1.30%</b>	<b>\$22,042</b>

At December 31, 2016, PSB had \$15,000 of advances which the FHLB may put back to PSB at a future date, ranging from 2021 to 2026. These advances are categorized in the table above based on the next FHLB put date as the maturity date.

PSB also provides letters of credit to municipal deposit customers which are secured by a FHLB guarantee of payment to the depositor in the event of PSB default. PSB had \$3,067 and \$2,459 of FHLB public unit deposit letters of credit outstanding at December 31, 2016 and 2015, respectively. These letters of credit had original maturities of two years or less upon origination.

FHLB advances are subject to a prepayment penalty if they are repaid prior to maturity. PSB may draw upon an FHLB open line of credit or provide public unit deposit letters of credit up to approximately 78% of qualifying unencumbered one- to four-family residential first mortgage loans and 51% of residential junior mortgage loans pledged as collateral out of its portfolio. The FHLB advances are also secured by \$1,861 of FHLB stock owned by PSB at December 31, 2016. PSB may draw both short-term and long-term advances on a maximum line of credit totaling approximately \$129,533 based on pledged performing residential real estate mortgage collateral totaling \$177,385 as of December 31, 2016. At December 31, 2016, PSB's available and unused portion of this line of credit totaled approximately \$87,772. PSB also has, under a current agreement with the FHLB, an ability to borrow up to an additional \$65,953 by pledging securities as collateral.

At December 31, 2016, FHLB advances drawn by PSB and other FHLB credit enhancements provided for the benefit of PSB totaling greater than \$41,760 would require PSB to purchase additional shares of FHLB capital stock. Transfer of FHLB stock is substantially restricted.

## Notes to Consolidated Financial Statements (dollars in thousands except per share data)

### **NOTE 11 Other Borrowings**

Other borrowings consist of the following obligations at December 31 as follows:

	<b>2016</b>	<b>2015</b>
Short-term repurchase agreements (overnight maturities)	\$ 9,360	\$ 6,027
Wholesale structured repurchase agreement	5,500	5,500
<b>Total other borrowings</b>	<b>\$14,860</b>	<b>\$11,527</b>

PSB is required to pledge U.S. Treasury and agency issued securities available for sale as collateral for repurchase agreements. The fair value of the securities pledged for repurchase agreements totaled \$18,630 and \$13,804 at December 31, 2016 and 2015, respectively. If the fair value of existing pledged securities declined, PSB would be required to pledge additional U.S. agency debentures or mortgage-backed securities so that the securities' fair value exceeds 105% of the book value of the repurchase agreement liability.

The following information relates to securities sold under repurchase agreements and other borrowings for the years ended December 31:

	<b>2016</b>	<b>2015</b>
As of end of year:		
Weighted average rate	1.63%	2.06%
For the year:		
Highest month-end balance	\$21,587	\$17,228
Daily average balance	\$13,681	\$11,165
Weighted average rate	1.79%	2.17%

The wholesale structured repurchase agreement at December 31, 2016, is with JP Morgan Chase Bank N.A. and carries a fixed interest rate of 4.09%, which matures in November 2017. The repurchase agreement may be put back by the lender to PSB for repayment on a quarterly basis.

PSB has an agreement with the Federal Reserve to participate in their "Borrower in Custody" program in which performing commercial and commercial real estate loans may be pledged against short-term Discount Window advances. At December 31, 2016, the maximum amount of available advances from the Discount Window totaled \$100,000, subject to available collateral pledged under the Borrower in Custody program or pledging of qualifying investment securities. At December 31, 2016, PSB had pledged \$82,806 of commercial purpose loans in the program, which permitted Discount Window advances up to \$59,990 against this collateral. No investment securities were pledged against the line at December 31, 2016 or 2015. There were no Discount Window advances outstanding at December 31, 2016 or 2015.

PSB maintains a line of credit at the parent holding company level with Bankers' Bank, Madison, Wisconsin, for advances up to \$3,000, which expires on December 30, 2017, and is secured by a pledge of PSB Holdings, Inc.'s investment in the common stock of its subsidiary, Peoples State Bank. The line carries a variable rate of interest based on changes in the three-month London Interbank Offered Rate (LIBOR). As of December 31, 2016, and 2015, no advances were outstanding on the line of credit. Draws on the line of credit are subject to several restrictive covenants including minimum regulatory capital ratios, minimum capital and loan loss allowances to nonperforming assets, and minimum loan loss allowances to nonperforming assets. PSB did not violate any of the covenants at December 31, 2016 or 2015.

During 2013, PSB borrowed \$2,000 on a term loan from Bankers' Bank at the parent holding company level with remaining principal balance of \$0 and \$500 at December 31, 2015 and 2014, respectively. Total interest expense on the term note totaled \$2 during 2015 and \$27 during 2014.

### **NOTE 12 Senior Subordinated Notes**

During 2013, PSB issued \$4,000 of 3.75% Senior Subordinated Notes (the "Notes") that along with \$1,000 in cash and a \$2,000 bank stock term loan repaid \$7,000 of 8% Notes issued during 2009. The Notes require only interest payments and mature on February 1, 2018. The Notes are held by related parties including directors and significant shareholders. Total interest expense on senior subordinated notes was \$103 during 2016, \$141 during 2015, and \$150 during 2014. Senior Subordinated Notes outstanding were \$2,500 and \$3,500 at December 31, 2016 and 2015, respectively.

## Notes to Consolidated Financial Statements (dollars in thousands except per share data)

### **NOTE 13 Junior Subordinated Debentures**

PSB has issued \$7,732 of junior subordinated debentures to PSB Holdings Statutory Trust I (the “Trust”) in connection with an issue of trust preferred securities during 2005 which mature in September 2035. The debentures currently pay a variable rate of interest based on changes in the three-month LIBOR plus 1.70%, adjusted quarterly. During 2010, PSB entered into a cash flow hedge to fix the payments of interest (excluding the credit spread) on the debentures for a seven-year period ending September 2017 at a rate of 2.72%. Including the credit spread, the net interest due on the notes until September 2017 will be equal to a fixed rate of 4.42%. Total interest expense on the junior subordinated debentures was \$343 in 2016, \$342 in 2015, and \$340 in 2014. The subordinated debentures may be called by PSB in part or in full on a quarterly basis.

PSB has fully and unconditionally guaranteed all the obligations of the Trust. The guarantee covers the quarterly distributions and payments on liquidation or redemption of the trust preferred securities to the extent of the funds held by the Trust. The trust preferred securities qualify as Tier 1 capital for regulatory capital purposes.

### **NOTE 14 Derivative Instruments and Hedging Activities**

PSB is exposed to certain risks relating to its ongoing business operations. The primary risk managed by using derivative instruments is interest rate risk. Interest rate swaps are entered into to manage interest rate risk associated with PSB’s variable rate junior subordinated debentures. Accounting standards require PSB to recognize all derivative instruments as either assets or liabilities at fair value in the balance sheet. PSB designates its interest rate swap associated with the junior subordinated debentures as a cash flow hedge of variable-rate debt. For derivative financial instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative instrument representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

From time to time, PSB will also enter into fixed interest rate swaps with customers in connection with their floating rate loans to PSB. When fixed rate swaps are originated with customers, an identical offsetting swap is also entered into by PSB with a correspondent bank. These swap arrangements are intended to offset each other as “back to back” swaps and allow PSB’s loan customer to obtain fixed rate loan financing via the swap while PSB exchanges these fixed payments with a correspondent bank. In these arrangements, PSB’s net cash flows and interest income are equal to the floating rate loan originated in connection with the swap. These customer swaps are not designated as hedging instruments and are accounted for at fair value with changes in fair value recognized in the income statement during the current period.

PSB is exposed to credit-related losses in the event of nonperformance by the counterparties to these agreements. PSB controls the credit risk of its financial contracts through credit approvals, limits, and monitoring procedures, and does not expect any counterparties to fail their obligations. PSB enters into agreements only with primary dealers. These derivative instruments are negotiated over-the-counter (OTC) contracts. Negotiated OTC derivative contracts are generally entered into between two counterparties that negotiate specific agreement terms, including the underlying instrument, amounts, exercise prices, and maturity.

As of December 31, PSB had the following outstanding interest rate swap that was entered into to hedge variable-rate debt:

	<b>2016</b>	<b>2015</b>
Notional amount	\$7,500	\$7,500
Pay fixed rate	2.72%	2.72%
Receive variable rate	0.96%	0.51%
Maturity	9/15/2017	9/15/2017
Unrealized loss (fair value)	\$94	\$223

This agreement provides for PSB to receive payments at a variable rate determined by the three-month LIBOR in exchange for making payments at a fixed rate. Actual maturities may differ from scheduled maturities due to call options and/or early termination provisions. No interest rate swap agreements were terminated prior to maturity in 2016 or 2015. Risk management results for the year ended December 31, 2016, related to the balance sheet hedging of variable rate debt indicates that the hedge was 100% effective, and no component of the derivative instrument’s gain or loss was excluded from the assessment of hedge effectiveness. At December 31, 2016, the fair value of the interest rate swap of \$94 was recorded in other liabilities. Net unrealized loss on the derivative instrument recognized in other comprehensive income during the year ended December 31, 2016, totaled \$16, net of tax. The net amount of other comprehensive loss reclassified into interest expense during the year ended December 31, 2016 was \$94, net of tax. As of December 31, 2016, approximately \$94 of losses reported in other comprehensive income related to the interest rate swap (\$57 after tax benefits) are expected to be reclassified into interest expense as a yield

## Notes to Consolidated Financial Statements (dollars in thousands except per share data)

adjustment of the hedged borrowings during the 12-month period ending December 31, 2017. The interest rate swap agreement was secured by cash and cash equivalents of \$230 at December 31, 2016, and \$430 at December 31, 2015.

During 2016, PSB reclassified \$155 (\$94 after tax impacts) of interest rate swap settlements which increased comprehensive income. The increase to comprehensive net income was recognized as a \$155 (\$94 after tax impacts) increase to interest expense on junior subordinated debentures on the statement of income during the year. During 2015, PSB reclassified \$185 (\$112 after tax impacts) of interest rate swap settlements which increased comprehensive income. The increase to comprehensive net income was recognized as a \$185 (\$112 after tax impacts) increase to interest expense on junior subordinated debentures on the statement of income during the year.

As of December 31, 2016, and 2015, PSB had various outstanding interest rate swaps with customers and correspondent banks associated with its lending activities that are not designed as hedges.

At December 31, the following floating interest rate swaps were outstanding with customers:

	<b>2016</b>	<b>2015</b>
Notional amount	\$3,046	\$6,513
Receive fixed rate (average)	2.14%	1.87%
Pay variable rate (average)	0.63%	0.24%
Maturity	3/2017-10/2021	12/2016-10/2021
Weighted average remaining term	3.7 years	2.7 years
Unrealized gain fair value	\$70	\$141

At December 31, the following offsetting fixed interest rate swaps were outstanding with correspondent banks:

	<b>2016</b>	<b>2015</b>
Notional amount	\$3,046	\$6,513
Pay fixed rate (average)	2.14%	1.87%
Receive variable rate (average)	0.63%	0.24%
Maturity	3/2017-10/2021	12/2016-10/2021
Weighted average remaining term	3.7 years	2.7 years
Unrealized loss fair value	(\$70)	(\$141)

### **NOTE 15 Retirement and Deferred Compensation Plans**

PSB has established a 401(k) profit sharing plan for its employees. PSB matches 100% of employees' salary deferrals up to the first 1% of pay deferred and 50% of salary deferrals of the next 5% of pay deferrals, for a maximum match of 3.5% of salary. PSB also may declare a discretionary profit sharing contribution. The expense recognized for contributions to the plan for the years ended December 31, 2016, 2015, and 2014 was \$660, \$646, and \$521 respectively.

PSB maintains deferred compensation agreements with certain executives and directors. PSB matches 20% of the amount of employees' salary deferrals up to the first 15% of base pay deferred. PSB directors may elect to defer earned directors' fees into a separate deferred directors' fees plan. No PSB match is made on deferred directors' fees. Cumulative deferred balances earn a crediting rate generally equal to 100% of PSB's return on average equity until retirement or separation from service. The agreements provide for benefits to be paid in a lump sum at retirement or in monthly installments for a period up to 15 years following each participant's normal retirement date with interest payable at a fixed interest rate ranging from 7% to 8%. PSB is accruing this liability over each participant's remaining period of service. The liability outstanding under the agreements was \$4,410 and \$3,932 at December 31, 2016 and 2015, respectively. The amount charged to operations was \$457, \$427, and \$333, for 2016, 2015, and 2014, respectively.

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

**NOTE 16 Self-Funded Health Insurance Plan**

PSB has established an employee medical benefit plan to self-insure claims up to \$75 during 2016 and 2017 for each individual with no stop-loss per year for participants in the aggregate. PSB and its covered employees contribute to the fund to pay the claims and stop-loss premiums. Medical benefit plan costs are expensed as incurred. The liability recognized for claims incurred but not yet paid was \$76 as of December 31, 2016, and \$95 as of December 31, 2015. Health and dental insurance expense recorded in 2016, 2015, and 2014 was \$1,203, \$1,053, and \$925, respectively.

**NOTE 17 Income Taxes**

The components of the provision for income taxes are as follows:

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Current income tax provision:			
Federal	\$3,247	\$3,151	\$2,236
State	1,016	920	763
<b>Total current</b>	<b>4,263</b>	<b>4,071</b>	<b>2,999</b>
Deferred income tax provision (benefit):			
Federal	(244)	(268)	(113)
State	(49)	(74)	20
<b>Total deferred</b>	<b>(293)</b>	<b>(342)</b>	<b>(93)</b>
<b>Total provision for income taxes</b>	<b>\$3,970</b>	<b>\$3,729</b>	<b>\$2,906</b>

A summary of the source of differences between income taxes at the federal statutory rate and the provision for income taxes for the years ended December 31 follows:

	<b>2016</b>		<b>2015</b>		<b>2014</b>	
	<b>Amount</b>	<b>Percent of Pretax Income</b>	<b>Amount</b>	<b>Percent of Pretax Income</b>	<b>Amount</b>	<b>Percent of Pretax Income</b>
Tax expense at statutory rate	\$ 4,218	34.0	\$ 3,903	34.0	\$ 3,178	34.0
Increase (decrease) in taxes resulting from:						
Tax-exempt interest	(595)	(4.8)	(617)	(5.4)	(605)	(6.5)
Bank-owned life insurance	(136)	(1.1)	(136)	(1.2)	(137)	(1.5)
Life insurance death benefits	(129)	(1.0)	-	-	-	-
State income tax	638	5.1	558	4.9	517	5.6
Other	(26)	(0.2)	21	0.2	(47)	(0.5)
<b>Provision for income taxes</b>	<b>\$ 3,970</b>	<b>32.0</b>	<b>\$ 3,729</b>	<b>32.5</b>	<b>\$ 2,906</b>	<b>31.1</b>

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of PSB's assets and liabilities. The major components of the net deferred tax assets are as follows:

	2016	2015
Deferred tax assets:		
Allowance for loan losses	\$ 2,410	\$ 2,502
Deferred compensation and directors' fees	1,738	1,621
Foreclosed assets	266	225
Unrealized loss on securities available for sale	444	-
Unrealized loss on interest rate swaps	37	88
Other	402	418
<b>Gross deferred tax assets</b>	<b>5,297</b>	<b>4,854</b>
Deferred tax liabilities:		
Premises and equipment	486	642
Mortgage servicing rights	766	692
FHLB stock	9	120
Unrealized gain on securities available for sale	-	150
Deferred net loan origination costs	105	143
Prepaid expenses	89	101
<b>Gross deferred tax liabilities</b>	<b>1,455</b>	<b>1,848</b>
<b>Net deferred tax asset</b>	<b>\$ 3,842</b>	<b>\$ 3,006</b>

At December 31, 2016, federal tax returns remained open for Internal Revenue Service (IRS) review for tax years after 2012, while state tax returns remain open for review by state taxing authorities for tax years after 2011. There were no federal or state income tax audits being conducted at December 31, 2016.

The following table presents income tax effects on items of comprehensive income (loss) for the years ended December 31:

	2016		2015		2014	
	Pretax Inc.(Exp.)	Income Tax Exp.(Credit)	Pretax Inc.(Exp.)	Income Tax Exp.(Credit)	Pretax Inc.(Exp.)	Income Tax Exp.(Credit)
Unrealized gain (loss) on securities available for sale	(\$1,322)	(\$521)	(\$683)	(\$269)	\$693	\$273
Reclassification adjustment for net security gain included in net income	-	-	-	-	(3)	(1)
Amortization of unrealized gain on securities available for sale transferred to securities held to maturity	(188)	(74)	(312)	(123)	(330)	(130)
Unrealized loss on interest rate swap	(26)	(10)	(83)	(33)	(73)	(29)
Reclassification adjustment of interest rate swap settlements included in earnings	155	61	185	73	188	74
<b>Totals</b>	<b>(\$1,381)</b>	<b>(\$544)</b>	<b>(\$893)</b>	<b>(\$352)</b>	<b>\$475</b>	<b>\$187</b>

## Notes to Consolidated Financial Statements (dollars in thousands except per share data)

### NOTE 18 Commitments, Contingencies, and Credit Risk

#### Financial Instruments With Off-Balance-Sheet Credit Risk

PSB is a party to 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 and standby letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheets.

PSB's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. PSB uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. These commitments at December 31 are as follows:

	2016	2015
Commitments to extend credit – Fixed and variable rates	\$ 84,020	\$96,206
Commercial standby letters of credit – Variable rate	2,241	3,614
Unused home equity lines of credit – Variable rate	33,638	32,909
Unused credit card commitments – Variable rate	563	405
Credit enhancement under the FHLB of Chicago		
Mortgage Partnership Finance program	924	924
<u>Totals</u>	<u>\$121,386</u>	<u>\$134,058</u>

Commitments to extend credit are agreements to lend to a customer if there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. PSB evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the party. Collateral held varies but may include accounts receivable, inventory, property, plant, and equipment, and income-producing commercial properties.

Letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which PSB deems necessary. The commitments are generally structured to allow for 100% collateralization on all letters of credit.

Unfunded commitments under home equity lines of credit are commitments for possible future extensions of credit to existing customers. These lines of credit are secured by residential mortgages not to exceed the collateral property fair market value upon origination and may or may not contain a specific maturity date.

Credit card commitments are commitments on credit cards issued by PSB and serviced by Elan Financial Services (a subsidiary of U.S. Bancorp). These commitments are unsecured. PSB normally sells all credit card balances and commitments to Elan. However, PSB provides full recourse to Elan against losses on certain card balances not owned by PSB. Aggregate exposure on the full recourse balances was \$562 at December 31, 2016, including \$403 of commitments unused by the cardholders.

PSB participates in the FHLB Mortgage Partnership Finance Program (the "Program") and also originates loans for purchase by FNMA and other secondary market entities. PSB enters into forward commitments to sell mortgage loans to these various secondary market agency providers under which loans are funded by the agencies and PSB receives an agency fee reported as a component of gain on sale of loans. PSB had approximately \$7,964 and \$5,435 in firm commitments to deliver loans to these providers outstanding at December 31, 2016 and 2015, respectively, from rate lock commitments made with customers.



## Notes to Consolidated Financial Statements (dollars in thousands except per share data)

### Concentration of Credit Risk

PSB grants residential mortgage, commercial, and consumer loans predominantly in Marathon, Oneida, and Vilas counties in Wisconsin. There are no significant concentrations of credit to any one debtor or industry group. Management believes the diversity of the local economy prevents significant losses during economic downturns.

### Contingencies

In the normal course of business, PSB is involved in various legal proceedings. In the opinion of management, any liability resulting from such proceedings would not have a material adverse effect on the consolidated financial statements.

### NOTE 19 Stock Based Compensation

PSB granted shares of restricted stock to certain employees having a market value of \$220, \$200, and \$200, during 2016, 2015, and 2014, respectively. The restricted shares vest to employees based on continued PSB service over a six-year period and are recognized as compensation expense over the vesting period. Cash dividends are paid on unvested shares at the same time and amount as paid to PSB common shareholders. Cash dividends paid on unvested restricted stock shares are charged to retained earnings since significantly all restricted shares are expected to vest to employees. As of December 31, 2016, 24,964 shares of restricted stock are outstanding that remained unvested. Unvested shares are subject to forfeiture upon employee termination.

The following table summarizes information regarding unvested restricted stock and shares outstanding during the three years ended December 31, 2016, 2015, and 2014.

	Unvested Shares	Weighted Average Grant Value
January 1, 2014	32,602	\$ 21.30
Restricted shares granted	6,400	31.25
Restricted shares vested	(7,640)	(18.91)
December 31, 2014	31,362	23.92
Restricted shares granted	5,634	25.50
Restricted shares vested	(8,457)	(19.75)
Unvested restricted shares forfeited	(1,652)	(23.08)
December 31, 2015	26,887	27.71
Restricted shares granted	4,971	44.25
Restricted shares vested	(6,894)	(23.64)
December 31, 2016	24,964	\$ 32.13

During 2016, total compensation expense of \$193 (before tax benefits of \$76) was recorded from amortization of restricted shares expected to vest. During 2015, total compensation expense of \$163 (before tax benefits of \$64) was recorded from amortization of restricted shares expected to vest. During 2014, total compensation expense of \$166 (before tax benefits of \$65) was recorded from amortization of restricted shares expected to vest. Future projected compensation expense (before tax benefits) assuming all restricted shares eventually vest to employees would be as follows:

2017	\$ 176
2018	162
2019	124
2020	84
2021	44
Total	\$ 590

## Notes to Consolidated Financial Statements (dollars in thousands except per share data)

### **NOTE 20 Capital Requirements and Regulatory Matters**

PSB and the Bank are subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory—and possibly additional discretionary—actions by regulators that, if undertaken, could have a direct material effect on PSB's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, PSB and the Bank must meet specific capital guidelines that involve quantitative measures of 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.

Effective January 1, 2015, PSB and the Bank are subject to a new capital adequacy framework called Basel III. Basel III includes several changes to the capital adequacy guidelines, including a new Common Equity Tier 1 capital requirement, increases to the minimum required Tier 1 risk-based capital ratios, and other changes to the calculation of regulatory capital and risk-weighted assets.

The payment of dividends by PSB or the Bank would be restricted if the Bank does not meet the minimum Capital Conservation Buffer as defined by Basel III regulatory capital guidelines and/or if, after payment of the dividend, the Bank would be unable to maintain satisfactory regulatory capital ratios. The Bank is also limited in making loans and advances to PSB. At December 31, 2016, management believes that maintaining the regulatory framework of the Bank at the well-capitalized level will effectively restrict potential dividends from the Bank to an amount less than \$23,674. Furthermore, any Bank dividend distributions to PSB above customary levels are subject to approval by the FDIC, the Bank's primary federal regulator, and the Wisconsin Department of Financial Institutions, the Bank's primary state regulator.

During 2015, the Federal Reserve Board amended its Small Bank Holding Company Policy Statement, which increased the asset threshold to qualify for the policy statement from \$500 million to \$1 billion. As a result, PSB qualifies for the policy statement in 2015 and, therefore, is not subject to consolidated regulatory capital requirements as of December 31, 2016. However, the subsidiary Bank is still subject to the regulatory capital requirements discussed above and whose capital ratios are shown in this footnote.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of Common Equity Tier 1 capital (as defined in the regulations), Tier 1 and Total capital to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2016, the Bank met all capital adequacy requirements. In addition, as of December 31, 2016, the most recent regulatory financial report categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the Bank must maintain minimum Common Equity Tier 1, Tier 1 risk-based, Total risk-based, and Tier 1 to average assets as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category.

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

The Bank's actual and regulatory capital amounts and ratios are as follows:

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<u>As of December 31, 2016:</u>						
<u>Peoples State Bank:</u>						
Common Equity Tier 1 capital (to risk weighted assets)	\$76,595	12.97%	\$26,567	4.50%	\$38,374	6.50%
Tier 1 capital (to risk weighted assets)	\$76,595	12.97%	\$35,422	6.00%	\$47,229	8.00%
Total capital (to risk weighted assets)	\$82,711	14.01%	\$47,229	8.00%	\$59,037	10.00%
Tier 1 capital (to average assets)	\$76,595	9.52%	\$32,175	4.00%	\$40,219	5.00%

As of December 31, 2015:

Peoples State Bank:

Common Equity Tier 1 capital (to risk weighted assets)	\$71,932	13.11%	\$24,693	4.50%	\$35,667	6.50%
Tier 1 capital (to risk weighted assets)	\$71,932	13.11%	\$32,924	6.00%	\$43,898	8.00%
Total capital (to risk weighted assets)	\$78,327	14.27%	\$43,898	8.00%	\$54,873	10.00%
Tier 1 capital (to average assets)	\$71,932	9.38%	\$30,688	4.00%	\$38,360	5.00%

**NOTE 21 Earnings Per Share**

Basic earnings per share of common stock are based on the weighted average number of common shares outstanding during the period. Unvested but issued restricted shares are considered to be outstanding shares and used to calculate the weighted average number of shares outstanding and determine net book value per share. Diluted earnings per share is calculated by dividing net income by the weighted average number of shares adjusted for the dilutive effect of outstanding stock options. The computation of earnings per share for the years ended December 31 is as follows:

	2016	2015	2014
Weighted average shares outstanding	1,539,985	1,603,907	1,651,045
Effect of dilutive stock options outstanding	-	-	-
Diluted weighted average shares outstanding	1,539,985	1,603,907	1,651,045
Basic earnings per share	\$5.48	\$4.83	\$3.90
Diluted earnings per share	\$5.48	\$4.83	\$3.90

**NOTE 22 Fair Value Measurements**

Certain assets and liabilities are recorded or disclosed at fair value to provide financial statement users additional insight into PSB's quality of earnings. Under current accounting guidance, PSB groups assets and liabilities which are recorded at fair value in three levels based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement (with Level 1 considered highest and Level 3 considered lowest). All transfers between levels are recognized as occurring at the end of the reporting period.

## Notes to Consolidated Financial Statements (dollars in thousands except per share data)

Following is a brief description of each level of the fair value hierarchy:

**Level 1** – Fair value measurement is based on quoted prices for identical assets or liabilities in active markets.

**Level 2** – Fair value measurement is based on (1) quoted prices for similar assets or liabilities in active markets; (2) quoted prices for identical or similar assets or liabilities in markets that are not active; or (3) valuation models and methodologies for which all significant assumptions are or can be corroborated by observable market data.

**Level 3** – Fair value measurement is based on valuation models and methodologies that incorporate at least one significant assumption that cannot be corroborated by observable market data. Level 3 measurements reflect PSB's estimates about assumptions market participants would use in measuring fair value of the asset or liability.

Some assets and liabilities, such as securities available for sale, loans held for sale, mortgage rate lock commitments, and interest rate swaps, are measured at fair value on a recurring basis under GAAP. Other assets and liabilities, such as impaired loans, foreclosed assets, mortgage servicing rights, and other intangible assets are measured at fair value on a nonrecurring basis.

Following is a description of the valuation methodology used for each asset and liability measured at fair value on a recurring or nonrecurring basis, as well as the classification of the asset or liability within the fair value hierarchy.

**Securities available for sale** – Securities available for sale may be classified as Level 1, Level 2, or Level 3 measurements within the fair value hierarchy and are measured on a recurring basis. Level 1 securities include equity securities traded on a national exchange. The fair value measurement of a Level 1 security is based on the quoted price of the security. Level 2 securities include U.S. government and agency securities, obligations of states and political subdivisions, corporate debt securities, mortgage-related securities, and negotiable FDIC insured certificates of deposit. The fair value measurement of a Level 2 security is obtained from an independent pricing service and is based on recent sales of similar securities and other observable market data and represents a market approach to fair value.

At December 31, 2016 and 2015, Level 3 securities include a common stock investment in Bankers' Bank, Madison, Wisconsin, that is not traded on an active market. Historical cost of the common stock is assumed to approximate fair value of this investment.

**Loans held for sale** – Loans held for sale in the secondary market are carried at the lower of aggregate cost or estimated fair value and are measured on a recurring basis. The fair value measurement of a loan held for sale is based on current secondary market prices for similar loans, which is considered a Level 2 measurement and represents a market approach to fair value.

**Impaired loans** – Loans are not measured at fair value on a recurring basis. Carrying value of impaired loans that are not collateral dependent are based on the present value of expected future cash flows discounted at the applicable effective interest rate and, thus, are not fair value measurements. However, impaired loans considered to be collateral dependent are measured at fair value on a nonrecurring basis. The fair value measurement of an impaired loan that is collateral dependent is based on the fair value of the underlying collateral. Fair value measurements of underlying collateral that utilize observable market data, such as independent appraisals reflecting recent comparable sales, are considered Level 2 measurements. Other fair value measurements that incorporate internal collateral appraisals or broker price opinions, net of selling costs, or estimated assumptions market participants would use to measure fair value, such as discounted cash flow measurements, are considered Level 3 measurements and represent a market approach to fair value.

In the absence of a recent independent appraisal, collateral dependent impaired loans are valued based on a recent broker price opinion generally discounted by 10% plus estimated selling costs. In the absence of a broker price opinion, collateral dependent impaired loans are valued at the lower of last appraisal value or the current real estate tax value discounted by 30%, plus estimated selling costs. Property values are impacted by many macroeconomic factors. In general, a declining economy or rising interest rates would be expected to lower fair value of collateral dependent impaired loans while an improving economy or falling interest rates would be expected to increase fair value of collateral dependent impaired loans.

**Foreclosed assets** – Real estate and other property acquired through, or in lieu of, loan foreclosure are not measured at fair value on a recurring basis. Initially, foreclosed assets are recorded at fair value less estimated costs to sell at the date of foreclosure. Estimated selling costs typically range from 5% to 15% of the property value. Valuations are periodically performed by management, and the real estate or other property is carried at the lower of carrying amount or fair value less estimated costs to sell. Fair value measurements are based on current formal or informal appraisals of property value compared to recent comparable sales of similar property. Independent appraisals reflecting comparable sales are considered Level 2 measurements, while internal assessments of appraised value based on current market activity, including broker price opinions, are considered Level 3 measurements and represent a market approach to fair value. Property values are impacted by many macroeconomic factors. In general, a declining economy or rising interest rates would be expected to lower fair value of foreclosed assets while an improving economy or falling interest rates would be expected to increase fair value of foreclosed assets.

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

**Mortgage servicing rights** – Mortgage servicing rights are not measured at fair value on a recurring basis. However, mortgage servicing rights that are impaired are measured at fair value on a nonrecurring basis. Serviced loan pools are stratified by year of origination and term of the loan, and a valuation model is used to calculate the present value of expected future cash flows for each stratum. When the carrying value of a stratum exceeds its fair value, the stratum is measured at fair value. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as costs to service, a discount rate, custodial earnings rate, ancillary income, default rates and losses, and prepayment speeds. Although some of these assumptions are based on observable market data, other assumptions are based on unobservable estimates of what market participants would use to measure fair value. As a result, the fair value measurement of mortgage servicing rights is considered a Level 3 measurement and represents an income approach to fair value. When market mortgage rates decline, borrowers may have the opportunity to refinance their existing mortgage loans at lower rates, increasing the risk of prepayment of loans on which PSB maintains mortgage servicing rights. Therefore, declining long-term interest rates would decrease the fair value of mortgage servicing rights. Significant unobservable inputs at December 31, 2016, used to measure fair value included:

Direct annual servicing cost per loan	\$ 70
Direct annual servicing cost per loan in process of foreclosure	\$ 600
Weighted average prepayment speed: CPR	32.20%
Weighted average prepayment speed: PSA	576.07%
Weighted average cash flow discount rate	7.93%
Asset reinvestment rate	4.00%
Short-term cost of funds	0.25%
Escrow inflation adjustment	1.00%
Servicing cost inflation adjustment	1.00%

**Mortgage rate lock commitments** – The fair value of mortgage rate lock commitments is measured on a recurring basis. Fair value is based on current secondary market pricing for delivery of similar loans and the value of OMSR on loans expected to be delivered, which is considered a Level 2 fair value measurement.

**Interest rate swap agreements** – Fair values for interest rate swap agreements are based on the amounts required to settle the contracts based on valuations provided by third-party dealers in the contracts, which is considered a Level 2 fair value measurement, and are measured on a recurring basis.

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

Information regarding the fair value of assets and liabilities measured at fair value on a recurring basis as of December 31:

	<b>Recurring Fair Value Measurements Using</b>			
	<b>Assets and Liabilities Measured at Fair Value</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
<u>2016</u>				
Assets:				
Securities available for sale:				
U.S. agency issued residential MBS and CMO	\$87,995	\$ -	\$87,995	\$ -
U.S. agency issued commercial mortgage-backed securities	2,626	-	2,626	-
Privately issued residential MBS and CMO	10	-	10	-
Negotiable FDIC insured bank certificates of deposit	2,940	-	2,940	-
Nonrated SBA loan fund	950	-	950	-
Other equity securities	47	-		47
Total securities available for sale	94,568	-	94,521	47
Loans held for sale	802	-	802	-
Mortgage rate lock commitment	151	-	151	-
Interest rate swap agreements	70	-	70	-
<b>Total assets</b>	<b>\$95,591</b>	<b>\$ -</b>	<b>\$95,544</b>	<b>\$ 47</b>
<b>Liabilities – Interest rate swap agreements</b>	<b>\$164</b>	<b>\$ -</b>	<b>\$164</b>	<b>\$ -</b>
<u>2015</u>				
Assets:				
Securities available for sale:				
U.S. agency issued residential MBS and CMO	\$80,339	\$ -	\$80,339	\$ -
Privately issued residential MBS and CMO	18	-	18	-
Negotiable FDIC insured bank certificates of deposit	1,952	-	1,952	-
Nonrated SBA loan fund	950	-	950	-
Other equity securities	47	-	-	47
Total securities available for sale	83,306	-	83,259	47
Mortgage rate lock commitment	49	-	49	-
Interest rate swap agreements	141	-	141	-
<b>Total assets</b>	<b>\$83,496</b>	<b>\$ -</b>	<b>\$83,449</b>	<b>\$ 47</b>
<b>Liabilities – Interest rate swap agreements</b>	<b>\$363</b>	<b>\$ -</b>	<b>\$363</b>	<b>\$ -</b>

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

There were no changes or activity in the Level 3 fair value measurements using significant unobservable inputs during the years ended December 31, 2016 or 2015.

Information regarding the fair value of assets and liabilities measured at fair value on a nonrecurring basis as of December 31 follows:

	<b><u>Nonrecurring Fair Value Measurements Using</u></b>			
		<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
	<b>Assets Measured at Fair Value</b>			
<u>2016</u>				
Assets:				
Impaired loans	\$ 75	\$-	\$ -	\$ 75
Foreclosed assets	373	-	53	320
Mortgage servicing rights	1,943	-	-	1,943
<b>Total assets</b>	<b>\$2,391</b>	<b>\$-</b>	<b>\$ 53</b>	<b>\$2,338</b>
<u>2015</u>				
Assets:				
Impaired loans	\$1,382	\$-	\$ -	\$1,382
Foreclosed assets	1,378	-	251	1,127
Mortgage servicing rights	1,757	-	-	1,757
<b>Total assets</b>	<b>\$4,517</b>	<b>\$-</b>	<b>\$ 251</b>	<b>\$4,266</b>

## **Notes to Consolidated Financial Statements (dollars in thousands except per share data)**

At December 31, 2016, loans with a carrying amount of \$135 were considered impaired and were written down to their estimated fair value of \$75, net of a valuation allowance of \$60. At December 31, 2015, loans with a carrying amount of \$1,670 were considered impaired and were written down to their estimated fair value of \$1,382, net of a valuation allowance of \$288. Changes in the valuation allowances are reflected through earnings as a component of the provision for loan losses or as a charge-off against the allowance for loan losses.

In 2016, foreclosed assets with a fair value of \$594 were acquired through or in lieu of foreclosure, which is the fair value net of estimated costs to sell. During 2016, foreclosed assets with a carrying amount of \$621 were written down to a fair value of \$373, less costs to sell. As a result, an impairment charge of \$248 was included in earnings for the year ended December 31, 2016. In 2015, foreclosed assets with a fair value of \$1,309 were acquired through or in lieu of foreclosure, which is the fair value net of estimated costs to sell. During 2015, foreclosed assets with a carrying amount of \$1,512 were written down to a fair value of \$1,378, less costs to sell. As a result, an impairment charge of \$134 was included in earnings for the year ended December 31, 2015.

At December 31, 2016, mortgage servicing rights with a carrying amount of \$1,998 were considered impaired and were written down to their estimated fair value of \$1,943, resulting in an impairment allowance of \$55. At December 31, 2015, mortgage servicing rights with a carrying amount of \$1,887 were considered impaired and were written down to their estimated fair value of \$1,757, resulting in an impairment allowance of \$130. Changes in the impairment allowances are reflected through earnings as a component of mortgage banking income.

PSB estimates fair value of all financial instruments regardless of whether such instruments are measured at fair value. The following methods and assumptions were used by PSB to estimate fair value of financial instruments not previously discussed.

**Cash and cash equivalents** – Fair value reflects the carrying value of cash, which is a Level 1 measurement.

**Securities held to maturity** – Fair value of securities held to maturity is based on dealer quotations on similar securities near period-end, which is considered a Level 2 measurement. Certain debt issued by banks or bank holding companies purchased by PSB as securities held to maturity is valued on a cash flow basis discounted using market rates reflecting credit risk of the borrower, which is considered a Level 3 measurement.

**Bank certificates of deposit** – Fair value of fixed rate certificates of deposit included in other investments is estimated by discounting future cash flows using current rates at which similar certificates could be purchased, which is a Level 3 measurement. These certificates of deposit are issued directly to PSB by the issuing bank and are subject to penalties for early withdrawal.

**Loans** – Fair value of variable rate loans that reprice frequently are based on carrying values. Loans with an active sale market, such as one- to four-family residential mortgage loans, estimate fair value based on sales of loans with similar structure and credit quality. Fair value of other loans is estimated by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings. Fair value of impaired and other nonperforming loans is estimated using discounted expected future cash flows or the fair value of underlying collateral, if applicable. Except for collateral dependent impaired loans valued using an independent appraisal of collateral value, reflecting a Level 2 fair value measurement, fair value of loans is considered to be a Level 3 measurement due to internally developed discounted cash flow measurements.

**Federal Home Loan Bank stock** – Fair value is the redeemable (carrying) value based on the redemption provisions of the Federal Home Loan Bank, which is considered a Level 3 fair value measurement.

**Accrued interest receivable and payable** – Fair value approximates the carrying value, which is considered a Level 3 fair value measurement.



**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

**Cash value of bank-owned life insurance** – Fair value is based on reported values of the assets by the issuer which are redeemable to the insured, which is considered a Level 2 fair value measurement.

**Deposits** – Fair value of deposits with no stated maturity, such as demand deposits, savings, and money market accounts, by definition, is the amount payable on demand on the reporting date. Fair value of fixed rate time deposits is estimated using discounted cash flows applying interest rates currently offered on issue of similar time deposits. Use of internal discounted cash flows provides a Level 3 fair value measurement.

**FHLB advances and other borrowings** – Fair value of fixed rate, fixed term borrowings is estimated by discounting future cash flows using the current rates at which similar borrowings would be made as calculated by the lender or correspondent. Fair value of borrowings with variable rates or maturing within 90 days approximates the carrying value of these borrowings. Fair values based on lender provided settlement provisions are considered a Level 2 fair value measurement. Other borrowings with local customers in the form of repurchase agreements with fixed interest rate terms in excess of 90 days are estimated using internal assessments of discounted future cash flows, which is a Level 3 measurement.

**Senior subordinated notes and junior subordinated debentures** – Fair value of fixed rate, fixed term notes and debentures are estimated internally by discounting future cash flows using the current rates at which similar borrowings would be made, which is a Level 3 fair value measurement.

The carrying amounts and fair values of PSB's financial instruments consisted of the following:

	December 31, 2016				
	Carrying Amount	Estimated Fair Value	Fair Value Hierarchy Level		
			Level 1	Level 2	Level 3
<b>Financial assets:</b>					
Cash and cash equivalents	\$ 34,994	\$ 34,994	\$34,994	\$ -	\$ -
Securities	166,004	165,515	-	163,766	1,749
Bank certificates of deposit	3,472	3,420	-	-	3,420
Net loans receivable and loans held for sale	586,911	586,685	-	802	585,883
Accrued interest receivable	2,189	2,189	-	-	2,189
Mortgage servicing rights	1,943	1,943	-	-	1,943
Mortgage rate lock commitments	151	151	-	151	-
FHLB stock	1,861	1,861	-	-	1,861
Cash surrender value of bank-owned life insurance	14,247	14,247	-	14,247	-
Interest rate swap agreements	70	70	-	70	-
<b>Financial liabilities:</b>					
Deposits	\$686,760	\$686,434	\$ -	\$ -	\$686,434
FHLB advances	37,769	37,467	-	37,467	-
Other borrowings	14,860	15,001	-	5,641	9,360
Senior subordinated notes	2,500	2,389	-	-	2,389
Junior subordinated debentures	7,732	7,484	-	-	7,484
Interest rate swap agreements	164	164	-	164	-
Accrued interest payable	633	633	-	-	633

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

	December 31, 2015				
	Carrying Amount	Estimated Fair Value	Fair Value Hierarchy Level		
			Level 1	Level 2	Level 3
<b>Financial assets:</b>					
Cash and cash equivalents	\$ 48,047	\$ 48,047	\$48,047	\$ -	\$ -
Securities	154,851	156,172	-	154,431	1,741
Bank certificates of deposit	9,178	9,201	-	-	9,201
Net loans receivable and loans held for sale	535,325	536,742	-	-	536,742
Accrued interest receivable	2,072	2,072	-	-	2,072
Mortgage servicing rights	1,757	1,757	-	-	1,757
Mortgage rate lock commitments	49	49	-	49	-
FHLB stock	2,556	2,556	-	-	2,556
Cash surrender value of bank-owned life insurance	13,981	13,981	-	13,981	-
Interest rate swap agreements	141	141	-	141	-
<b>Financial liabilities:</b>					
Deposits	\$666,176	\$665,903	\$ -	\$ -	\$665,903
FHLB advances	22,042	22,110	-	22,110	-
Other borrowings	11,527	11,823	-	5,796	6,027
Senior subordinated notes	3,500	3,264	-	-	3,264
Junior subordinated debentures	7,732	7,404	-	-	7,404
Interest rate swap agreements	363	363	-	363	-
Accrued interest payable	466	466	-	-	466

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

**NOTE 23 Condensed Parent Company Only Financial Statements**

The following are condensed balance sheets as of December 31, 2016 and 2015, and condensed statements of income and cash flows for the years ended December 31, 2016, 2015, and 2014, for PSB Holdings, Inc.

**Balance Sheets**  
December 31, 2016 and 2015

<i>Assets</i>	<b>2016</b>	<b>2015</b>
Cash and due from banks	\$ 3,628	\$ 4,464
Investment in Peoples State Bank	76,045	72,299
Other assets	435	500
<b>TOTAL ASSETS</b>	<b>\$80,108</b>	<b>\$77,263</b>
<i>Liabilities and Stockholders' Equity</i>		
Accrued dividends payable	\$ 687	\$ 662
Other borrowings	-	-
Senior subordinated notes	2,500	3,500
Junior subordinated debentures	7,732	7,732
Other liabilities	137	284
Total stockholders' equity	69,052	65,085
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$80,108</b>	<b>\$77,263</b>

**Statements of Income**  
Years Ended December 31, 2016, 2015, and 2014

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Income:			
Dividends from Peoples State Bank	\$4,400	\$5,600	\$3,900
Other interest and dividends	12	10	12
Total income	4,412	5,610	3,912
Expenses:			
Interest expense on other borrowings	-	2	27
Interest expense on senior subordinated notes	103	141	150
Interest expense on junior subordinated debentures	343	342	340
Other expenses	100	97	137
Total expenses	546	582	654
Income before income taxes and equity in undistributed net income of Peoples State Bank	3,866	5,028	3,258
Recognition of income tax benefit	209	223	251
Net income before equity in undistributed net income of Peoples State Bank	4,075	5,251	3,509
Equity in undistributed net income of Peoples State Bank	4,361	2,498	2,931
Net income	\$8,436	\$7,749	\$6,440

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

**Statements of Cash Flows**  
Years Ended December 31, 2016, 2015, and 2014

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Increase (decrease) in cash and due from banks:			
Cash flows from operating activities:			
Net income	\$8,436	\$7,749	\$6,440
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed net income of Peoples State Bank	(4,361)	(2,498)	(2,931)
Decrease in other assets	16	205	41
Decrease in other liabilities	(19)	(1)	(5)
Increase in dividends payable	25	10	8
Net cash provided by operating activities	4,097	5,465	3,553
Net cash provided by (used in) investing activities	-	-	-
Cash flows from financing activities:			
Repayment of senior subordinated notes	(1,000)	(500)	-
Repayment of other borrowings	-	(500)	(1,000)
Dividends declared	(1,379)	(1,337)	(1,316)
Purchase of treasury stock	(2,554)	(2,490)	(913)
Net cash used in financing activities	(4,933)	(4,827)	(3,229)
Net increase (decrease) in cash and due from banks	(836)	638	324
Cash and due from banks at beginning	4,464	3,826	3,502
Cash and due from banks at end	\$3,628	\$4,464	\$3,826

**Notes to Consolidated Financial Statements** (dollars in thousands except per share data)

**NOTE 24**      **Summary of Quarterly Results (Unaudited)**

	<b>Three Months Ended</b>			
	<b><u>March 31</u></b>	<b><u>June 30</u></b>	<b><u>September 30</u></b>	<b><u>December 31</u></b>
<u>2016</u>				
Interest income	\$6,951	\$7,098	\$7,382	\$7,486
Interest expense	937	960	1,035	988
Net interest income	6,014	6,138	6,347	6,498
Provision (credit) for loan losses	65	195	195	(400)
Noninterest income	1,480	1,771	1,905	1,813
Net income	1,845	2,057	2,224	2,310
Basic earnings per share*	1.18	1.33	1.45	1.51
Diluted earnings per share*	1.18	1.33	1.45	1.51
<u>2015</u>				
Interest income	\$6,573	\$6,916	\$6,906	\$6,977
Interest expense	904	898	944	945
Net interest income	5,669	6,018	5,962	6,032
Provision (credit) for loan losses	140	140	(1,020)	210
Noninterest income	1,461	1,584	1,577	1,526
Net income	1,678	1,877	2,358	1,836
Basic earnings per share*	1.03	1.16	1.48	1.16
Diluted earnings per share*	1.03	1.16	1.48	1.16
<u>2014</u>				
Interest income	\$6,405	\$6,618	\$6,833	\$6,762
Interest expense	1,231	1,168	1,099	988
Net interest income	5,174	5,450	5,734	5,774
Provision for loan losses	140	140	140	140
Noninterest income	1,320	1,369	1,481	1,524
Net income	1,450	1,403	1,782	1,805
Basic earnings per share*	0.87	0.85	1.08	1.10
Diluted earnings per share*	0.87	0.85	1.08	1.10

\* Basic and diluted earnings per share may not foot to the total for the year ended December 31 due to rounding.

# Notes

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