

PEOPLES-SIDNEY FINANCIAL CORPORATION
Sidney, Ohio

ANNUAL REPORT
June 30, 2016

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**SELECTED CONSOLIDATED FINANCIAL
INFORMATION AND OTHER DATA**

The following tables set forth certain information concerning the consolidated financial condition and earnings of, and other data regarding, the Corporation at the dates and for the periods indicated.

<u>Selected Financial Condition and Other Data:</u>	<u>At June 30,</u>				
	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
	(In thousands)				
Total amount of:					
Assets	\$ 111,309	\$ 111,703	\$ 118,245	\$ 119,861	\$ 129,239
Securities available for sale	8,006	7,986	5,979	1,961	2,070
FHLB stock	1,895	1,895	1,895	1,895	1,895
Loans, net (1)	82,257	79,105	82,585	90,740	105,067
Deposits	94,322	94,569	100,794	101,440	100,119
Borrowed funds	1,366	1,686	2,054	2,471	13,062
Shareholders' equity	15,075	15,028	14,866	15,390	15,473
<u>Selected Operations Data:</u>	<u>Year ended June 30,</u>				
	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
	(In thousands)				
Interest income	\$ 4,420	\$ 4,677	\$ 4,913	\$ 5,675	\$ 6,548
Interest expense	367	478	603	1,176	1,736
Net interest income	4,053	4,199	4,310	4,499	4,812
Provision for loan losses	41	119	854	134	897
Net interest income after provision for loan losses	4,012	4,080	3,456	4,365	3,915
Noninterest income (loss)	138	123	(178)	1	60
Noninterest expense	3,519	3,408	3,552	3,516	3,538
Income (loss) before income taxes	631	795	(274)	850	437
Income tax expense (benefit)	194	249	(138)	291	150
Net income (loss)	<u>\$ 437</u>	<u>\$ 546</u>	<u>\$ (136)</u>	<u>\$ 559</u>	<u>\$ 287</u>
Earnings (loss) per common share - basic	<u>\$ 0.35</u>	<u>\$ 0.44</u>	<u>\$ (0.11)</u>	<u>\$ 0.45</u>	<u>\$ 0.23</u>
Dividends declared per share	<u>\$ 0.32</u>	<u>\$ 0.32</u>	<u>\$ 0.32</u>	<u>\$ 0.46</u>	<u>\$ 0.47</u>

(Continued)

Selected Financial Ratios and Other Data:

Performance Ratios:	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Return on assets (ratio of net income to average total assets)	0.39%	0.48%	(0.11)%	0.43%	0.22%
Return on equity (ratio of net income to average equity)	2.90	3.65	(0.89)	3.63	1.81
Dividend payout ratio (6)	91.43	72.73	(290.91)	102.22	204.35
Interest rate spread (2)	3.63	3.73	3.64	3.48	3.55
Net interest margin (3)	3.69	3.81	3.72	3.60	3.72
Ratio of operating expense to average total assets	3.14	3.02	2.97	2.72	2.65
Ratio of average interest-earning assets to average interest-bearing liabilities	1.18x	1.17x	1.15x	1.13x	1.13x
Quality Ratios:					
Nonperforming assets to total assets at end of period (4)	2.22%	2.61%	4.74%	6.12%	7.13%
Allowance for loan losses to nonperforming loans	47.51	36.94	21.88	15.41	15.45
Allowance for loan losses to gross loans (5)	1.40	1.34	1.31	1.01	1.11
Capital Ratios:					
Shareholders' equity to total assets at end of period	13.54	13.45	12.57	12.84	11.97
Average equity to average assets	13.43	13.25	12.80	11.93	11.90
Other Data:					
Number of full service offices (7)	4	4	4	4	4

- (1) Loans are shown net of net deferred loan fees, loans in process and the allowance for loan losses.
- (2) The average interest rate spread represents the difference between the weighted average yield on interest-earning assets and the weighted average cost of interest-bearing liabilities.
- (3) The net interest margin represents net interest income as a percent of average interest-earning assets.
- (4) Nonperforming assets consist of nonperforming loans and foreclosed assets. Nonperforming loans consist of all accruing loans 90 days or more past due and all nonaccrual loans.
- (5) Gross loans are stated at unpaid principal balances, net of deferred loan fees.
- (6) Dividends declared per share divided by basic earnings per common share.
- (7) Full service offices include the main office and separate drive-through facility and three full-service branches located in Anna, Jackson Center and the Sidney Wal-Mart.

Yields Earned and Rates Paid. The following table sets forth certain information relating to the Corporation's average balance sheet and reflects the average yield on interest-earning assets and the average cost of interest-bearing liabilities for the periods indicated. Such yields and costs are derived by dividing income or expense by the average balances of interest-earning assets or interest-bearing liabilities, respectively, for the periods presented. Average balances are derived from average daily balances. Nonaccruing loans have been included in the table as loans carrying a zero yield.

(Continued)

	Year ended June 30,					
	2016			2015		
	Average outstanding balance	Interest earned/ paid	Yield/ rate	Average outstanding balance	Interest earned/ paid	Yield/ rate
	(Dollars in thousands)					
ASSETS:						
Interest-earning assets:						
Interest-earning deposits	\$ 17,343	\$ 49	0.28%	\$ 19,008	\$ 32	0.17%
Securities available for sale (1)	9,382	128	1.36	8,055	95	1.17
Loans (2)	81,260	4,167	5.13	81,244	4,474	5.51
FHLB stock	<u>1,895</u>	<u>76</u>	<u>4.01</u>	<u>1,895</u>	<u>76</u>	<u>4.00</u>
Total interest earning assets	<u>109,880</u>	<u>4,420</u>	<u>4.02</u>	<u>110,202</u>	<u>4,677</u>	<u>4.24</u>
Noninterest-earning assets:						
Cash and due from banks	1,450			1,465		
Allowance for loan losses	(1,121)			(1,103)		
Premises and equipment, net	1,372			1,430		
Accrued interest and other assets	<u>497</u>			<u>792</u>		
Total noninterest-earning assets	<u>2,198</u>			<u>2,584</u>		
Total assets	<u>\$ 112,078</u>			<u>\$ 112,786</u>		
LIABILITIES AND SHAREHOLDERS' EQUITY:						
Interest-bearing liabilities:						
Savings deposits	\$ 35,472	\$ 18	0.05%	\$ 33,166	\$ 16	0.05%
Demand and NOW deposits	29,709	20	0.07	28,726	21	0.07
Certificate accounts	<u>26,770</u>	<u>264</u>	<u>0.99</u>	<u>30,675</u>	<u>362</u>	<u>1.18</u>
Total interest-bearing deposits	91,951	302	0.33	92,567	399	0.43
Borrowed funds	<u>1,515</u>	<u>65</u>	<u>4.29</u>	<u>1,857</u>	<u>79</u>	<u>4.27</u>
Total interest-bearing liabilities	<u>93,466</u>	<u>367</u>	<u>0.39</u>	<u>94,424</u>	<u>478</u>	<u>0.51</u>
Noninterest-bearing liabilities						
Demand deposits	3,096			2,957		
Accrued interest payable and other liabilities	<u>468</u>			<u>457</u>		
Total noninterest-bearing liabilities	<u>3,564</u>			<u>3,414</u>		
Total liabilities	97,030			97,838		
Total shareholders' equity	<u>15,048</u>			<u>14,948</u>		
Total liabilities and shareholders' equity	<u>\$ 112,078</u>			<u>\$ 112,786</u>		
Net interest income; interest rate spread (3)						
		<u>\$ 4,053</u>	<u>3.63%</u>		<u>\$ 4,199</u>	<u>3.73%</u>
Net earning assets						
	<u>\$ 16,414</u>			<u>\$ 15,778</u>		
Net interest margin (4)						
			<u>3.69%</u>			<u>3.81%</u>
Average interest-earning assets to interest-bearing liabilities (5)						
	<u>1.18x</u>			<u>1.17x</u>		

(1) Average balance includes unrealized gains and losses while yield is based on amortized cost.

(2) Calculated net of deferred loan fees, loan discounts, loans in process and includes nonperforming loans.

(3) Net interest rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.

(4) Net interest margin represents net interest income divided by average interest-earning assets as calculated for the yields.

(5) Calculation uses average interest earning assets as calculated for the yields.

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Peoples-Sidney Financial Corporation
Sidney, Ohio

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Peoples-Sidney Financial Corporation, which comprise the consolidated balance sheets as of June 30, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Peoples-Sidney Financial Corporation as of June 30, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Cleveland, Ohio
September 9, 2016

PEOPLES-SIDNEY FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEETS
June 30, 2016 and 2015

	2016	2015
ASSETS		
Cash and due from financial institutions	\$ 1,582,542	\$ 1,542,416
Interest-bearing deposits in other financial institutions	8,585,346	6,111,641
Federal Reserve deposit	5,116,036	11,065,460
Overnight deposits	<u>1,000,000</u>	<u>1,000,000</u>
Total cash and cash equivalents	16,283,924	19,719,517
Interest-bearing time deposits in other financial institutions	992,000	992,000
Securities available for sale	8,005,926	7,985,862
Federal Home Loan Bank stock	1,894,500	1,894,500
Loans, net of allowance of \$1,172,000 and \$1,075,100	82,257,040	79,104,577
Accrued interest receivable	386,856	383,822
Premises and equipment, net	1,344,227	1,405,106
Other assets	<u>144,402</u>	<u>217,829</u>
 Total assets	 <u>\$ 111,308,875</u>	 <u>\$ 111,703,213</u>
 LIABILITIES		
Deposits	\$ 94,322,326	\$ 94,569,492
Borrowed funds	1,366,243	1,686,383
Accrued interest payable and other liabilities	<u>545,365</u>	<u>419,720</u>
Total liabilities	96,233,934	96,675,595
 SHAREHOLDERS' EQUITY		
Preferred stock, \$.01 par value, 500,000 shares authorized, none issued and outstanding	--	--
Common stock, \$.01 par value, 3,500,000 shares authorized, 1,670,224 shares issued	16,702	16,702
Additional paid-in capital	9,246,826	9,246,826
Retained earnings	11,003,683	10,965,367
Treasury stock, 424,814 shares at cost	(5,203,285)	(5,203,285)
Accumulated other comprehensive income	<u>11,015</u>	<u>2,008</u>
Total shareholders' equity	<u>15,074,941</u>	<u>15,027,618</u>
 Total liabilities and shareholders' equity	 <u>\$ 111,308,875</u>	 <u>\$ 111,703,213</u>

See accompanying notes to consolidated financial statements.

PEOPLES-SIDNEY FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Years Ended June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Interest income		
Loans, including fees	\$ 4,167,010	\$ 4,474,299
Securities	127,812	94,470
Demand, time and overnight deposits	49,067	32,490
Dividends on Federal Home Loan Bank stock	<u>75,936</u>	<u>75,780</u>
Total interest income	4,419,825	4,677,039
Interest expense		
Deposits	302,335	398,386
Borrowed funds	<u>64,952</u>	<u>79,236</u>
Total interest expense	<u>367,287</u>	<u>477,622</u>
Net interest income	4,052,538	4,199,417
Provision for loan losses	<u>41,139</u>	<u>118,800</u>
Net interest income after provision for loan losses	4,011,399	4,080,617
Noninterest income		
Service fees and other charges	134,629	134,514
Gain (loss) on sale of REO and repossessions	1,854	(33,858)
Mortgage banking income	925	664
Gain on sale of premises and equipment	-	6,500
Other	<u>1,135</u>	<u>15,082</u>
Total noninterest income	138,543	122,902
Noninterest expense		
Compensation and benefits	1,940,333	1,846,859
Director fees	120,000	120,000
Occupancy and equipment	372,291	373,603
Computer processing	426,863	393,805
Professional services	177,924	165,755
State taxes	132,727	132,969
Federal deposit insurance	85,706	93,916
REO and repossessions expense	-	4,193
Other	<u>262,951</u>	<u>277,621</u>
Total noninterest expense	<u>3,518,795</u>	<u>3,408,721</u>
Income before income taxes	631,147	794,798
Income tax expense	<u>194,300</u>	<u>248,900</u>
Net income	<u>\$ 436,847</u>	<u>\$ 545,898</u>
Earnings per common share - basic	<u>\$ 0.35</u>	<u>\$ 0.44</u>

See accompanying notes to consolidated financial statements.

PEOPLES-SIDNEY FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Net Income	\$ 436,847	\$ 545,898
Other comprehensive income:		
Unrealized gains on securities:		
Unrealized holding gain arising during the period	13,647	20,968
Tax effect	<u>(4,640)</u>	<u>(7,130)</u>
Total other comprehensive income	<u>9,007</u>	<u>13,838</u>
Comprehensive income	<u>\$ 445,854</u>	<u>\$ 559,736</u>

See accompanying notes to consolidated financial statements.

PEOPLES-SIDNEY FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years Ended June 30, 2016 and 2015

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balance, July 1, 2014	\$ 16,702	\$ 9,246,826	\$ 10,818,000	\$ (5,203,285)	\$ (11,830)	\$ 14,866,413
Net income for the year ended June 30, 2015	--	--	545,898	--	--	545,898
Other comprehensive income	--	--	--	--	13,838	13,838
Cash dividends - \$.32 per share	--	--	(398,531)	--	--	(398,531)
Balance, June 30, 2015	16,702	9,246,826	10,965,367	(5,203,285)	2,008	15,027,618
Net income for the year ended June 30, 2016	--	--	436,847	--	--	436,847
Other comprehensive income	--	--	--	--	9,007	9,007
Cash dividends - \$.32 per share	--	--	(398,531)	--	--	(398,531)
Balance, June 30, 2016	<u>\$ 16,702</u>	<u>\$ 9,246,826</u>	<u>\$ 11,003,683</u>	<u>\$ (5,203,285)</u>	<u>\$ 11,015</u>	<u>\$ 15,074,941</u>

See accompanying notes to consolidated financial statements.

PEOPLES-SIDNEY FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended June 30, 2016 and 2015

	2016	2015
Cash flows from operating activities		
Net income	\$ 436,847	\$ 545,898
Adjustments to reconcile net income to net cash from operating activities		
Depreciation	123,050	120,120
Gain on sale of premises and equipment	--	(6,500)
Provision for loan losses	41,139	118,800
Amortization of mortgage servicing rights	2,007	1,048
Net accretion of securities	(6,417)	(3,994)
(Gain) loss on sale of REO and repossessions	(1,854)	33,858
Charitable contribution of real estate	--	22,560
Deferred taxes expense	(19,671)	80,327
Change in:		
Accrued interest receivable and other assets	(14,400)	62,168
Accrued expense and other liabilities	223,462	(100,957)
Deferred loan fees	(3,076)	(24,372)
Net cash from operating activities	781,087	848,956
Cash flows from investing activities		
Proceeds from calls of securities available for sale	12,000,000	4,000,000
Purchases of securities available for sale	(12,000,000)	(5,982,200)
Proceeds from maturities of time deposits	248,000	--
Purchases of time deposits	(248,000)	(992,000)
Net change in loans	(3,190,272)	3,397,077
Premises and equipment expenditures	(62,171)	(41,683)
Proceeds from sale of premises and equipment	--	6,500
Proceeds from sale of REO and repossessions	1,600	523,288
Net cash from investing activities	(3,250,843)	910,982
Cash flows from financing activities		
Net change in deposits	(247,166)	(6,224,972)
Repayments of long-term FHLB advances	(320,140)	(367,512)
Cash distribution for redemption of common stock in conjunction with 2008 reverse stock split	--	(10,000)
Cash dividends paid	(398,531)	(398,531)
Net cash used in financing activities	(965,837)	(7,001,015)
Net change in cash and cash equivalents	(3,435,593)	(5,241,077)
Cash and cash equivalents at beginning of year	19,719,517	24,960,594
Cash and cash equivalents at end of year	\$ 16,283,924	\$ 19,719,517
Supplemental cash flow information		
Interest paid	\$ 369,135	\$ 481,002
Income taxes paid	110,000	120,000
Supplemental noncash disclosures		
Transfer from loans to REO and repossessions	1,600	117,280
Transfer from REO to loans for properties sold under land contracts	--	124,948

See accompanying notes to consolidated financial statements.

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The consolidated financial statements include Peoples-Sidney Financial Corporation (“Peoples”) and its wholly-owned subsidiary, Peoples Federal Savings and Loan Association (the “Association”), a federal stock savings and loan association, together referred to as the Corporation. Intercompany accounts and transactions have been eliminated in consolidation.

Nature of Operations: The Corporation provides financial services through its main office in Sidney, Ohio, and branch offices in Sidney, Anna and Jackson Center, Ohio. Its primary deposit products are checking, savings and term certificate accounts, and its primary lending products are residential mortgages, commercial real estate, land, commercial business and consumer loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets and commercial and residential real estate. Commercial real estate and commercial business loans are expected to be repaid from cash flow from operations of businesses. There are no significant concentrations of loans to any one industry or customer. However, the customers’ ability to repay their loans is dependent on the real estate and general economic conditions in the area. Other financial instruments, which potentially represent concentrations of credit risk, include deposit accounts in other financial institutions and overnight deposits.

Subsequent Events: The Corporation has evaluated subsequent events for recognition and disclosure through September 9, 2016, which is the date that the Corporation’s financial statements were available to be issued.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ.

Cash Flows: Cash and cash equivalents include cash, deposits with financial institutions and the Federal Reserve, overnight deposits, and time deposits with original maturities of 90 days or less. Overnight deposits are sold for one-day periods. Net cash flows are reported for loan and deposit transactions, as well as short-term borrowings under its cash management line of credit with the Federal Home Loan Bank of Cincinnati. Overnight deposits with a carrying amount of \$1,000,000 were pledged to secure public deposits totaling \$750,000 as of June 30, 2016.

Interest-Bearing Time Deposits in Other Financial Institutions: Interest-bearing time deposits in other financial institutions mature within two years and are carried at cost.

Securities: Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains or losses reported in other comprehensive income, net of tax.

Interest income includes amortization of premiums and accretion of discounts recognized on the level yield method. Realized gains and losses on sales of securities are recorded on the trade date and determined using the amortized cost of the specific security sold.

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Management evaluates securities for other-than-temporary impairment (“OTTI”) at least on a quarterly basis and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of these criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

Federal Home Loan Bank (FHLB) Stock: The Association is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Loans Held for Sale: Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

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

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, less net deferred loan fees and the allowance for loan losses. The recorded investment in loans also includes accrued interest receivable.

Interest income is accrued on the unpaid principal balance using the interest method and includes amortization of net deferred loan fees over the loan term. Interest income on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. Past due status is based upon the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Under the cost-recovery method, interest income is not recognized until the loan balance is reduced to zero. Under the cash-basis method, interest income is recorded when the payment is received in cash. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 the Corporation 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 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 reason for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Commercial, commercial real estate and one- to four-family rental loans are individually evaluated for impairment. In addition, one- to four-family residential loans are evaluated for impairment if cross-collateralized with previously mentioned loan segments. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. 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 separately identified for impairment disclosures. Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective interest rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The general component covers non-impaired loans and loans collectively evaluated for impairment and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Corporation over the most recent three years. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels and trends in nonperforming loans; changes in portfolio composition; results of outside loan reviews; changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; trends and changes in property values; local economic trends and conditions; impact of competition and regulations; and effects of changes in credit concentrations. The following portfolio segments have been identified.

Residential Mortgages Loans: Residential mortgage loans represent loans to consumers for the construction, purchase, refinance or improvement of a residence. These loans also include variable rate home equity lines of credit. Real estate market values at the time of origination directly affect the amount of credit extended and, in the event of default, subsequent changes in these values may impact the severity of losses. Factors considered by management include unemployment levels and residential real estate values in the Corporation's market area.

Commercial Real Estate Loans: Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans. These loans are viewed primarily as cash flow loans and the repayment of these loans is largely dependent on the successful operation of the property. 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 property types. Management specifically considers vacancy rates in its market area, as well as real estate values and, to a lesser extent, unemployment and energy prices.

Land Loans: Land loans include loans to develop vacant or raw land and are made to various builders and developers with whom the Corporation has had long-standing relationships. The Corporation also makes loans to individuals who purchase and hold land for various reasons, such as the future construction of a residence. Land lending is considered to involve a higher level of credit risk due to the fact that funds are advanced upon the security of the land, which is of uncertain value prior to its development.

Commercial Business Loans: Commercial credit is extended to commercial customers for use in normal business operations to finance working capital needs, equipment purchases, or other projects. The majority of these borrowers are customers doing business in the Corporation's primary market area. These loans are generally underwritten individually and secured with the assets of the company and the personal guarantee of the business owners. Commercial business loans are made based primarily on the basis of the borrower's ability to make repayment from the historical and projected cash flow of the borrower's business and the underlying collateral provided by the borrower. Management specifically considers unemployment, energy prices and, to a lesser extent, real estate values and vacancies in the Corporation's market area.

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Consumer Loans: Consumer loans are primarily comprised of secured loans including automobile loans, loans on savings deposits and home improvement loans, and to a lesser extent unsecured personal loans. These loans are underwritten based on several factors including debt to income, type of collateral and loan to collateral value, credit history and relationship with the borrower. Unemployment rates and energy prices are specifically considered by management.

Servicing Assets: Servicing rights are recognized separately when they are acquired through sales of loans. When mortgage loans are sold, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present of estimated future net servicing income. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Corporation later determines that all or portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income for servicing loans is based on a contractual percentage of the outstanding principal; or a fixed amount per loan and is recorded as income when earned. The amortization of mortgage servicing rights is netted against mortgage banking income.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Corporation, the transferee obtains the right (free of conditions that constrain it from taking advantage of the right) to pledge or exchange the transferred assets, and the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Other Real Estate Owned and Repossessions: Assets acquired through or instead of loan foreclosure are initially recorded at fair value at acquisition less estimated selling costs, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Any reduction to fair value from the carrying value of the related loan at the time the property is acquired is accounted for as a loan charge-off. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Gains and losses on disposition, and changes in the valuation allowance are reported in net gain or loss on other real estate owned.

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation expense is calculated using the straight-line method based on the estimated useful lives of the assets. The useful lives range from 10 years to 40 years for building and improvements, 3 years to 20 years for furniture and equipment and 5 years for automobiles. These assets are reviewed for impairment when events indicate the carrying amount may not be recoverable. Maintenance and repairs are charged to expense as incurred and improvements are capitalized.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax basis of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense.

Employee Stock Ownership Plan: The cost of shares issued to the Employee Stock Ownership Plan (“ESOP”), but not yet allocated to participants, is shown as a reduction of shareholders’ equity. Compensation expense is based on the average market price of shares as quoted on the Over the Counter Bulletin Board, as they are committed to be released to participant accounts. Dividends on allocated ESOP shares reduce retained earnings; dividends on unearned ESOP shares reduce debt and accrued interest. Participants may exercise a put option and require the Corporation to repurchase their ESOP shares upon termination of employment.

Advertising Costs: Advertising costs are generally expensed as incurred. Advertising expense included in other noninterest expense totaled \$16,537 and \$14,184 for the years ending June 30, 2016 and 2015.

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

Earnings Per Common Share: Basic earnings per common share (“EPS”) is net income divided by the weighted average number of common shares outstanding during the period. ESOP shares are considered outstanding for this calculation unless unearned. Weighted average common shares outstanding were 1,245,410 for 2016 and 2015.

Dividend Restriction: Financial institution regulations require the maintenance of certain capital levels and may limit the amount of dividends that may be paid. For detail on dividend restrictions and regulatory capital requirements, see Note 10.

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 June 30, 2016 and 2015

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income, net of tax. Other comprehensive income includes net unrealized gains and losses on securities available for sale, which is also recognized as a separate component of equity.

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

Restrictions on Cash: At June 30, 2016 and 2015, the Association was required to have \$34,000 and \$31,000 on deposit with its correspondent banks as a compensating clearing requirement.

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

Reclassifications: Reclassification of certain amounts in the prior years consolidated financial statements have been made to conform to the current presentation. Reclassification had no effect on prior year net income or shareholders' equity.

NOTE 2 - SECURITIES AVAILABLE FOR SALE

The amortized cost and fair value of available for sale securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income were as follows.

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<u>2016</u>				
U.S. Government agencies	<u>\$ 7,989,236</u>	<u>\$ 16,690</u>	<u>\$ --</u>	<u>\$ 8,005,926</u>
<u>2015</u>				
U.S. Government agencies	<u>\$ 7,982,819</u>	<u>\$ 12,159</u>	<u>\$ (9,116)</u>	<u>\$ 7,985,862</u>

Contractual maturities of securities available for sale at year-end 2016 were as follows. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in less than one year	<u>\$ 1,989,236</u>	<u>\$ 2,000,081</u>
Due after one year through five years	<u>6,000,000</u>	<u>6,005,845</u>
	<u>\$ 7,989,236</u>	<u>\$ 8,005,926</u>

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PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 2 - SECURITIES AVAILABLE FOR SALE (Continued)

No securities were pledged at year-end 2016 or 2015. There were no sales of securities in fiscal 2016 or 2015.

Securities with unrealized losses at year-end 2015, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows. At year-end 2016, the Corporation held no securities which were in an unrealized loss position.

<u>Description of Securities</u>	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>
<u>2015</u>						
U.S. Government agencies	\$ 2,990,884	\$ (9,116)	\$ --	\$ --	\$ 2,990,884	\$ (9,116)

Unrealized losses on the investment securities have not been recognized into income because the securities are of high credit quality (rated AA or higher), management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates and other market conditions. These securities were called during fiscal 2016 at par which was equal to the securities amortized cost resulting in no realized gain or loss.

NOTE 3 - LOANS

Year-end loans were as follows.

	<u>2016</u>	<u>2015</u>
Residential mortgages:		
1-4 family residential	\$ 39,021,561	\$ 36,268,919
1-4 family rental	17,119,693	18,990,531
Home equity line of credit	1,897,358	1,887,580
Commercial real estate	17,062,672	15,646,961
Land	1,379,851	1,450,793
Commercial Business	4,930,566	4,208,860
Consumer	<u>2,211,790</u>	<u>1,923,560</u>
Total loans	83,623,491	80,377,204
Less:		
Allowance for loan losses	(1,172,000)	(1,075,100)
Deferred loan fees	<u>(194,451)</u>	<u>(197,527)</u>
	<u>\$ 82,257,040</u>	<u>\$ 79,104,577</u>

At June 30, 2016 and 2015, there were no loans held for sale. Mortgage loans serviced for others are not reported as assets. The principal balance of these loans at June 30, 2015 was \$351,371. Servicing rights associated with the serviced loans totaled \$2,007 at June 30, 2015. No mortgage loans were serviced for others at June 30, 2016.

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PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 3 - LOANS (Continued)

The following table presents the activity in the allowance for loan losses by portfolio segment for the years ending June 30, 2016 and 2015:

<u>June 30, 2016</u>	<u>Residential Mortgages</u>	<u>Commercial Real Estate</u>	<u>Land</u>	<u>Commercial Business</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
Allowance for loan losses:							
Beginning balance	\$ 957,900	\$ 38,200	\$ 3,600	\$ 74,400	\$ 1,000	\$ --	\$ 1,075,100
Provision for loan losses	(198,776)	56,900	500	4,976	15,439	162,100	41,139
Loans charged-off	(25,170)	--	--	(12,291)	(6,739)	--	(44,200)
Recoveries	<u>97,346</u>	<u>--</u>	<u>--</u>	<u>2,615</u>	<u>--</u>	<u>--</u>	<u>99,961</u>
Total ending allowance balance	<u>\$ 831,300</u>	<u>\$ 95,100</u>	<u>\$ 4,100</u>	<u>\$ 69,700</u>	<u>\$ 9,700</u>	<u>\$ 162,100</u>	<u>\$ 1,172,000</u>
<u>June 30, 2015</u>							
Allowance for loan losses:							
Beginning balance	\$ 930,400	\$ 20,000	\$ 3,600	\$ 134,500	\$ 6,100	\$ 1,000	\$ 1,095,600
Provision for loan losses	170,034	18,200	--	(57,369)	(11,065)	(1,000)	118,800
Loans charged-off	(144,868)	--	--	(3,031)	(1,594)	--	(149,493)
Recoveries	<u>2,334</u>	<u>--</u>	<u>--</u>	<u>300</u>	<u>7,559</u>	<u>--</u>	<u>10,193</u>
Total ending allowance balance	<u>\$ 957,900</u>	<u>\$ 38,200</u>	<u>\$ 3,600</u>	<u>\$ 74,400</u>	<u>\$ 1,000</u>	<u>\$ --</u>	<u>\$ 1,075,100</u>

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of June 30, 2016 and 2015. The recorded investment in loans includes the unpaid principal balance, \$356,775 of accrued interest and (\$194,451) of unamortized deferred loan fees at June 30, 2016. The recorded investment in loans includes the unpaid principal balance, \$363,723 of accrued interest and (\$197,527) of unamortized deferred loan fees at June 30, 2015.

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 3 - LOANS (Continued)

<u>June 30, 2016</u>	<u>Residential Mortgages</u>	<u>Commercial Real Estate</u>	<u>Land</u>	<u>Commercial Business</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
Allowance for loan losses attributable to loans evaluated for impairment:							
Individually	\$ 75,700	\$ --	\$ --	\$ 31,200	\$ --	\$ --	\$ 106,900
Collectively	<u>755,600</u>	<u>95,100</u>	<u>4,100</u>	<u>38,500</u>	<u>9,700</u>	<u>162,100</u>	<u>1,065,100</u>
Total ending allowance	<u>\$ 831,300</u>	<u>\$ 95,100</u>	<u>\$ 4,100</u>	<u>\$ 69,700</u>	<u>\$ 9,700</u>	<u>\$ 162,100</u>	<u>\$ 1,172,000</u>
Loans evaluated for impairment at year-end:							
Individually	\$ 734,431	\$ 1,335,346	\$ --	\$ 49,753	\$ --	\$ --	\$ 2,119,530
Collectively	<u>57,353,104</u>	<u>15,817,835</u>	<u>1,390,222</u>	<u>4,894,158</u>	<u>2,210,966</u>	<u>--</u>	<u>81,666,285</u>
Total ending loans	<u>\$ 58,087,535</u>	<u>\$ 17,153,181</u>	<u>\$ 1,390,222</u>	<u>\$ 4,943,911</u>	<u>\$ 2,210,966</u>	<u>\$ --</u>	<u>\$ 83,785,815</u>
<u>June 30, 2015</u>							
Allowance for loan losses attributable to loans evaluated for impairment:							
Individually	\$ 148,400	\$ --	\$ --	\$ 49,000	\$ --	\$ --	\$ 197,400
Collectively	<u>809,500</u>	<u>38,200</u>	<u>3,600</u>	<u>25,400</u>	<u>1,000</u>	<u>--</u>	<u>877,700</u>
Total ending allowance	<u>\$ 957,900</u>	<u>\$ 38,200</u>	<u>\$ 3,600</u>	<u>\$ 74,400</u>	<u>\$ 1,000</u>	<u>\$ --</u>	<u>\$ 1,075,100</u>
Loans evaluated for impairment at year-end:							
Individually	\$ 1,397,683	\$ 1,354,658	\$ --	\$ 79,299	\$ --	\$ --	\$ 2,831,640
Collectively	<u>55,800,357</u>	<u>14,380,530</u>	<u>1,460,767</u>	<u>4,146,249</u>	<u>1,923,857</u>	<u>--</u>	<u>77,711,760</u>
Total ending loans	<u>\$ 57,198,040</u>	<u>\$ 15,735,188</u>	<u>\$ 1,460,767</u>	<u>\$ 4,225,548</u>	<u>\$ 1,923,857</u>	<u>\$ --</u>	<u>\$ 80,543,400</u>

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 3 - LOANS (Continued)

The following table presents information related to impaired loans by class of loans as of and for the year ended June 30, 2016 and June 30, 2015:

<u>June 30, 2016</u>	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Allowance for Loan Losses Allocated</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Cash Basis Interest Recognized</u>
With no related allowance recorded:						
Residential mortgages:						
1-4 family residential	\$ 125,477	\$ 125,213	\$ --	\$ 128,468	\$ --	\$ --
1-4 family rental	412,250	410,758	--	693,111	3,971	3,971
Home equity line of credit	--	--	--	--	--	--
Commercial real estate	1,336,314	1,335,346	--	1,345,372	65,676	65,676
Land	--	--	--	--	--	--
Commercial business	18,573	18,520	--	24,764	1,161	1,161
Consumer	--	--	--	--	--	--
Subtotal	<u>1,892,614</u>	<u>1,889,837</u>	<u>--</u>	<u>2,191,715</u>	<u>70,808</u>	<u>70,808</u>
With an allowance recorded:						
Residential mortgages:						
1-4 family residential	--	--	--	--	--	--
1-4 family rental	198,874	198,460	75,700	207,246	--	--
Home equity line of credit	--	--	--	--	--	--
Commercial real estate	--	--	--	--	--	--
Land	--	--	--	--	--	--
Commercial business	31,233	31,233	31,200	32,546	2,852	2,852
Consumer	--	--	--	--	--	--
Subtotal	<u>230,107</u>	<u>229,693</u>	<u>106,900</u>	<u>239,792</u>	<u>2,852</u>	<u>2,852</u>
Total	<u>\$ 2,122,721</u>	<u>\$ 2,119,530</u>	<u>\$ 106,900</u>	<u>\$ 2,431,507</u>	<u>\$ 73,660</u>	<u>\$ 73,660</u>

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 3 - LOANS (Continued)

<u>June 30, 2015</u>	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Allowance for Loan Losses Allocated</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Cash Basis Interest Recognized</u>
With no related allowance recorded:						
Residential mortgages:						
1-4 family residential	\$ 222,734	\$ 222,312	\$ --	\$ 277,292	\$ 4,664	\$ 4,664
1-4 family rental	762,529	760,466	--	948,974	12,523	12,523
Home equity line of credit	--	--	--	--	--	--
Commercial real estate	1,355,742	1,354,658	--	2,007,984	76,698	76,698
Land	--	--	--	--	--	--
Commercial business	30,452	30,312	--	26,425	703	703
Consumer	--	--	--	--	--	--
Subtotal	<u>2,371,457</u>	<u>2,367,748</u>	<u>--</u>	<u>3,260,675</u>	<u>94,588</u>	<u>94,588</u>
With an allowance recorded:						
Residential mortgages:						
1-4 family residential	--	--	--	--	--	--
1-4 family rental	415,927	414,905	148,400	371,234	6,866	6,866
Home equity line of credit	--	--	--	--	--	--
Commercial real estate	--	--	--	--	--	--
Land	--	--	--	--	--	--
Commercial business	48,987	48,987	49,000	60,356	3,130	3,130
Consumer	--	--	--	--	--	--
Subtotal	<u>464,914</u>	<u>463,892</u>	<u>197,400</u>	<u>431,590</u>	<u>9,996</u>	<u>9,996</u>
Total	<u>\$ 2,836,371</u>	<u>\$ 2,831,640</u>	<u>\$ 197,400</u>	<u>\$ 3,692,265</u>	<u>\$ 104,584</u>	<u>\$ 104,584</u>

The recorded investment in loans includes accrued interest receivable and loan origination fees, net. The average recorded investment excludes loan origination fees, net due to immateriality.

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 3 - LOANS (Continued)

The following tables present the recorded investment in nonaccrual and loans past due 90 days or more still on accrual by class of loans as of June 30, 2016 and June 30, 2015:

	Nonaccrual		Loans Past Due 90 Days or More Still Accruing	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Residential Mortgages:				
1-4 family residential	\$ 469,016	\$ 295,654	\$ --	\$ --
1-4 family rental	609,218	1,175,372	--	--
Home equity line of credit	--	--	--	--
Commercial real estate	1,335,346	1,354,658	--	--
Land	--	--	--	--
Commercial business	49,753	79,299	--	--
Consumer	--	--	--	--
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total	<u>\$ 2,463,333</u>	<u>\$ 2,904,983</u>	<u>\$ --</u>	<u>\$ --</u>

Nonaccrual loans and loans past due 90 days or more still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following table presents the aging of the recorded investment in past due loans by class of loans.

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Not Past Due	Total
	<u>June 30, 2016</u>					
Residential Mortgages:						
1-4 family residential	\$ 342,524	\$ --	\$ 469,016	\$ 811,540	\$ 38,244,568	\$ 39,056,108
1-4 family rental	5,891	--	280,724	286,615	16,831,333	17,117,948
Home equity LOC	--	--	--	--	1,913,479	1,913,479
Commercial real estate	--	--	661,218	661,218	16,491,963	17,153,181
Land	--	--	--	--	1,390,222	1,390,222
Commercial business	6,515	--	18,520	25,035	4,918,876	4,943,911
Consumer	<u>27,741</u>	<u> </u>	<u> </u>	<u>27,741</u>	<u>2,183,225</u>	<u>2,210,966</u>
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total	<u>\$ 382,671</u>	<u>\$ --</u>	<u>\$ 1,429,478</u>	<u>\$ 1,812,149</u>	<u>\$ 81,973,666</u>	<u>\$ 83,785,815</u>
<u>June 30, 2015</u>						
Residential Mortgages:						
1-4 family residential	\$ 673,664	\$ 108,351	\$ 206,535	\$ 988,550	\$ 35,321,188	\$ 36,309,738
1-4 family rental	101,522	--	440,626	542,148	18,443,351	18,985,499
Home equity LOC	--	--	--	--	1,902,803	1,902,803
Commercial real estate	691,289	80,599	248,384	1,020,272	14,714,916	15,735,188
Land	--	--	--	--	1,460,767	1,460,767
Commercial business	18,657	--	45,103	63,760	4,161,788	4,225,548
Consumer	<u>19,790</u>	<u>12,354</u>	<u> </u>	<u>32,144</u>	<u>1,891,713</u>	<u>1,923,857</u>
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total	<u>\$ 1,504,922</u>	<u>\$ 201,304</u>	<u>\$ 940,648</u>	<u>\$ 2,646,874</u>	<u>\$ 77,896,526</u>	<u>\$ 80,543,400</u>

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 3 - LOANS (Continued)

Troubled Debt Restructurings

Included in loans individually impaired are loans with balances of \$308,138 and \$447,086 for which the Corporation has allocated \$73,500 and \$57,600 of the allowance for loan losses to customers whose loans have been classified as troubled debt restructurings as of June 30, 2016 and 2015. There are no commitments to lend additional amounts to borrowers with loans that are classified as troubled debt restructurings at June 30, 2016 and 2015. All troubled debt restructured loans are on nonaccrual at June 30, 2016 and 2015.

Troubled debt restructured loans include loans initiated or existing loans with modified terms made to borrowers experiencing financial difficulty. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Corporation's internal underwriting policy. There were no loans modified as troubled debt restructurings that occurred during the year ending June 30, 2016. There was one loan modified as troubled debt restructurings that occurred during the year ending June 30, 2015.

The following table presents loans by class modified as trouble debt restructurings that occurred during the year ending June 30, 2015.

	<u>Number of Loans</u>	<u>Pre-Modification Outstanding Recorded Investment</u>	<u>Post-Modification Outstanding Recorded Investment</u>
Troubled Debt Restructurings:			
Residential Mortgages:			
1-4 family residential	--	\$ --	\$ --
1-4 family rental	1	143,400	143,400
Home equity line of credit	--	--	--
Commercial real estate	--	--	--
Land	--	--	--
Commercial business	--	--	--
Consumer	--	--	--
Total	<u>1</u>	<u>\$ 143,400</u>	<u>\$ 143,400</u>

The troubled debt restructuring described above increased the allowance for loan losses by \$23,400 and resulted in no charge-offs during the year ended June 30, 2015.

A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms. There were no loans modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the years ending June 30, 2016 and 2015.

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 3 - LOANS (Continued)

Credit Quality Indicators

The Corporation categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, underlying value of the collateral and current economic trends, among other factors. The Corporation analyzes loans individually by classifying the loans as to credit risk. This analysis includes non-homogeneous loans, such as all commercial real estate and commercial business loans. This analysis is performed at least annually and more frequently if the Corporation has concerns about the status of a borrower. Loans that are rated Watch, Special Mention, Substandard or Doubtful receive increased monitoring, on at least a monthly basis.

The Corporation uses the following definitions for risk rating.

Watch: Loans classified as watch are considered satisfactory but which are below average credit risk due to financial weakness or uncertainty. The level of risk in the watch classification is considered acceptable and within normal underwriting guidelines, so long as the loan is given the proper level of management supervision.

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

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

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass-rated loans. Loans listed as not rated are included in groups of homogeneous loans.

As of June 30, 2016 and 2015, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows.

	<u>Pass</u>	<u>Watch</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Not Rated</u>	<u>Total</u>
<u>June 30, 2016</u>						
Residential mortgages:						
1-4 family residential	\$ 385,229	\$ --	\$ --	\$ 469,016	\$ 38,201,863	\$ 39,056,108
1-4 family rental	--	--	--	1,018,507	16,099,441	17,117,948
Home equity LOC	--	--	--	--	1,913,479	1,913,479
Commercial real estate	15,207,196	--	--	1,945,985	--	17,153,181
Land	--	--	--	--	1,390,222	1,390,222
Commercial business	4,833,901	--	--	110,010	--	4,943,911
Consumer	--	--	--	--	2,210,966	2,210,966
Total	<u>\$ 20,426,326</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 3,543,518</u>	<u>\$ 59,815,971</u>	<u>\$ 83,785,815</u>

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 3 - LOANS (Continued)

	Pass	Watch	Special Mention	Substandard	Not Rated	Total
<u>June 30, 2015</u>						
Residential mortgages:						
1-4 family residential	\$ 470,293	\$ --	\$ --	\$ 295,654	\$ 35,543,791	\$ 36,309,738
1-4 family rental	--	--	--	1,690,965	17,294,534	18,985,499
Home equity LOC	--	--	--	--	1,902,803	1,902,803
Commercial real estate	14,035,881	--	--	1,699,307	--	15,735,188
Land	--	--	--	--	1,460,767	1,460,767
Commercial business	4,065,168	--	--	160,380	--	4,225,548
Consumer	--	--	--	--	1,923,857	1,923,857
Total	<u>\$ 18,571,342</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 3,846,306</u>	<u>\$ 58,125,752</u>	<u>\$ 80,543,400</u>

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, the Corporation also evaluates credit quality based on the performance status of the loan. Nonperforming loans include loans on nonaccrual status and loans past due 90 days or more still accruing interest. The following table presents the recorded investment in residential and consumer loans based on performance status as of June 30, 2016 and 2015.

	Residential mortgage			Consumer
	1-4 family Residential	1-4 family Rental	Home Equity LOC	
<u>June 30, 2016</u>				
Performing	\$ 38,587,092	\$ 16,508,730	\$ 1,913,479	\$ 2,210,966
Nonperforming	469,016	609,218	--	--
Total	<u>\$ 39,056,108</u>	<u>\$ 17,117,948</u>	<u>\$ 1,913,479</u>	<u>\$ 2,210,966</u>
<u>June 30, 2015</u>				
Performing	\$ 36,014,084	\$ 17,810,127	\$ 1,902,803	\$ 1,923,857
Nonperforming	295,654	1,175,372	--	--
Total	<u>\$ 36,309,738</u>	<u>\$ 18,985,499</u>	<u>\$ 1,902,803</u>	<u>\$ 1,923,857</u>

Loans to executive officers, directors and companies with which they are affiliated totaled \$1,249,000 at June 30, 2016, and \$910,000 at June 30, 2015.

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 4 - PREMISES AND EQUIPMENT

Year-end premises and equipment was as follows.

	2016	2015
Land	\$ 225,166	\$ 225,166
Buildings and improvements	2,724,462	2,702,398
Furniture and equipment	1,639,904	1,624,311
Automobile	33,081	33,081
Total cost	4,622,613	4,584,956
Accumulated depreciation	(3,278,386)	(3,179,850)
	\$ 1,344,227	\$ 1,405,106

The Association entered into a lease for a branch in the Super Wal-Mart in Sidney that commenced in June 2001. The lease was renewed at \$49,688 annually and expired June 30, 2016. Total rental expense was \$49,688 for both years ended June 30, 2016 and 2015. A new lease agreement commenced in July 2016 for \$49,688 annually and expires July 1, 2021.

Rental commitments under the noncancelable operating lease were as follows.

Year ending June 30,	
2017	49,688
2018	49,688
2019	49,688
2020	49,688
2021	49,688
	\$ 248,440

NOTE 5 - FEDERAL INCOME TAXES

Income tax expense was as follows.

	2016	2015
Current	\$ 213,971	\$ 168,573
Deferred	(19,671)	80,327
	\$ 194,300	\$ 248,900

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 5 - FEDERAL INCOME TAXES (Continued)

Effective tax rates differ from federal statutory rates applied to financial statement income due to the following.

	2016	2015
Income taxes computed at the statutory tax rate on pretax income	\$ 214,590	\$ 270,231
Add tax effect of:		
Dividends on ESOP shares	(23,560)	(22,971)
Other, net	3,270	1,640
	\$ 194,300	\$ 248,900
Statutory tax rate	34.0%	34.0%
Effective tax rate	30.8%	31.3%

Year-end deferred tax assets and deferred tax liabilities were due to the following.

	2016	2015
Items giving rise to deferred tax assets		
Deferred loan fees	\$ 65,939	\$ 66,966
Reserve for delinquent interest	19,737	16,347
Depreciation	21,059	19,097
Allowance for loan losses	379,521	365,534
Accrued compensation	6,657	5,753
Total deferred tax assets	492,913	473,697
Items giving rise to deferred tax liabilities		
Prepaid expenses	(23,574)	(23,982)
Securities accretion	(2,715)	(2,080)
Unrealized gain on securities available for sale	(5,675)	(1,035)
FHLB stock dividends	(429,729)	(429,729)
Mortgage servicing rights	--	(682)
Total deferred tax liabilities	(461,693)	(457,508)
Net deferred tax asset	\$ 31,220	\$ 16,189

Retained earnings at June 30, 2016 and 2015 included approximately \$2,174,000 for which no provision for federal income taxes had been made. This amount represents the qualifying and non-qualifying tax bad debt reserve as of December 31, 1987, which is the end of the Association's base year for purposes of calculating the bad debt deduction for tax purposes. If this portion of retained earnings is used in the future for any purpose other than to absorb bad debts, it will be added to future taxable income. The related amount of unrecognized deferred tax liability was approximately \$739,000 at June 30, 2016 and 2015.

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 June 30, 2016 and 2015

NOTE 5 - FEDERAL INCOME TAXES (Continued)

The Corporation and its subsidiary are subject to U.S. federal income tax. There were no penalties or interest recorded in the income statement for the years ended June 30, 2016 and 2015 and no amounts accrued for penalties and interest as of June 30, 2016 and 2015. There are no unrecognized tax benefits as of June 30, 2016 and 2015. The Corporation does not expect the amount of unrecognized tax benefits to significantly change in the next twelve months. The Corporation is no longer subject to examination by taxing authorities for years before 2012.

NOTE 6 - DEPOSITS

Year-end deposits were as follows.

	<u>2016</u>	<u>2015</u>
Noninterest-bearing demand deposits	\$ 3,137,719	\$ 2,984,956
NOW accounts	14,520,542	13,008,384
Money market accounts	15,172,700	14,745,301
Savings accounts	36,402,176	34,982,779
Certificates of deposit	<u>25,089,189</u>	<u>28,848,072</u>
	<u>\$ 94,322,326</u>	<u>\$ 94,569,492</u>

Deposits at FDIC-insured institutions are insured up to \$250,000 per depositor for each account ownership category. There were no certificates of deposit with a minimum denomination of \$250,000 or more at June 30, 2016 or 2015. Related party deposits were \$1,282,000 and \$1,060,000 at June 30, 2016 and 2015.

The scheduled maturities of certificates of deposit for the next five years as of June 30, 2016 were as follows.

Year ended June 30,	
2017	\$ 10,950,111
2018	5,978,651
2019	4,057,109
2020	1,630,379
2021	<u>2,472,939</u>
	<u>\$ 25,089,189</u>

NOTE 7 - BORROWED FUNDS

At June 30, 2015, the Association had a cash management line of credit enabling it to borrow up to \$8,000,000 from the Federal Home Loan Bank of Cincinnati ("FHLB"). There were no outstanding borrowings on this line of credit at June 30, 2015. This line of credit expired in December 2015 and was subsequently renewed in July 2016 for \$10,000,000. The current line of credit expires in July 2017. All cash management advances have an original maturity of 90 days.

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 June 30, 2016 and 2015

NOTE 7 - BORROWED FUNDS (Continued)

At June 30, 2016, based on the Association's current FHLB stock ownership, total assets and pledgable residential mortgage loan portfolio, the Association had the ability to obtain borrowings up to a maximum of \$38.0 million.

Advances from the Federal Home Loan Bank at year-end were as follows.

	2016	2015
Select pay mortgage-matched advances with rates ranging from 3.31% to 4.72% for 2016 and 2015, final maturities ranging from November 2017 to March 2023 for 2016 and 2015	<u>\$ 1,366,243</u>	<u>\$ 1,686,383</u>

The select pay mortgage-matched advances require monthly principal and interest payments and annual additional principal payments.

Advances under the borrowing agreements were collateralized by the Association's FHLB stock owned and \$57,750,000 and \$58,405,000 of qualifying mortgage loans at year-end 2016 and 2015.

Maturities of FHLB advances for the next five years and thereafter were as follows.

Year ended June 30,		
2017	\$	288,689
2018		249,790
2019		218,137
2020		193,414
2021		177,409
Thereafter		<u>238,804</u>
		<u>\$ 1,366,243</u>

NOTE 8 - RETIREMENT PLANS

The Corporation maintains a 401(k) profit sharing plan. With certain exceptions, all employees who have attained the age of 21 and who have completed one year of employment, during which they worked at least 1,000 hours, are eligible to participate in the plan. The Corporation provides a matching contribution on behalf of participants who make elective compensation deferrals at the rate of 100% of the first 6% of participant contributions up to a maximum match of 6% of the participant's compensation. The Corporation may change this matching formula at their discretion. The Corporation may also contribute additional amounts at its discretion. Employee contributions are vested at all times and the Corporation's matching contributions vest evenly over five years of service. The cash contribution and related expense included in salaries and employee benefits was \$90,615 and \$86,226 for the years ended June 30, 2016 and 2015.

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 9 - EMPLOYEE STOCK OWNERSHIP PLAN

The Corporation offers an employee stock ownership plan (“ESOP”) for the benefit of substantially all employees of the Corporation. The ESOP received a favorable determination letter from the Internal Revenue Service on the qualified status of the ESOP under applicable provisions of the Internal Revenue Code. The ESOP borrowed funds from Peoples in order to acquire common shares of Peoples. As of June 30, 2010, the borrowed funds have been fully repaid. Dividends on allocated shares increase participant accounts. Participants receive the shares at the end of employment. A participant may require stock received to be repurchased by the Corporation unless the stock is traded on an established market. During the years ended June 30, 2016 and 2015, the ESOP purchased 6,591 and 6,584 additional shares with cash in the plan. All shares have been allocated in the ESOP and totaled 220,782 and 214,191 at June 30, 2016 and 2015. The fair value of allocated shares subject to repurchase obligation was \$1,894,310 at June 30, 2016 and \$1,707,102 at June 30, 2015. The fair value was determined by an annual independent appraisal performed for the ESOP plan.

NOTE 10 - REGULATORY MATTERS

The Association is subject to various regulatory capital requirements administered by the federal regulatory agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Association must meet specific capital guidelines that involve quantitative measures of the Association’s assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the regulators. Failure to meet minimum capital requirements can initiate regulatory action.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required.

Effective January 1, 2015, the Association became subject to the final rules establishing a new comprehensive capital framework for U.S. banking organizations, including community banks (the “Basel III Capital Rules”), which substantially revised the risk-based capital requirements in comparison to the existing U.S. risk-based capital rules which were in effect through December 31, 2014. The Basel III Capital rules, among other things, (i) introduced a new capital measure called “Common Equity Tier 1” (“CET1”), (ii) increased the minimum requirements for Tier 1 Capital ratio as well as the minimum to be considered well capitalized under prompt corrective action; (iii) and introduced the “capital conservation buffer”, designed to absorb losses during periods of economic stress. Institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer may face constraints on dividends, equity repurchases and discretionary bonuses to executive officers based on the amount of the shortfall. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 10 - REGULATORY MATTERS (Continued)

At June 30, 2016 and 2015, management believes the Association complies with all regulatory capital requirements to which they are subject. Based on the Association's computed regulatory capital ratios, the Association is considered well capitalized under the Federal Deposit Insurance Act at June 30, 2016 and 2015. No conditions or events have occurred subsequent to the last notification by regulators that management believes would change the Association's category.

At year-end 2016 and 2015, the Association's actual capital levels and minimum required levels were as follows.

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective-Action Regulations</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
			(Dollars in thousands)			
<u>2016</u>						
Total risk-based capital (to risk-weighted assets)	\$ 15,703	26.0%	\$ 4,838	8.0%	\$ 6,048	10.0%
Tier 1 (core) capital (to risk-weighted assets)	14,942	24.7	3,629	6.0	4,838	8.0
Common equity Tier 1 (Core) Capital (to risk-weighted assets)	14,942	24.7	2,721	4.5	3,931	6.5
Tier 1 (core) capital (to adjusted total assets)	14,942	13.4	4,466	4.0	5,582	5.0
<u>2015</u>						
Total risk-based capital (to risk-weighted assets)	\$ 15,658	27.2%	\$ 4,606	8.0%	\$ 5,757	10.0%
Tier 1 (core) capital (to risk-weighted assets)	14,934	25.9	3,454	6.0	4,606	8.0
Common equity Tier 1 (Core) Capital (to risk-weighted assets)	14,934	25.9	2,591	4.5	3,742	6.5
Tier 1 (core) capital (to adjusted total assets)	14,934	13.3	4,475	4.0	5,594	5.0

The Qualified Thrift Lender test requires at least 65% of assets be maintained in housing-related finance and other specified areas. If this test is not met, limits are placed on growth, branching, new investments, FHLB advances and dividends, or the Association must convert to a commercial bank charter. Management believes the Association satisfies this test.

When the Association converted from a mutual to a stock institution, a "liquidation account" was established at \$9,307,000, which was net worth reported in the conversion prospectus. Eligible depositors who have maintained their accounts, less annual reductions to the extent they have reduced their deposits, would receive a distribution from this account if the Association liquidated. Dividends may not reduce shareholders' equity below the required liquidation account balance.

In addition to the liquidation account restriction discussed above, the payment of dividends by the Association to the Corporation is subject to restrictions by its regulatory agency. Generally, capital distributions are permitted with notice if the distributions are limited to current year to date undistributed net income and prior two years' undistributed net income, as long as the institution remains well capitalized after the proposed distribution. If dividends to be paid would exceed the net income test, an application would be required. This evaluation is made for the Association on a calendar year basis. At June 30, 2016 the Association had paid dividends in excess of retained net income for calendar years 2014, 2015 and calendar year to date 2016 of \$269,000. Therefore, the Association must apply for approval to pay additional dividends to Peoples until such time as the total of retained net income for the current calendar to date plus the previous two calendar years exceeds the amount of planned dividends at that time.

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 11 - OFF-BALANCE-SHEET ACTIVITIES

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

The contractual amount of financial instruments with off-balance-sheet risk was as follows at year-end.

	2016	2015
1-4 family residential real estate – variable rate	\$ 407,000	\$ 160,000
1-4 family residential real estate – fixed rate	124,000	989,000
1-4 family residential real estate construction – fixed rate	--	256,000
Commercial real estate – variable rate	206,000	--
Commercial lines of credit – variable rate	1,879,000	2,256,000
Home equity lines of credit – variable rate	1,400,000	1,192,000

The interest rate on fixed-rate commitments ranged from 3.625%- 4.25% at June 30, 2016 and from 3.625%- 4.875% at June 30, 2015. Commitments to make loans are generally made for a period of 30 days or less. The maximum maturity for fixed-rate commitments range from 10 years to 20 years.

NOTE 12 - FAIR VALUE

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

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant, unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The following is a description of the Corporation's valuation methodologies used to measure and disclose the fair values of its financial assets and liabilities on a recurring or nonrecurring basis:

Securities Available-For-Sale: Securities classified as available-for-sale are reported at fair value utilizing Level 2 inputs. Security fair values are calculated based on market prices of similar securities.

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 12 - FAIR VALUE (Continued)

Impaired Loans: At the time a loan is considered impaired, it is valued at the lower of cost or fair value, less estimated cost to sell. Impaired loans carried at fair value either have specific allocations of the allowance for loans or have been charged down to fair value. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification.

Assets and liabilities measured at fair value are summarized below.

	Carrying Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<u>June 30, 2016</u>				
Assets and liabilities measured at fair value				
• On a recurring basis:				
Available for sale securities				
U.S. Government Agencies	\$ 8,005,926	\$ --	\$ 8,005,926	\$ --
• On a nonrecurring basis:				
Impaired loans				
1-4 family rental	45,158	--	--	45,158
Commercial business	--	--	--	--
<u>June 30, 2015</u>				
Assets and liabilities measured at fair value				
• On a recurring basis:				
Available for sale securities				
U.S. Government Agencies	\$ 7,985,862	\$ --	\$ 7,985,862	\$ --
• On a nonrecurring basis:				
Impaired loans				
1-4 family rental	496,534	--	--	496,534
Commercial business	--	--	--	--

Impaired loans that are measured for impairment using the fair value of the collateral, less estimated cost to sell for collateral dependent loans, had a principal balance of \$109,758 and \$670,534 with a valuation allowance of \$64,600 and \$174,000 at June 30, 2016 and 2015, resulting in a negative provision for loan losses of (\$193,932) for the fiscal year ended June 30, 2016, versus an additional provision for loan losses of \$43,222 for the fiscal year ended June 30, 2015. The June 30, 2016 and 2015 totals include \$31,000 and \$49,000 of commercial business loans that have a full valuation allowance. Excluded from the fair value of impaired loans at June 30, 2016 and 2015 disclosed above is \$120,315 and \$131,722 of loans with a valuation allowance of \$42,300 and \$23,400, classified as troubled debt restructurings which are evaluated for impairment using the present value of estimated future cash flows.

(Continued)

PEOPLES-SIDNEY FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 12 - FAIR VALUE (Continued)

The following table presents quantitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at June 30, 2016 and 2015.

	<u>Fair value</u>	<u>Valuation Technique</u>	<u>Unobservable Input</u>	<u>Range (Weighted Average)</u>
<u>June 30, 2016</u>				
Impaired loans				
1-4 family rental	\$ 45,158	Sales comparison approach	Adjustment for differences between the comparable sales	-55.6% - 17.6% (-22.2%)
<u>June 30, 2015</u>				
Impaired loans				
1-4 family rental	\$ 496,534	Sales comparison approach	Adjustment for differences between the comparable sales	-69.8% - 184.6% (7.9%)

The carrying amounts and estimated fair values of financial instruments at year-end were as follows.

	<u>June 30, 2016</u>		<u>June 30, 2015</u>	
	<u>Carrying Value</u>	<u>Estimated Fair Value</u>	<u>Carrying Value</u>	<u>Estimated Fair Value</u>
Financial assets:				
Cash and cash equivalents	\$ 16,283,924	\$ 16,283,924	\$ 19,719,517	\$ 19,719,517
Interest-bearing time deposits in other financial institutions	992,000	992,000	992,000	992,000
Securities available for sale	8,005,926	8,005,926	7,985,862	7,985,862
Federal Home Loan Bank stock	1,894,500	N/A	1,894,500	N/A
Loans, net	82,257,040	83,506,806	79,104,577	80,528,694
Accrued interest receivable	386,856	386,856	383,822	383,822
Financial liabilities:				
Deposits	(94,322,326)	(94,522,373)	(94,569,492)	(94,908,529)
Borrowed funds	(1,366,243)	(1,642,967)	(1,686,383)	(2,072,556)
Accrued interest payable	(6,118)	(6,118)	(7,966)	(7,966)

The estimated fair value approximates carrying amounts for all items except those described below. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair value of debt is based on current rates for similar financing. It was not practical to determine the fair value of Federal Home Loan Bank stock due to restrictions placed on its transferability. The fair value of off-balance-sheet items is based on the current fees or cost that would be charged to enter into or terminate such arrangements, which are not material.

SHAREHOLDER INFORMATION

ANNUAL MEETING

The Annual Meeting of Shareholders will be held at 11:00 a.m., Sidney, Ohio on October 21, 2016, at the Hampton Inn, I-75 and Fair Road, Sidney, Ohio. Further information with regard to the meeting can be found in the proxy statement.

STOCK LISTING

Peoples-Sidney Financial Corporation common stock is traded on the OTC Bulletin Board under the symbol "PPSF."

SHAREHOLDERS AND GENERAL INQUIRIES

Douglas Stewart, President
Peoples-Sidney Financial Corporation
101 East Court Street
P.O. Box 727
Sidney, Ohio 45365-3021
(937) 492-6129

TRANSFER AGENT

Computershare
480 Washington Blvd., 29th Floor
Jersey City, NJ 07310
(800) 368-5948

ANNUAL AND OTHER REPORTS

A copy of Peoples-Sidney Financial Corporation's Annual Report for the year ended June 30, 2016, may be obtained without charge by contacting Douglas Stewart, President and Chief Executive Officer, Peoples-Sidney Financial Corporation, 101 East Court Street, P.O. Box 727, Sidney, Ohio 45365-3021.

CORPORATE INFORMATION

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BOARD OF DIRECTORS

Douglas Stewart
*President and Chief Executive Officer of
Peoples Federal Savings and Loan Association*

Harry N. Faulkner
*Partner in the law firm of Faulkner, Garmhausen,
Keister & Shenk LPA*

Jeffery S. Sargeant
*Owner and President of Community
Insurance Group, Ltd., a full line insurance
company*

James W. Kerber
*Owner of James W. Kerber CPA, a private practice
accounting firm*

Richard T. Martin (Chairman of the Board)
Certified Public Accountant

Devon A. Beer
*President and Chief Operating Officer of Fresh
Unlimited Inc. DBA as Freshway Foods, a regional
fresh-cut producer and distribution company*

**OFFICERS OF THE CORPORATION AND
THE ASSOCIATION**

Douglas Stewart, President & CEO
David R. Fogt, Vice President of Operations
Gary N. Fullenkamp, Vice President of
Mortgage Loans and Corporate Secretary
Debra A. Geuy, Vice President, COO, CFO
and Treasurer

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