HARVARD ILLINOIS BANCORP, INC.

2016
Annual Report

Harvard Illinois Bancorp, Inc.

Independent Auditor's Report and
Financial Statements

December 31, 2016

Harvard Illinois Bancorp, Inc.

December 31, 2016

Contents

BKD LLP
CPAs & Advisors

225 N. Water Street, Suite 400 // Decatur, IL 62523-2326
217.429.2411 // fax 217.429.6109 // bkd.com

Independent Auditor's Report

Audit Committee and Board of Directors
Harvard Illinois Bancorp, Inc.
Rockford, Illinois

We have audited the accompanying statement of net assets in liquidation of Harvard Illinois Bancorp, Inc. ("Company") as of December 31, 2016, the related statement of changes in net assets in liquidation for the period November 3, 2016 to December 31, 2016, and the related notes (financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of 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 the financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the balance sheet is 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 financial statements referred to above present fairly, in all material respects, the net assets in liquidation of Harvard Illinois Bancorp, Inc. as of December 31, 2016, and the changes in its net assets in liquidation for the period November 3, 2016 to December 31, 2016, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 2 to the financial statements, the stockholders of Harvard Illinois Bancorp, Inc. approved a plan of liquidation on November 2, 2016, and the Company determined liquidation is imminent. As a result the Company changed its basis of accounting for the period subsequent to November 2, 2016. Our opinion is not modified with respect to this matter.

Other Matter

Management is responsible for the accompanying statements of income, stockholders' equity and cash flows for the period ended November 2, 2016, in accordance with accounting principles generally accepted in the United States of America. We have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants. We did not audit or review the financial statements nor were we required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, we do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

BKD, LLP

Decatur, Illinois
April 3, 2017

Harvard Illinois Bancorp, Inc.
Statement of Net Assets in Liquidation
December 31, 2016
(dollars in thousands, except share data)

	2016
Nonintererst-bearing demand deposits in banks	$ 283
Interest-bearing demand deposits in other financial institutions	1,935
Interest-bearing deposits in other financial institutions	4,000
Cash and cash equivalents	6,218
Asset in lieu of secured borrowing	8,100
Other assets	274
Deferred compensation	(1,155)
Accrued liquidation costs	(1,873)
Other liabilities	(99)
Net assets in liquidation	$ 11,465

Harvard Illinois Bancorp, Inc.

Statement of Changes in Net Assets in Liquidation

For the Period November 3, 2016 to December 31, 2016

(dollars in thousands, except share data)

	2016
Net Assets in Liquidation as of November 3, 2016	$ 11,465
Remeasurement of Assets and Liabilities	—
Net Assets in Liquidation as of December 31, 2016	$ 11,465

See Notes to Financial Statement

Harvard Illinois Bancorp, Inc.
Statement of Income (Unaudited)
For the Period Ended November 2, 2016
(dollars in thousands, except share data)

	2016
Interest and Dividend Income	$ 37
Noninterest Income	
Other	130
Noninterest Expense	
Compensation and benefits	323
Occupancy	7
Professional fees	181
Other	33
Total noninterest expense	544
Loss From Continuing Operations Before Income Taxes	(377)
Income From Operations of Discontinued Subsidiary (including gain on sale of $2,247)	2,665
Provision for Income Taxes	—
Net Income	$ 2,288

Harvard Illinois Bancorp, Inc.

Statement of Stockholders' Equity (Unaudited)

For the Period Ended November 2, 2016

(dollars in thousands, except share data)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance, January 1, 2016	$ 8	$ 7,482	$ 3,720	$ 73	$ 11,283
Net income (Unaudited)	—	—	2,288	—	2,288
Sale of securities (Unaudited)	—	—	—	(73)	(73)
Stock option exercise	—	6	—	—	6
Stock compensation expense (Unaudited)	—	61	—	—	61
Balance, November 2, 2016	$ 8	$ 7,549	$ 6,008	$ —	$ 13,565

Harvard Illinois Bancorp, Inc.
Statement of Cash Flows (Unaudited)
For the Period Ended November 2, 2016
(dollars in thousands, except share data)

	2016
Operating Activities from Continuing Operations	
Net loss	$ (377)
Items not requiring (providing) cash	
Deferred income taxes	—
Net realized gains on available-for-sale securities	(27)
Changes in	
Other assets	(84)
Deferred compensation	(1,047)
Other liabilities	99
Net cash used in operating activities	(1,436)
Investing Activity from Continuing Operations	
Proceeds from the sales of available-for-sale securities	37
Net cash provided by investing activities	37
Financing Activity from Continuing Operations	
Stock options exercised	6
Net cash provided by financing activities	6
Net Cash Provided by Discontinued Operations	1,143
Net Decrease in Cash and Cash Equivalents	(250)
Cash and Cash Equivalents, January 1, 2016	6,695
Cash and Cash Equivalents, November 2, 2016	$ 6,445
Supplemental Cash Flows Information	
Income taxes paid	$ —
Cash Flows from Discontinued Operations	
Net cash used in operating activities	$ (745)
Net cash provided by investing activities	5,076
Net Cash used in financing activities	(3,188)
Net Cash Provided by Discontinued Operations	$ 1,143

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

On August 1, 2016, Harvard Savings Bank (Bank), which was the wholly owned subsidiary of Harvard Illinois Bancorp, Inc. (Company), completed the sale of substantially all of its assets and the transfer of substantially all of its liabilities to State Bank, located in Wonder Lake, Illinois. Following the purchase and assumption of the assets of the Bank, the Bank subsequently merged with and into the Company. The Company does not currently have any business operations and will continue to exist solely for purposes of collecting and distributing its assets.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the valuation of asset in lieu of secured borrowing and accrued liquidation costs.

Cash Equivalents

The Company considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2016, cash equivalents consisted primarily of interest-bearing demand deposits.

At December 31, 2016, none of the Company’s cash accounts exceeded federally insured limits.

Asset in Lieu of Secured Borrowing

At December 31, 2016, the Company had an undivided interest in certain assets, including real estate, cash and other miscellaneous assets obtained in partial satisfaction of a repurchase agreement as further described in Note 3. These assets are either under the control of a court appointed receiver or held in a liquidating trust and are valued at fair value less the estimated cost of disposal (net realizable value).

Stock Options

At December 31, 2016, the Company recognizes the fair value (calculated value) of stock-based awards to employees as compensation cost over the requisite service period. The stock based compensation plan is described more fully in Note 7.

Income Taxes

The Company accounts for income taxes in accordance with income tax accounting guidance (ASC 740, *Income Taxes*). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Tax positions are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to management's judgment. With a few exceptions, the Company is no longer subject to U.S. federal, state and local or non-U.S. income tax examinations by tax authorities for years before 2013.

The Company recognizes interest and penalties on income taxes as a component of income tax expense.

(dollars in thousands)

Note 2: Liquidation Basis of Accounting

The Company's stockholders approved a plan of dissolution and complete liquidation (the "Plan of Dissolution") of the Company and the dissolution of the Company at its annual stockholders meeting held November 2, 2016.

Liabilities include estimated costs to be incurred through liquidation. These include approximately $1,600 in operating costs and $500 in professional fees as of November 3, 2016.

The following is a reconciliation of stockholders' equity as of November 2, 2016 to net assets in liquidation as of December 31, 2016:

Stockholders' Equity as of November 2, 2016	$	13,565
Accrued liquidation costs (added with adoption of liquidation basis of accounting on November 3, 2016)		(2,100)
Net assets in liquidation as of December 31, 2016	$	11,465

The following is a reconciliation of accrued liquidation costs as of November 3, 2016 to those as of December 31, 2016:

Accrued liquidation costs as of November 3, 2016	$	2,100
Expense incurred (11/3/16 to 12/31/16)		(227)
Accrued liquidation costs as of December 31, 2016	$	1,873

Note 3: Asset in Lieu of Secured Borrowing

During 2013, the Company entered into a repurchase agreement with First Farmers Financial, LLC ("FFF"), which was represented to be backed by the guaranteed portion of certain United States Department of Agriculture (USDA) loans, through a Third-Party. FFF was an approved USDA lender. The Company had a long history with the Third-Party and has participated in similar arrangements since 2003. In September 2014, the Third-Party notified the Company that it no longer believed that certain of the loans underlying the repurchase agreement were enforceable loans to the stated borrowers, and that further that the USDA guarantee and related USDA assignment guarantee agreements were invalid. As of the date of this discovery, the Company's interest in the repurchase agreement totaled approximately $18,058.

The default on the repurchase agreement during September 2014 was initially accounted for as a secured borrowing. In an effort to recoup losses, the Third-Party is pursuing various collection efforts that have resulted in court approved agreements identifying and seizing certain assets (which have been recognized in the accompany balance sheet as Assets in Lieu of Secured Borrowing) that are to be liquidated by a receiver or the Third-Party for the benefit of the Company and other investors. Assets in Lieu of Secured Borrowing consist of cash and cash equivalents, commercial and other real estate, and other assets. As of December 31, 2016, the Company's interest in the Assets in Lieu of Secured Borrowing totaled approximately $8,100. During 2016, the Company received no payments to decrease the balance in the asset in lieu of secured borrowing.

The value of the Company's interest in the Assets in Lieu of Secured Borrowing is subject to uncertainties with respect to the collection and liquidation and the estimate of the amount recoverable could differ materially in the near term. The Company is closely monitoring and supporting the collection efforts by the Third-Party and will continue to vigorously pursue all possible avenues to fully collect the initial recorded amount of the asset.

Note 4: Shares Outstanding

Shares outstanding as of December 31, 2016 are as follows:

- Preferred stock, $.01 par value, 1,000,000 shares authorized, no shares issued or outstanding
- Common stock, $.01 par value, 30,000,000 shares authorized; issued and outstanding – 797,873 shares

Harvard Illinois Bancorp, Inc.
Notes to Financial Statements
December 31, 2016
(dollars in thousands)

Note 5: Income Taxes

The Company files income tax returns in the U.S. federal and state of Illinois jurisdictions.

The tax effects of temporary differences related to deferred taxes shown on the balance sheet were:

Deferred tax assets		
Accrued compensation and employee benefits	$	395
Net operating loss carryforwards		2,267
Capital loss carryforwards		146
Other		2
		2,810
Deferred tax liabilities		—
Net deferred tax asset before valuation allowance		2,810
Valuation allowance		
Beginning balance		4,425
Increase (decrease) during the period		(1,615)
Ending balance		2,810
Net deferred tax asset	$	—

As of December 31, 2016 management established a full valuation allowance of $2,810 against existing net deferred tax assets. Under accounting principles generally accepted in the United States of America, a valuation allowance is required to be recognized if it is "more likely than not" that a deferred tax asset will not be realized. The realizability of the deferred tax asset is based on management's evaluation of both positive and negative evidence, the forecasts of future income, prudent and feasible tax planning strategy and assessments of current and future economic and business conditions. Positive evidence includes the existence of taxes paid in available carry-back years as well as taxable income projections for future periods, while negative evidence includes losses in the current year and reduced regulatory capital ratios. After evaluating all of the factors previously summarized and considering the weight of the positive evidence compared to the negative evidence, the Company has determined a full valuation adjustment was necessary as of December 31, 2016.

The Company's deferred tax asset valuation allowance includes realized losses of equity securities.

At December 31, 2016, the Company had federal net operating loss carryforwards totaling approximately $6,666, which expire in varying amounts between 2024 and 2035.

At December 31, 2016, the Company had Illinois net operating loss carryforwards totaling approximately $7,672. Management had not previously recorded a deferred tax asset for the state net operating loss carryforwards.

The increase (decrease) in the valuation allowance in 2016 was to provide an allowance for the entire deferred tax asset.

Note 6: Employee Benefit Plans and Agreement

The Company has a supplemental employee retirement plan with certain officers of the Company. The plan provides for benefits to be paid upon retirement of the officers. The charge to the expense for the plan was $91 (Unaudited) in 2016. Such charges reflect the straight-line accrual over the period until full eligibility of the present value of benefits due each participant on the full eligibility date, using a 5.12 percent to 8.84 percent annual discount factor. The liability for the plan was $1,155 at December 31, 2016. During 2016, the director plans were terminated and corresponding liabilities were paid in full. The charge to the expense for the director plans was $24 (Unaudited) in 2016.

As of December 31, 2016, the Company has employment agreements with two officers which provide for compensation and other benefits if the officers are employed during the time of the Company's dissolution and complete liquidation.

Note 7: Stock-based Compensation

On May 26, 2011, the stockholders approved the Harvard Illinois Bancorp, Inc. 2011 Equity Incentive Plan (the "Equity Incentive Plan") for employees and directors of the Company. The Equity Incentive Plan authorizes the issuance of up to 109,856 shares of the Company's common stock, with no more than 31,387 of shares as restricted stock awards and 78,469 as stock options, either incentive stock options or non-qualified stock options. The Company believes that such awards better align the interests of its employees with those of its shareholders. The exercise price of options granted under the Equity Incentive Plan may not be less than the fair market value on the date the stock option is granted. The compensation committee of the board of directors has sole discretion to determine the amount and to whom equity incentive awards are granted. Certain option awards provide for accelerated vesting if there is a change of control (as defined in the Equity Incentive Plan).

On June 23, 2011, the compensation committee of the board of directors approved the awards of 73,761 options to purchase Company stock and 31,387 shares of restricted stock. Of the 73,761 stock options granted, 63,167 were qualified stock options and 10,594 were nonqualified. The remaining 4,708 shares were awarded on November 29, 2012. Stock options and restricted stock vest over a five year period, and stock options expire ten years after issuance. Apart from the vesting schedule for both stock options and restricted stock, there are no performance-based conditions or any other material conditions applicable to the awards issued.

The fair value of each option award is estimated on the date of grant using a Black-Scholes option valuation model that uses the various assumptions. Expected volatility is based on historical volatility of the Company's stock and other factors. The Company uses historical data to estimate option exercise and employee termination within the valuation model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The expected term of options granted represents the period of time that options are expected to be outstanding; the range given below results from certain groups of employees exhibiting different behavior. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

A summary of the option activity under the Equity Incentive Plan as of December 31, 2016 and changes during the years then ended, is presented below (dollars in thousands):

	2016			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, beginning of year	52,960	$ 8.67		
Granted	—	—		
Exercised	785	8.10		
Forfeited or expired	17,975	8.51		
Outstanding, end of year	34,200	$ 8.76	3.62	$ 213
Exercisable, end of year	34,200	$ 8.76	3.62	$ 213

(dollars in thousands)

The Company granted no options in 2016. The total intrinsic value of options exercised during the year ended December 31, 2016 was $6.

Stock-based compensation expense for stock options for the year ended December 31, 2016 was $35 (Unaudited). There is no remaining unrecognized compensation expense as of December 31, 2016

The total fair value of shares vested during the year ended December 31, 2016 was $72.

A summary of the status of the Company's nonvested shares as of December 31, 2016 and changes during the year then ended, is presented below:

	December 31, 2016	
	Shares	Weighted-Average Grant-Date Fair Value
Nonvested, beginning of year	17,125	$ 4.23
Granted	—	—
Vested	(17,125)	4.23
Forfeited	—	—
Nonvested, end of year	—	$ —

The following table summarizes nonvested restricted stock activity for the year ended December 31, 2016:

	2016	
	Shares	Weighted Average Grant-Date Fair Value
Balance, beginning of year	6,131	$ 9.23
Granted	—	—
Forfeited	(188)	(8.10)
Earned and issued	(5,491)	(8.35)
Balance, end of year	452	$ 17.25

The fair value of the restricted stock awards is amortized to compensation expense over the vesting period (five years) and is based on the market price of the Company's common stock at the date of grant multiplied by the number of shares granted that are expected to vest. At the date of grant the par value of the shares granted was recorded in equity as a credit to common stock and a debit to paid-in capital. Stock-based compensation expense for restricted stock for the years ended December 31, 2016 was $23 (Unaudited). There was no unrecognized compensation expense for nonvested restricted stock awards at December 31, 2016.

Total compensation expense for both plans for the year ended December 31, 2016 was $61 (Unaudited).

Note 8: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Other significant estimates and concentrations not discussed in those footnotes include:

General Litigation and Other

The Company is subject to claims and lawsuits that arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the financial position, results of operations and cash flows of the Company.

The Company must also indemnify the buyer for a certain period after the sale of the subsidiary. This is not expected to have a material adverse effect on the financial position of the Company.

Other Assets in Lieu of Secured Borrowing

Other assets in lieu of secured borrowing have a carrying value of $8,100 at December 31, 2016. The carrying value reflects management's best estimate of the amount to be realized from the liquidation of the collateral and distribution to the investors. While the estimate is based on valuations by an independent appraiser, pending sales contracts and assessed tax values, for the various real estate, the market for such properties is limited. Therefore, the amount that the Company realizes from the liquidation of the collateral and distribution to the investors could differ materially in the near term from the carrying value reflected in these financial statements.

Note 9: Subsequent Event

Subsequent events have been evaluated through the date of the Independent Auditor's Report, which is the date the financial statements were available to be issued.

This Page Intentionally Left Blank

This Page Intentionally Left Blank