

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

UNIVERSITY BANCORP INC /DE/

Form 10-K

April 01, 2002

1

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

for the fiscal year ended December 31, 2001

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-16023

UNIVERSITY BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware 38-2929531
(State or other jurisdiction of (I.R.S. Employer incorporation)
Identification No.

959 Maiden Lane, Ann Arbor, Michigan 48105
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (734) 741-5858

Securities registered pursuant to section 12(b) of the Act: NONE Securities
registered pursuant to section 12(g) of the Act:
Common Stock, par value \$.010 per share

Indicate by check mark whether the registrant: (1) has filed all reports
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of
1934 during the preceding 12 months (or for such shorter period that the
registrant was required to file such reports), and (2) has been subject to such
filing requirements for the past 90 days.

Yes X No

Indicate by check mark if disclosure of delinquent filers pursuant to Item
405 of Regulation S-K is not contained herein, and will not be contained, to the
best of registrant's knowledge, in definitive proxy or other information
statements incorporated by reference in Part III of this Form 10-K or any
amendment to this Form 10-K. ☒

The number of shares outstanding of the Registrant's Common Stock as of
March 22, 2002: 3,752,501 shares. The aggregate market value of the voting stock
held by non-affiliates of the Registrant based on \$0.73 per share, the average
bid and asked price for the Registrant's Common Stock on March 22, 2002, as
reported by NASDAQ, was approximately \$686,315.

* For purposes of this calculation shares of the Registrant held by
directors and officers of the Registrant and by other affiliates have been
excluded.

Page 1 of 87 pages
Exhibit index on sequentially numbered page 83

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

PART I.

Item 1. - Business

General

University Bancorp, Inc. The Company is a Delaware corporation which operates as a bank holding company for its wholly-owned subsidiary, University Bank. The Company changed its name to 'University Bancorp, Inc.' from 'Newberry Bancorp, Inc.' in 1996, in order to better identify itself with the Bank.

University Bank. The Bank is a state chartered community bank. The Bank was chartered by the state of Michigan in 1908 and began business in 1890. In 1994, we sold the bank's offices in Newberry, Michigan and Sault Ste. Marie, Michigan. As part of a non-compete agreement with the purchaser of the bank's offices, we relocated the Bank's main office to the former offices of its mortgage operation in Sault Ste. Marie, Michigan. In 1995, the Bank changed its name from 'The Newberry State Bank' to 'University Bank' to more closely identify with its current place of business, Ann Arbor, Michigan. Ann Arbor is a university town, home to the University of Michigan and is the largest city in Washtenaw County, just west of the Detroit Metropolitan Statistical Area. The Bank's primary market area is defined as the City of Ann Arbor and surrounding areas in greater Washtenaw County.

Midwest Loan Services. In 1995, University Bank acquired 80% of the common stock of Midwest Loan Services. Midwest specializes in the servicing and subservicing of mortgage loans for various credit unions, financial institutions and mortgage brokers. Most of their servicing and subservicing portfolio is comprised of residential mortgage loans sold to Fannie Mae, Freddie Mac and other private residential mortgage conduits.

University Insurance & Investment Services. In 1996, University Bank established an insurance and investment products sales agency. This subsidiary of the Bank, called "University Insurance & Investment Services, Inc." (the Agency) is based in the Bank's Ann Arbor office. The Agency is licensed by the State of Michigan to sell insurance as agent for licensed insurance companies. A d/b/a of the Agency, University Insurance Center, commenced business in 1999, adding a full service property and casualty insurance agency offering insurance for homes, autos, apartments and businesses in addition to the original products which included life and health care insurance, annuities and mutual fund sales. Employees of the Agency are also licensed to sell investment products such as annuities and mutual funds, and the President of the Bank, who is also Chairman of the Agency, also offers broker-dealer investment services including money management through a clearing arrangement with Equitas America LLC and Pershing.

Michigan BIDCO. In 1993, Stephen Lange Ranzini and Joseph Louis Ranzini founded BIDCO, which is a Business and Industrial Development Company, called Michigan BIDCO, Inc. The BIDCO is licensed by the Michigan Office of Financial and Insurance Services under the State of Michigan BIDCO program. Michigan BIDCO (formerly known as Northern Michigan BIDCO) invests in businesses in Michigan with the objective of fostering job growth and economic development. As a result of the recent buyout of the Bank's interest in the BIDCO, University Bancorp currently owns 6.10% of the BIDCO. The Bank also holds \$600,000 of 7.5% cumulative preferred stock of the BIDCO.

Northern Michigan Foundation. In 1995, Michigan BIDCO donated \$225,000 to capitalize Northern Michigan Foundation, and in 1996, donated an additional \$75,000 to the Foundation. The Foundation is an IRS-approved 501c(3) non-profit which is an intermediary lender to rural small businesses under the U.S. Department of Agriculture's Rural Economic Community Development Division's

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

Intermediary Re-lending Program. The Foundation has the right to borrow a total of up to \$2 million from the Intermediary Re-lending Program at 1% interest with a 30-year term because of a \$300,000 donation received from Michigan BIDCO. Pursuant to a management services agreement with the BIDCO, the BIDCO and the Foundation share administrative staffs and offices, with the Foundation reimbursing the BIDCO for these management services.

Varsity Funding. In 1995, University Bank established a mortgage-banking subsidiary, Varsity Funding, L.L.C. to specialize in the purchase and origination of impaired credit, or sub-prime quality, residential mortgages, for sale to non-U.S. government agency-backed mortgage conduits. In 1999, this subsidiary was sold to another financial institution and is no longer included with the current operations of the Bank.

Varsity Mortgage. In 1996, University Bank established Varsity Mortgage, L.L.C. to purchase residential home loans which generally qualify for sale to secondary market investors under the underwriting criteria of the Federal Home Loan Mortgage Corporation and Federal National Mortgage Association from correspondents in Michigan and in adjacent states. In 1999, this subsidiary was sold to another financial institution and is no longer included with the current operations of the Bank.

Employees

The Company employed 69 full-time equivalents as of March 22, 2002:

| | |
|-----------------------------------|----|
| University Bank, Ann Arbor | 28 |
| Midwest Loan Services | 35 |
| University Insurance & Investment | 2 |

Properties

The Bank owns a building in Ann Arbor, Michigan that is the Bank's main office.

The Bank leases a site that includes a registered historic building in Ann Arbor, at the corner of Washtenaw Avenue and Stadium Boulevard as a multiple ATM drive-through location, a BIDCO office and an off-site storage facility. The minimum lease period ends May 2006 with two optional five-year extensions.

The Bank leases an ATM location with an adjacent meeting room in Dexter, Michigan under a month-to-month lease. Additionally, the Bank leases space for another ATM at a location in Ann Arbor near the University of Michigan Campus. The minimum period of this lease ends December 2005.

The Bank owns a former loan office in Sault Ste. Marie and such space is leased to an unrelated third-party. Management is in negotiations to sell this property.

Midwest Loan Services leases an office in Houghton, Michigan under a year-to-year lease.

The Company believes that the office facilities are adequate to support the anticipated level of future expansion of business.

Lines of Business

Deposit Products & Services

University Bank offers traditional retail savings products and services to

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

its customers. These include demand deposit and NOW interest-bearing checking accounts, money market deposit accounts, regular savings accounts and term deposit certificates ranging in maturity from three to three hundred months. The Bank also offers self-directed retirement accounts, free access to 24-Hour ATM machines, telephone banking, VISA debit cards and Gold VISA accounts. The Bank is also a member of MasterCard, but currently is not offering a MasterCard product. From time to time to raise liquidity, the Bank relies on brokers to sell CDs. At December 31, 2001, the Bank had approximately \$11.0 million in CDs issued through brokers.

Lending Products

University Bank offers a range of traditional lending products, including commercial small business loans, residential real estate mortgage loans, home equity loans, commercial real estate mortgage loans, consumer installment loans, and land development and construction loans.

Classifications of the loan portfolio as of December 31, 2001 are as follows:

| | Amount Outstanding(1) | % of Total |
|---------------------------------|-----------------------|------------|
| Commercial, Real Estate & Other | \$15,088,956 | 43.1% |
| Residential Construction | 2,683,594 | 7.7% |
| Residential Real estate | 11,738,595 | 33.5% |
| Residential Home equity | 4,805,407 | 13.7% |
| Consumer | 628,526 | 1.8% |
| Credit Card | 80,946 | 0.2% |
| Gross Loans | \$ 35,026,024 | 100.0% |

(1) - Excludes loans held for sale.

The Bank's loan portfolio is geographically concentrated in Ann Arbor and Washtenaw County, Michigan. The ability of individual loan customers to honor their debts is partially dependent on the local economy. The Ann Arbor area is primarily dependent on the education, healthcare, services, and manufacturing (automotive and other) industries.

Most of the Bank's commercial loans are secured by commercial real estate. Commercial real estate loans have a loan to value ratio typically less than 80% at the time the loan is originated. In no cases is the loan to value ratio for commercial real estate loans greater than 85% (except for one SBA guaranteed loan which had a 90% loan to value ratio at the time of origination). The primary risk of commercial loans is that the area's economy declines and rents

decrease while vacancy increases, thereby decreasing the value of the building. If the guarantor suffers a financial reverse, the Bank is then exposed to a loss.

Residential loans typically have a loan to value ratio less than 80% at the time the loan is originated, unless the borrower's financial position is very strong, in which case a loan to value ratio of up to 90% is considered. To meet the Bank's goals for first time homebuyers, the Bank has originated a portfolio of 97% loan to value residential loans totaling about \$3 million, although real estate prices in Washtenaw County where these loans were originated have been rising at 10-12% per year for two years in a row, and most of these loans were originated in 1998 and 1999. Home equity secured residential loans have loan to value ratios of less than 90% at time of origination in the case of fixed rate fully-amortizing loans and 80% for home equity lines of credit. The primary risk of residential lending is that home prices drop (typically this occurs during recessions) and borrowers walk away from their home or file for bankruptcy. All of the Bank's construction loans, are secured by residential properties with a loan to value ratio of 80% or less. The Bank controls the risk of construction

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

lending by performing inspections prior to disbursing interim construction funds to avoid cost overruns.

The Bank makes very few unsecured loans, typically for borrowers who are multi-millionaires, but even in these cases, the Bank typically takes collateral out of an abundance of caution. Most of the Bank's credit card loans are secured by residential properties. Consumer loans are generally secured by vehicles (primarily cars or trucks). The primary risk of these loans is that the value of the car depreciates faster than the loan balance amortizes, and the borrower loses their job or has a severe medical problem in their family. In these circumstances, the collateral could be insufficient to repay the loan if the borrower files for bankruptcy. In addition, if the economy is soft, used vehicle prices tend to deteriorate creating additional risk of insufficient collateral in the event of a default.

The Bank makes very few business loans that are not secured by real estate. Business Lines of Credit are typically made up to a 50% ratio of inventory and other equipment at current market value, and 70% of current receivables. Business Manager Loans are also structured as Lines of Credit and are secured by individual receivables up to 90% of face value individually purchased with recourse to the borrower and additional insurance to protect the bank against fraud and bankruptcy of the issuer of the account which is receivable to the borrower. The primary risk of this type of lending backed by non-real estate business assets is that if the business suffers a financial reverse, the collateral is easily dissipated by an unscrupulous borrower, causing the Bank a loss. For this reason, the Bank de-emphasizes this type of lending.

Typically with respect to all personal and residential loans, a ratio of total debt payments to total income of all borrowers and guarantors less than 42% is required. With respect to commercial real estate and business loans, a ratio of income to all debt payments of greater than 1.25x is required. Therefore, the Bank typically has both income and asset backing to secure its loans. However, there can always exist valid reasons to have exceptions to each rule and the Bank's loan committee retains the power to take unusual circumstances into account when evaluating each loan request versus the Bank's policies. Loans that are lacking current demonstrated income are classified and increased reserves are established for those loans. Loans that are lacking both

current demonstrated income and asset backing are allocated even higher reserves equal to the amount estimated to be realized upon the sale of the collateral less all estimated costs.

Mortgage Banking

The Bank originates internally or via other financial institutions residential home loans which generally qualify for sale to secondary market investors under the underwriting criteria of the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association and the Government National Mortgage Association. Loans purchased or originated internally are either sold directly to FHLMC, FNMA or GNMA, or are pooled into mortgage-backed securities and the securities are sold to investors in the secondary market. With the exception of Midwest Loan Services, the Bank is currently selling the servicing rights on all mortgages originated that are sold to the secondary market. Some residential mortgages are held in the Bank's loan portfolio as an investment.

University Bank became a seller/servicer and began originating Federal Home Loan Mortgage Corporation (FHLMC) insured mortgages in 1991 and became a seller/servicer and began originating Federal National Mortgage Association (FNMA) insured mortgages 1994. The Bank has also been approved as a

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

seller/servicer of Government National Mortgage Association (GNMA) mortgages for many years but only began using our license in 1999 to originate and sell these loans without retaining the servicing rights.

Mortgage Subservicing

Mortgage servicing firms receive monthly payments from loan customers, aggregate and account for these payments, and send the funds to mortgage-backed securities holders, including pension funds and financial institutions. For some mortgage customers, escrow funds are also accumulated, and funds sent to taxing authorities and insurance companies as needed. Mortgage servicers also dun delinquent accounts and foreclose loans, if required. Mortgage servicers receive a fixed monthly fee for performing this service. When these services are performed for the Bank, it is called 'servicing'. When these services are performed for other institutions, it is called 'subservicing'. The Bank's 80%-owned subsidiary, Midwest Loan Services, specializes in subservicing residential mortgage loans sold to FNMA and FHLMC and other non-agency private conduits for the account of credit unions, other financial institutions and mortgage brokers. Midwest is licensed and regulated by FHLMC and FNMA.

Investment Securities

The Bank maintains surplus available funds in investments consisting of short-term money market instruments, U.S. government bonds, U.S. federal agency obligations, mortgage-backed securities backed by federal agency obligations and obligations of local units of government. These investments are managed by the Bank's President, who is a licensed Registered Representative, and purchase/sale decisions are subject to the review and approval of the Board of Directors. The securities portfolio provides a source of liquidity to meet Bank operating needs. At December 31, 2001, the portfolio had a net unrealized loss of approximately \$167,000 versus a net unrealized loss of \$335,000 at December 31,

2000, and \$585,000 at December 31, 1999.

Information regarding securities where cost exceeded more than 10% of the Company's stockholders' equity at December 31, 2001 are as follows:

| Issuer | Coupon | Yield | Final Maturity | Market Value | Amortized Cost |
|----------------------|--------|-------|----------------|--------------|----------------|
| FHLBI equity (1) ... | VAR | 6.75% | None | \$ 848,400 | \$ 848,400 |
| FNMA CMO 93-205H (2) | PO | 4.15% | 9/25/23 | 1,835,646 | 1,947,252 |
| US Treasury Strip .. | PO | 5.19% | 5/15/16 | 423,100 | 478,836 |

(1) The rate varies quarterly. The Bank is required to maintain the investment in Federal Home Loan Bank of Indianapolis common stock in an amount related to the Bank's single family mortgage related assets and FHLBI advances. Shares can be redeemed or sold at par value to the FHLBI as required from time to time.

(2) This Principal Only strip has an expected average life of less than five years. The increase in market value is due to interest rate fluctuations which have shortened the average life of the instrument. Accrued net interest income on this zero coupon bond was increased in 2001 to reflect the decreased average life. The bond is rated AAA.

Merchant Banking (Michigan BIDCO & Northern Michigan Foundation)

Michigan BIDCO. Initially, Michigan BIDCO made both loans and direct equity investments but now focuses typically on loans that are fully collateralized with equity participation upside. As a matter of policy, University Bank restricts itself from investing or lending to a business that the BIDCO

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

finances, and related parties which co-invest with BIDCO must do so on a basis equal to or less favorable than BIDCO's. BIDCO has a loan to one borrower limit of \$500,000, but sells participations and/or seeks loan guarantees from government agencies for larger financings. As of December 31, 2001, approximately \$16.5 million in loans and/or investments (at original cost) had been made to various types of businesses in the state of Michigan.

Michigan BIDCO (BIDCO) was founded in 1993 and is licensed by the Michigan Office of Financial and Insurance Services under the State of Michigan BIDCO Act. In 1993, BIDCO received \$3 million in financing from the Michigan Strategic Fund (MSF). This investment was made in the form of a 10-year loan, which carried concessionary terms allowing it to be converted to a grant over time under certain circumstances. BIDCO earned job and sales credits to be applied against the principal and interest owed to the Michigan Strategic Fund. Credits were earned from the growth of businesses invested in by BIDCO. The loan has been fully repaid from these credits.

In 1993, Michigan BIDCO issued \$3,000,000 in 9% senior convertible bonds to match the State of Michigan's commitment. University Bancorp purchased \$27,000 in bonds and the Bank contributed \$280,000 for 280 shares of Michigan BIDCO stock. This represented a 44.1% interest in Michigan BIDCO. The financial results of Michigan BIDCO were accounted for under the equity method of accounting until March 1999. In April 1999, \$1,850,000 of Michigan BIDCO bonds were repurchased by the BIDCO, and University Bancorp converted its \$27,000 of bonds into common stock, thereby increasing the Bank's equity ownership to 80.1%. Effective April 1999, Michigan BIDCO's financial results became consolidated into the results of University Bancorp. The remaining Michigan BIDCO bonds were converted into common stock on May 31, 2000, and thus diluted University Bancorp's equity ownership down to 28.8%. In December 2001, BIDCO

repurchased all of the Bank's 280 shares of BIDCO for an amount equal to the Bank's carrying cost in exchange for cash and \$600,000 of 7.5% cumulative preferred stock. At December 31, 2001, University Bancorp's equity ownership was 6.10%. As a result of the reduction in ownership, the BIDCO is no longer consolidated in the financial statements of University Bancorp. Subsequent to May 31, 2000 the investment has been accounted for under the equity method of accounting. As a result of its investment in Michigan BIDCO, the Bank made a total profit of \$1,243,464 on its \$280,000 investment.

The financial statements of BIDCO are presented using the investment company method, and, accordingly, BIDCO's investments in stocks, stock rights, limited liability companies and loans are reported at fair value. BIDCO typically invests in companies for which current market quotations are not readily available; therefore we estimate the fair value of BIDCO investments on a quarterly basis and the Board of Directors approves the fair value estimates. In deriving its estimates, BIDCO management reviews the financial condition and operating performance of investee companies, as well as performance of the company with its contractual arrangements with BIDCO. BIDCO management estimates the fair value of investments by using cash flow multiples applicable to a company's industry, discounted cash flow analyses, and other valuation techniques. The Company believes the procedures used and assumptions made are reasonable in the circumstances; however, the fair value estimates may differ significantly from the values that would have been used had current market quotations been available.

The Company's profit (loss) from the investment in BIDCO was \$(114,551) \$234,740, and \$916,991 for the years ended December 31, 2001, 2000, and 1999, respectively.

Northern Michigan Foundation. BIDCO management operates a 501(c)3

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

tax-exempt non-profit re-lending organization, Northern Michigan Foundation under a management contract. The Foundation has received the right to borrow \$2 million at 1% interest for 30-years from the U.S. Department of Agriculture (USDA) Rural Intermediary Relending Program. The Foundation is one of the non-profit, privately-run, USDA Intermediary Relending Programs in northern Michigan. Each of these community development loan funds covers six counties as its primary market area. The Foundation makes loans that are fully collateralized, but assumes more credit risk in a typical investment than commercial banks generally are willing to take when they make loans. No equity participation is sought or retained.

The Foundation recently applied to take on an additional six counties along with a \$2 million 1% interest 30-year loan from another Rural Intermediary that wishes to discontinue its program. There is no guarantee that USDA will approve the transfer or that the Foundation will be able to meet the USDA's requirements to add the additional counties.

Competition

Community Banking, Ann Arbor

The attraction and retention of deposits depend on the Bank's ability to provide investment opportunities that satisfy the requirements of investors with respect to rate of return, liquidity, risk and other factors. The Bank competes for these deposits by offering personal service and attention, fair and competitive rates, low fees, and a variety of savings programs including tax-deferred retirement programs.

The Bank competes for loan originations primarily through the quality of

services provided to the loan customers, competitive interest rates and reasonable loan fees, rapid and local decision-making and the range of services offered. Competition in originating loans comes principally from other commercial banks, credit unions, insurance companies, mortgage banking companies and savings and loans.

The following table shows market share of deposits for Washtenaw County by financial institution for June 2001, June 2000 and June 1999, respectively from the FDIC and National Credit Union Association's annual branch deposit survey.

Washtenaw County Financial Institution Deposits:

| | 2001 | 2000 | 1999 |
|---------------------------------|-------|-------|-------|
| TCF National Bank | 16.2% | 16.5% | 17.8% |
| National City Bank | 11.9% | 12.8% | 12.8% |
| Comerica Bank | 11.9% | 11.6% | 10.7% |
| Bank One | 9.4% | 10.5% | 11.1% |
| Key Bank | 7.2% | 8.0% | 7.3% |
| Standard Federal FSB | 6.2% | 6.5% | 6.7% |
| Flagstar Bank FSB | 5.1% | 4.9% | 4.0% |
| Ann Arbor Commerce Bank | 4.9% | 4.9% | 4.5% |
| University of Michigan CU | 4.2% | 3.9% | 3.5% |
| Bank of Ann Arbor | 3.9% | 3.5% | 2.8% |
| Chelsea State Bank | 3.1% | 3.5% | 3.3% |
| Huron River Area CU | 3.1% | 3.1% | 3.0% |
| Citizens Bank | 2.8% | 3.0% | 3.2% |
| Midwest Financial CU | 2.1% | 2.1% | 2.0% |
| Republic Bank | 2.3% | 1.9% | 2.3% |
| United Bank & Trust | 1.3% | 1.1% | 0.9% |
| University Bank | 0.9% | 0.9% | 0.9% |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | | | |
|------------------------------------|---------|---------|---------|
| Charter One FSB | 0.7% | 0.7% | 0.7% |
| Other institutions | 2.8% | 0.6% | 2.6% |
| | | | |
| Total deposits (in billions) | \$4.342 | \$3.942 | \$3.865 |

Total deposits in the county increased 10.2% from June 2000 to June 2001. Total deposits in the county increased 2.0% from June 1999 to June 2000. In attracting deposits, the Bank's primary competitors for deposits are mutual funds, other commercial banks, credit unions, savings and loans and insurance companies.

The Bank's main office is adjacent to the University of Michigan Hospital complex. The complex employs a total of 7,800 persons. In February 1999, the nearest competitor to the Bank's main office, a National City Bank branch, was permanently closed. While the Bank competes with all of these financial institutions for loans and deposits and in particular the eight financial institutions that have branch offices in the northeast Ann Arbor market area, the other major competitor in the immediate local deposit market near the Medical Center complex is Midwest Financial Credit Union, formerly known as Hospital & Health Services Credit Union. The Bank's main office was formerly the headquarters of this credit union, which moved its office to a new office building three miles from the Medical Center Complex.

The Ann Arbor banking market is dominated by banks owned by out-of-state holding companies. In the city of Ann Arbor, the University of Michigan Credit

Union is the largest locally-owned financial institution. The only locally-owned community financial institutions, excluding University Bank, are University of Michigan Credit Union, Huron River Area Credit Union, Midwest Financial Credit Union, Bank of Ann Arbor, Automotive Federal Credit Union and several smaller credit union.

Mortgage Banking

The Bank's retail mortgage origination operations encounter competition for the origination of residential real estate loans primarily from savings institutions, commercial banks, insurance companies and other mortgage banking firms. Many of these firms have a well-established customer and/or borrower client base. Some competitors, primarily savings institutions, insurance companies and commercial banks, have the ability to create unique loan products from time to time because they are able to hold the loans in their own portfolio rather than sell into the secondary market. The Bank's ability to hold mortgage loans in our portfolio helps us to compete more effectively. Most loans sold into the secondary market, however, go to the same sources, those being FHLMC, FNMA, and GNMA. Most lenders have access to these secondary market sources; therefore, competition often becomes more a matter of service and pricing than that of product. As a mortgage loan originator and a purchaser of mortgage loans through correspondents, the Bank must be able to compete with respect to the types of loan products offered by competitors to borrowers and correspondents, including the price of the loan in terms of origination fees or fee premium or discount, loan processing costs, interest rates, and the service provided by our staff. An important element to competing is master purchase agreements negotiated periodically with FNMA and FHLMC with low and competitive loan guarantee fees, a wide variety of mortgage programs, and a variety of flexible underwriting criteria. The Bank's ability to secure these master purchase agreements is dependent upon the performance from a quality perspective of loans previously sold to the agencies.

During lower interest rate environments, competition for loans is less intense due to the large number of loans available for origination. As interest

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

rates rise and the number of loans available for origination diminishes, competition becomes quite intense and companies with larger investor bases, flexibility with respect to type of product offered and greater experience in dealing in these types of markets tend to be the most successful.

The Bank also originates residential loans to be held in portfolio, and management believes that this product together with the product offerings from FHLMC, FNMA and GNMA are sufficient for the Bank. The Bank also is licensed as a HUD Title 1 and Multifamily seller/servicer, but has no plans at this time to expand utilization of HUD or GNMA programs.

Mortgage Servicing and Subservicing. Servicing competition is somewhat less intense than the loan origination aspect of mortgage banking. Due to net worth and management requirements, many mortgage origination companies do not have the capacity to service loans. Falling interest rates present competitive challenges for the mortgage servicing operation in that mortgagors are more likely to refinance existing mortgages. The quality of service and the ability of the origination operation to compete on price and service is important in retaining these customers by refinancing them internally, rather than losing the refinancing transaction to a competitor. Increased refinancing activity as a result of falling interest rates should decrease profitability of mortgage servicing by increasing amortization charges on purchased mortgage servicing rights.

In the subservicing business, Midwest Loan Services competes primarily with about 30 firms nationwide, including specialized subservicing units of mortgage banking companies, and specialized firms owned by banks and savings and loans. Most of these companies have substantially larger financial resources than Midwest Loan Services, and some of them are located in rural areas with low prevailing wages.

Midwest Loan Services is located in Houghton, Michigan in the western upper peninsula of Michigan. Personnel and occupancy costs are the largest costs in a mortgage servicing operation, and the prevailing wages and occupancy costs in the upper peninsula of Michigan are generally lower than the national average. Midwest Loan Services has developed a unique business extranet website for its business partners and their retail customers. Through its website at www.subservice.com, Midwest Loan Services provides the opportunity for all customers to access their mortgage information 24 hours a day 7 days a week in an environment which provides seamless access to all information. Business partners have access to all mortgage data as easily as if it were serviced on their in-house computer system. Customers can access all information about their accounts and perform any type of transaction through the internet. As a result of low personnel costs, its internet technology and the relationships it has developed in the credit union industry over time, the Company believes that Midwest Loan Services' mortgage servicing operation has a competitive advantage.

Michigan BIDCO

Michigan BIDCO makes loans that are fully collateralized with equity participation upside. BIDCO assumes more credit risk in a typical investment than commercial banks generally are willing to take when they make loans. BIDCO also makes direct equity investments similar to the investments that venture capital investors make. BIDCO seeks to invest in businesses located in Michigan. The BIDCO's objective is to seek profit while fostering job and economic growth in its market area. BIDCO competes with non-bank financial institutions, other specialized lenders such as finance companies and receivable factoring companies, and wealthy investors who make risk-oriented investments. There is only one other active BIDCO in the state of Michigan. At year-end 2001, BIDCO was fully invested. The source of funds for new loans will come from loan payoffs or scheduled amortization of loans, or from additional pools of

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

investment capital. The BIDCO is investigating its options in this regard.

Since 1996, the BIDCO has pursued a strategy of liquidating its existing investment portfolio to raise cash for two purposes: 1) the buyout of some of the investors in the BIDCO; and 2) expanding its funds under management through other government agency economic development programs (Conifer Capital L.P. - a small business investment company and Northern Michigan Foundation).

Northern Michigan Foundation

Generally, when it makes loans the Foundation competes with other specialized non-bank lenders and wealthy investors who make risk-oriented investments in businesses located in northern Michigan. Each Rural Relending Intermediary has a specific territory of six counties, and as a result they do not compete with each other.

Regulation

Primary Regulators of University Bancorp. The Company is bank holding company registered under the Federal Bank Holding Company Act of 1956. The Federal Reserve Bank of Chicago is the Company's primary regulator and the Company is subject to regulation, supervision and examination by the Federal Reserve. The Company is required to file semi-annual reports with the Federal Reserve and other information as required under the rules of the Board of Governors of the Federal Reserve System. Additionally, the Federal Reserve Board possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to bar the payment of dividends by banks and bank holding companies.

Acquisitions. The Company is generally prohibited from engaging in a non-banking activities since it is a bank holding company. The Company cannot acquire more than 5% of the shares of another company engaged in non-banking activities. The Company can only acquire direct or indirect control of more than 5% of the voting shares of a company engaged in a banking related activity with the prior approval by the Federal Reserve Board to acquire these shares or by regulatory exemption. The Federal Reserve Board has identified specific banking related activities in which a bank holding company may engage with notice to the Federal Reserve. The Federal Reserve considers managerial, capital, and other financial factors, including the impact on local competition of any proposal and past performance under the Community Reinvestment Act in acting on acquisition or merger application. Bank holding companies may acquire other banks located in any state in the United States without regard to geographic restrictions or reciprocity requirements imposed by state law, but subject to certain conditions, including limitations on the aggregate amount of deposits that may be held by the acquiring company and all of its insured depository institution affiliates.

Commitments. In connection with obtaining the consent of the Federal Reserve to a 1989 merger transaction when the Company obtained public listing on the NASDAQ Small-Cap Market, certain commitments were made to the Federal Reserve. Management agreed that the Employee Stock Ownership Plan would not purchase more than 10% of the common stock or 5% of any other class of our voting shares, without the prior approval of the Federal Reserve. Management also agreed not to incur additional debt or to have the Bank pay dividends to us without the prior approval of the Federal Reserve.

Capital Requirements. The Federal Reserve Board imposes certain capital requirements on the Company under the Federal Bank Holding Company Act, including a minimum leverage ratio and a minimum ratio of "qualifying" capital

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

to risk-weighted assets. These requirements are described below under "Capital Regulations". The Federal Reserve uses capital adequacy guidelines in its examination and regulation of bank holding companies. If capital falls below minimum guidelines, a bank holding company may, among other things, be denied approval to acquire or establish additional banks or non-bank businesses. The "prompt corrective action" provisions of federal law and regulation authorizes the Federal Reserve to restrict the payment of dividends to us from an insured bank which fails to meet specified capital levels.

Source of Strength. In accordance with Federal Reserve Board policy, the Company is expected to act as a source of financial strength to the Bank and to

commit resources to support the Bank in circumstances in which the Company may not otherwise wish to do so. Under the Federal Bank Holding Company Act, the Federal Reserve may require a bank holding company to terminate any activity or relinquish control of a bank subsidiary if the agency determines that divestiture may aid the depository institution's financial condition. In addition, if the Commissioner deems our Bank's capital to be impaired, the Commissioner may require the Bank to restore its capital by a special assessment upon us as University Bank's sole stockholder. If the Company were to fail to pay an assessment, the directors of the Bank would be required, under Michigan law, to sell the shares of the Bank's stock owned by the Company to the highest bidder at either a public or private auction and use the proceeds of the sale to restore the Bank's capital.

Financial Holding Companies. Beginning March 11, 2000, bank holding companies may apply to become Financial Holding Companies. We have not applied to become a Financial Holding Company. Financial Holding Companies may engage in a wider range of non-banking activities than Bank Holding Companies, including greater authority to engage in securities and insurance activities. The expanded powers are available to a bank holding company only if the bank holding company and its bank subsidiaries remain well-capitalized and well-managed. The new law also imposes various restrictions on transactions between the depository institution subsidiaries of bank holding companies and their non-bank affiliates. These restrictions are intended to protect the depository institutions from the risks of the new non-banking activities permitted to affiliates.

Primary Regulators of University Bank. The Bank is a Michigan banking corporation and its deposit accounts are insured by the Bank Insurance Fund (BIF) of the Federal Deposit Insurance Corporation (FDIC). As a Michigan-chartered commercial bank, University Bank is subject to the examination, supervision, reporting and enforcement powers of the Commissioner, as the chartering authority for Michigan banks, and the FDIC, as administrator of the BIF. These agencies and the federal and state laws applicable to the Bank and its operations, extensively regulate various aspects of the banking business including, among other things, reserves against loans, capital levels relative to operations, lending activities and practices, collateral for loans, establishment of branches, mergers, acquisitions and consolidations, payment of dividends, internal controls, permissible types and amounts of loans, investments and other activities, interest rates on loans and on deposits, and the safety and soundness and scope of banking practices. As an insured bank, University Bank is also required to file quarterly reports and other information as required with the FDIC.

All subsidiaries of University Bank including Midwest Loan Services and University Insurance & Investment Services are all also subject to all regulations applicable to University Bank itself, including regular on-site examination by both the OFIS and the FDIC.

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

Other Regulators. As a FHLMC, FNMA, and HUD Title 1 and Title 2 and HUD multifamily seller/servicer, University Bank's mortgage banking operation is subject to regulation and regular on-site examination by FHLMC, FNMA and HUD.

Other Regulations. University Bank and its subsidiaries are also subject to various regulations including:

- o the Community Reinvestment Act,
- o the federal Truth-in-Lending Act,
- o the Home Mortgage Disclosure Act,
- o the Equal Credit Opportunity Act,
- o the Fair Credit Reporting Act,
- o the Fair Debt Collection Act,
- o the Right to Privacy Act,
- o the Real Estate Settlement Procedures Act,
- o the Bank Secrecy Act,
- o the Electronic Funds Transfer Act,
- o Federal Reserve regulations,
- o state usury laws, and
- o federal laws concerning interest rates.

Also, University Bank may not engage in any activity not authorized by the Michigan Banking Code unless it is authorized by the Commissioner of the OFIS as being closely related to banking.

These laws and regulations are primarily intended to protect depositors and the deposit insurance fund of the FDIC, not the Bank nor the Company's stockholders. The following is a summary of certain statutes and regulations affecting University Bank. The following information is qualified in its entirety by reference to the particular statutory and regulatory provisions.

Various changes to the Federal Deposit Insurance Act (FDIA) are currently proposed in Congress. Any change in applicable laws, regulations or regulatory policies of various governmental regulatory authorities may have a material effect on the Company's business, operations and prospects. Those authorities include, but are not limited to, the Board of Governors of the Federal Reserve System, the FDIC, the Commissioner of the Michigan Office of Financial and Insurance Services, the Internal Revenue Service, and state taxing authorities. The Company is unable to predict the nature or extent of the effects that fiscal or monetary policies, economic controls or new federal or state legislation may have on future business and earnings.

Deposit Insurance. As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system under which all insured depository institutions are placed into one of nine categories and assessed insurance premiums, based upon their respective levels of capital and results of supervisory evaluation. Banks classified as well-capitalized, as defined by the FDIC, and considered healthy pay the lowest premium while institutions that are less than adequately capitalized, as defined by the FDIC, and considered to be of substantial supervisory concern pay the highest premium. Risk classification of all insured institutions is made by the FDIC for each semi-annual assessment period.

The Federal Deposit Insurance Act (FDIA) requires the FDIC to establish assessment rates at levels which will maintain the Deposit Insurance Fund at a mandated reserve ratio of not less than 1.25% of estimated insured deposits.

The FDIC may terminate the deposit insurance of any insured depository institution if the FDIC determines, after a hearing, that the institution or its directors have engaged or are engaging in unsafe or unsound practices, or have violated any applicable law, regulation, order, or any condition imposed in writing by, or written agreement with, the FDIC, or if the institution is in an

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

unsafe or unsound condition to continue operations. The FDIC may also suspend deposit insurance temporarily during the hearing process for a permanent termination of insurance if the institution has no tangible capital.

Commissioner Assessments. Michigan banks are required to pay supervisory fees to the Commissioner to fund the operations of the Commissioner. The amount of supervisory fees paid by a bank is based upon the bank's total assets, as reported to the Commissioner.

FICO Assessments. Pursuant to federal legislation enacted in 1996, University Bank, as a member of the BIF, is subject to assessments to cover the payments on outstanding obligations of the Financing Corporation (FICO). FICO was created in 1987 to finance the re-capitalization of the Federal Savings and Loan Insurance Corporation, the predecessor to the FDIC's Savings Association Insurance Fund (SAIF) which insures the deposits of thrift institutions. Between January 1, 2000 and the maturity of the outstanding FICO obligations in 2019, BIF members and SAIF members will share the cost of the interest on the FICO bonds on a pro rata basis. It is estimated that FICO assessments during this period will be less than 0.025% of deposits.

Capital Regulations. The FDIC has established the following minimum capital standards for state-chartered, FDIC-insured non-member banks, like University Bank:

- o a leverage requirement consisting of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly-rated banks with minimum requirements of 4% to 5% for all others;
- o and a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8%, at least one-half of which must be Tier 1 capital.

Tier 1 capital consists principally of stockholders' equity. These capital requirements are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions. For example, FDIC regulations provide that higher capital may be required to take adequate account of, among other things, interest rate risk and the risks posed by concentrations of credit, nontraditional activities or securities trading activities.

Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: requiring the submission of a capital restoration plan; placing limits on asset growth and restrictions on activities; requiring the institution to issue additional capital stock, including additional voting stock, or to be acquired; restricting transactions with affiliates; restricting the interest rate the institution may pay on deposits; ordering a new election of directors of the institution; requiring that senior executive officers or directors be dismissed; prohibiting the institution from accepting deposits from correspondent banks; requiring the institution to divest certain subsidiaries; prohibiting the payment of principal or interest on subordinated debt; and ultimately, appointing a receiver for the institution.

In general, a depository institution may be reclassified to a lower category than is indicated by its capital levels if the appropriate federal depository institution regulatory agency determines the institution to be otherwise in an unsafe or unsound condition or to be engaged in an unsafe or unsound practice. This could include a failure by the institution, following receipt of a less-than-satisfactory rating on its most recent examination report, to correct the deficiency.

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

The extent of the regulators' powers depends on whether the institution in question is "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized." An institution is critically undercapitalized if it has a tangible equity to total assets ratio that is equal to or less than 2%. An institution is well capitalized if it has a total risk-based capital ratio of 10% or greater, core risk-based capital of 6% or greater, and a leverage ratio of 5% or greater, and the institution is not subject to an order, written agreement, capital directive, or prompt corrective action directive to meet and maintain a specific capital level for any capital measure. An institution is adequately capitalized if it has a total risk-based capital ratio of not less than 8%, a core risk-based capital of not less than 4%, and a leverage ratio of not less than 4%.

These capital guidelines can affect the Bank in several ways. Capital levels are currently adequate, however, rapid growth, poor loan portfolio performance, or poor earnings performance, or a combination of these factors, could change our capital position in a relatively short period of time, making an additional capital infusion necessary. In general, if the FDIC's assessment of a Bank's financial and managerial strength changes negatively, the Bank's cost of FDIC insurance will rise in subsequent semi-annual periods. A financial institution may also be ordered to restrict its growth, dispose of certain assets, rescind agreements or contracts, or take other actions as determined by the ordering agency to be appropriate.

Dividends. Under Michigan law, the Bank is restricted as to the maximum amount of dividends it may pay on its common stock. The Bank may not pay dividends except out of net profits after deducting its losses and bad debts. The Bank may not declare or pay a dividend unless the Bank will have a surplus amounting to at least 20% of its capital after the payment of the dividend. If the Bank has a surplus less than the amount of its capital, it may not declare or pay any dividend until an amount equal to at least 10% of net profits for the preceding one-half year (in the case of quarterly or semi-annual dividends) or full-year (in the case of annual dividends) has been transferred to surplus. The Bank may not declare or pay any dividend until the cumulative dividends on preferred stock have been paid in full.

Federal law generally prohibits the Bank from making any capital distribution, including payment of a dividend, or paying any management fee to us if the Bank would thereafter be undercapitalized. The FDIC may prevent the Bank from paying dividends if the Bank is in default of payment of any assessment due to the FDIC. In addition, the FDIC may prohibit the payment of dividends by the Bank, if a payment is determined, by reason of the financial condition of the Bank, to be an unsafe and unsound banking practice.

Insider Transactions. The Bank is subject to certain restrictions imposed by the Federal Reserve Act including any extensions of credit to us, investments in our stock or other securities, and the acceptance of our stock as collateral for loans. Certain limitations and reporting requirements are also placed on extensions of credit by the Bank to its directors and officers, to our directors and officers, to our principal stockholders, and to "related interests" of the directors, officers and principal stockholders. In addition, federal law and regulations may affect the terms upon which any person becoming one of our directors or officers or one of our principal stockholders may obtain credit from banks with which the Bank maintains a correspondent relationship.

Safety and Soundness Standards. Federal banking agencies have adopted guidelines to promote the safety and soundness of federally insured depository institutions. These guidelines establish standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings.

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

In general, the guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the institution's primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. The preamble to the guidelines states that the agencies expect to require a compliance plan from an institution whose failure to meet one or more of the standards is of the severity that it could threaten the safe and sound operation of the institution. Failure to submit an acceptable compliance plan, or failure to adhere to a compliance plan that has been accepted by the appropriate regulator, would constitute grounds for further enforcement action.

State Bank Activities. Under federal law and FDIC regulations, FDIC-insured state banks are prohibited, subject to certain exceptions, from making or retaining equity investments of a type, or in an amount, that are not permissible for a national bank. Federal law, as implemented by FDIC regulations, also prohibits FDIC-insured state banks and their subsidiaries, subject to certain exceptions, from engaging as principal in any activity that is not permitted for a national bank or its subsidiary, respectively, unless the bank meets, and continues to meet, its minimum regulatory capital requirements and the FDIC determines the activity would not pose a significant risk to the deposit insurance fund of which the bank is a member. Impermissible investments and activities must be divested or discontinued within certain time frames set by the FDIC in accordance with federal law.

Consumer Protection Laws. The Bank's business includes making a variety of types of loans to individuals. In making these loans, the Bank is subject to state usury and regulatory laws, and various federal statutes, including:

- o the Equal Credit Opportunity Act,
- o the Fair Credit Reporting Act,
- o the Truth in Lending Act,
- o the Real Estate Settlement Procedures Act, and
- o the Home Mortgage Disclosure Act.

Regulations flowing from these laws prohibit discrimination, specify disclosures to be made to borrowers regarding credit and settlement costs, and regulate the mortgage loan servicing activities of Midwest Loan Services, including the maintenance and operation of escrow accounts and the transfer of mortgage loan servicing.

In receiving deposits, the Bank is subject to extensive regulation under State and federal law and regulations, including:

- o the Truth in Savings Act,
- o the Expedited Funds Availability Act,
- o the Bank Secrecy Act,
- o the Electronic Funds Transfer Act and
- o the Federal Deposit Insurance Act.

Violation of these laws could result in the imposition of significant damages and fines upon the Bank and its directors and officers.

Real Estate Lending Regulations. Federal regulators have adopted uniform standards for appraisals of loans secured by real estate or made to finance improvements to real estate. Banks are required to establish and maintain written internal real estate lending policies consistent with safe and sound banking practices and appropriate to the size of the institution and the nature and scope of its operations. The regulations establish maximum loan to value ratio limitations on real estate loans, which generally are equal to or greater than the loan to value limitations established under the Bank's lending

policies.

Branching Authority. Michigan banks, including University Bank, have authority under Michigan law to establish branches anywhere in the State of Michigan, subject to receipt of all required regulatory approvals, including approval of the Commissioner and the FDIC. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 allows banks to establish interstate branch networks through acquisitions of other banks, subject to certain conditions, including certain limitations on the aggregate amount of deposits that may be held by the surviving bank and all of its insured depository institution affiliates. The establishment of de novo interstate branches or the acquisition of individual branches of a bank in another state, rather than the acquisition of an out-of-state bank in its entirety, is allowed only if specifically authorized by state law.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 allowed individual states to "opt-out" of interstate branching authority by enacting appropriate legislation prior to June 1, 1997. Michigan did not opt out, and now permits both U.S. and non-U.S. banks to establish branch offices in Michigan. The Michigan Banking Code permits the following in appropriate circumstances and with the approval of the Commissioner:

- o acquisition of all or substantially all of the assets of a Michigan-chartered bank by an FDIC-insured bank, savings bank, or savings and loan association located in another state;
- o acquisition by a Michigan-chartered bank of all or substantially all of the assets of an FDIC-insured bank, savings bank or savings and loan association located in another state;
- o consolidation of one or more Michigan-chartered banks and FDIC-insured banks, savings banks or savings and loan associations located in other states having laws permitting this consolidation, with the resulting organization chartered by Michigan;
- o establishment by a foreign bank, which has not previously designated any other state as its home state under the International Banking Act of 1978, of branches located in Michigan;
- o establishment or acquisition of branches in Michigan by FDIC-insured banks located in other states, the District of Columbia or U.S. territories or protectorates having laws permitting Michigan-chartered banks to establish branches in these jurisdictions.

Further, the Michigan Banking Code permits the following, upon written notice to the Commissioner:

- o acquisition by a Michigan-chartered bank of one or more branches, not comprising all or substantially all of the assets, of an FDIC-insured bank, savings bank or savings and loan association located in another state, the District of Columbia, or a U.S. territory or protectorate;
- o establishment by Michigan-chartered banks of branches located in other states, the District of Columbia, or U.S. territories or protectorates; and
- o consolidation of one or more Michigan-chartered banks and FDIC-insured banks, savings banks or savings and loan associations located in other states, with the resulting organization chartered by one of the other states.

Primary Regulators for Michigan BIDCO. BIDCO is regulated and supervised by the Michigan Department of Commerce, Office of Financial and Insurance Services, Bank & Trust Division. BIDCO is examined annually by the Bank & Trust Division, and is required to make annual filings of financial statements, to maintain a license from the Bureau and to operate under strict rules on transactions with affiliates. Licensing under the terms of the Michigan BIDCO Act conveys certain exemptions upon BIDCO under Michigan law which are beneficial to the operations

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

and investment flexibility of the BIDCO. Most importantly, BIDCO is partially exempt from the state's usury law. As a result, BIDCO can lend money and take equity participation in the firm it lends to, with the result that BIDCO's overall combined yield on the investment and loan can exceed the state's usury limit. The amount of BIDCO's return from the equity participation or contingent payments is excluded from the calculation to determine compliance with the state's usury limits.

Primary Regulator of Midwest Loan Services. Midwest is an approved seller/servicer of single family mortgage loans for FNMA, FHLMC and HUD Title II (GNMA), and is subject to their rules, regulations and examinations.

Primary Regulator of University Insurance & Investment Services. University Insurance & Investment Services is licensed by the State of Michigan's Office of Financial and Insurance Services, Insurance Division as both a life and health and a property casualty insurance agency, and is subject to their rules, regulations and examinations. University Insurance & Investment Services also sells broker-dealer investment products and it and its licensed employees are subject to the rules, regulations and examinations of the National Association of Securities Dealers, and the Securities & Exchange Commission.

Item 3. - Legal Proceedings

We are not currently involved in any material pending legal disputes.

Item 4. - Submission of Matters to a Vote of Security Holders

Not applicable.

PART II.

Item 5. - Market for Registrant's Common Equity and Related Stockholder Matters

Common Stock and Dividend Information

Our common stock trades on the NASDAQ Small-Cap Market under the symbol UNIB. The high and low sales prices of our common stock as quoted by NASDAQ, for each quarter since January 1, 1999 are listed below:

| | High | Low |
|----------------|---------|---------|
| 1999 | | |
| First Quarter | \$3 3/8 | \$2 1/8 |
| Second Quarter | 4 3/16 | 2 |
| Third Quarter | 3 1/2 | 2 9/16 |
| Fourth Quarter | 2 3/4 | 1 1/4 |
| 2000 | | |
| First Quarter | \$2 5/8 | \$1 3/4 |
| Second Quarter | 1 7/8 | 1 |
| Third Quarter | 2 1/16 | 0 1/4 |
| Fourth Quarter | 3 1/2 | 0 1/2 |
| 2001 | | |
| First Quarter | \$2 1/2 | \$0 1/2 |
| Second Quarter | 2 1/8 | 1 1/2 |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | | |
|----------------|---------|---------|
| Third Quarter | 2 61/64 | 1 45/64 |
| Fourth Quarter | 2 1/2 | 0 53/64 |

These quotations represent inter-dealer prices, without retail markup, markdown or commission, and may not represent actual transactions. As of the March 26, 2002 we had approximately 375 stockholders including approximately 240 beneficial owners of shares held by brokerage firms or other institutions.

We effected a three for two stock split of our common stock (effected as a stock dividend) in February 1998. All per share and number of share amounts in this report are adjusted to reflect the stock split. No cash dividends have been paid on our common stock. We do not currently anticipate declaring or paying dividends.

Certain Sales of Equity Securities

Not applicable.

Item 6. - Selected Financial Data

University Bancorp, Inc. Selected Consolidated Financial and Other Data (Dollars in Thousands Except Per Share Data)

| | 2001 | 2000 | 1999 |
|---|---------|---------|---------|
| Summary of operations (1) | | | |
| Interest income | \$3,543 | \$3,315 | \$3,195 |
| Interest expense | 1,805 | 2,074 | 1,967 |
| Net interest income | 1,738 | 1,241 | 1,228 |
| Provision for loan losses | 40 | 111 | 93 |
| Net interest income after provision for loan losses | 1,698 | 1,130 | 1,135 |
| Net gain (loss) on securities | 13 | 18 | (15) |
| Profit(loss)from investment in Michigan BIDCO | (115) | 235 | 917 |
| Other non-interest income | 4,057 | 2,397 | 1,387 |
| Non-interest expense | 5,960 | 4,695 | 4,116 |
| Income (loss) before tax | | (915) | (692) |
| Income tax expense (benefit) | - | - | 32 |
| Net income (loss)from continuing operations | (307) | (915) | (724) |
| Net income (loss) | (307) | (915) | (915) |
| Selected Year End Balances | | | |
| Total assets | 45,623 | 47,671 | 40,823 |
| Loans, net | 34,447 | 35,644 | 30,580 |
| Loans, held for sale | 2,138 | 268 | 305 |
| Cash, cash equivalents and investment securities | 3,946 | 5,340 | 5,919 |
| Deposits | 40,198 | 38,179 | 32,051 |
| Short-term borrowings | 92 | 4,094 | 3,114 |
| Long-term borrowings | 1,658 | 926 | 2,627 |
| Minority interest | 305 | 283 | 506 |
| Stockholders' equity | 2,737 | 2,042 | 1,950 |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

Per Share Data (2)

| | | | |
|--|----------|----------|----------|
| Common shares, year-end | 3,753 | 2,028 | 2,013 |
| Weighted avg shares, year-end | 2,278 | 2,027 | 1,994 |
| Cash dividends | - | - | - |
| Net income (loss) from continuing operations | (\$0.13) | (\$0.45) | (\$0.36) |
| Net income (loss) | (\$0.13) | (\$0.45) | (\$0.46) |
| Book value of common shares | \$0.73 | \$0.65 | \$0.97 |

Selected Ratios

| | | | |
|-------------------------------|----------|----------|----------|
| Net yield on earning assets | 4.37% | 3.33% | 3.14% |
| Return on average assets | (0.67%) | (2.06%) | (1.92%) |
| Return on average equity | (12.49%) | (53.56%) | (36.38%) |
| Average equity to avg. assets | 5.38% | 3.84% | 5.28% |

(1) Excludes results from discontinued operations.

(2) Retroactively restated to reflect a 3 for 2 stock split in 1998.

Item 7. - Management's Discussion and Analysis of Financial Condition and Results of Operations

The purpose of the following discussion and analysis is to assist the reader in understanding and evaluating the changes in financial position and results of operations over the past several years. Investors should refer to the consolidated financial statements, the related notes thereto, and statistical information presented elsewhere in this report when reading this section of the report.

The cautionary statements described below are for the purpose of qualifying for the "safe harbor" provisions of Section 21E of the Securities Exchange Act of 1934.

RISK FACTORS

Our business involves a high degree of risk. You should carefully consider the risks and uncertainties described below and the other information in this report before deciding whether to invest in shares of our common stock. If any of the following risks actually occur, our business, financial condition and results of operations could be materially adversely affected. This could cause the trading price of our common stock to decline, with the loss of all or part of an investment in our common stock.

Described below, are the material risks of investing in University Bancorp's common stock. Investors should carefully consider these prior to purchasing any shares.

If We Are Delisted From The NASDAQ Small-Cap Market the Marketability of Our Shares Could Decrease

NASDAQ has informed management that the Company's common stock would be de-listed from the NASDAQ Small Cap Market if the market value of shares held by non-insiders of the Company remains below \$1,000,000 through May 15, 2002. As of March 28, 2001, 940,158 shares of University Bancorp common stock were owned by non-insiders of the Company. A floor bid price of \$1.07 per share is needed to meet the public float requirement of \$1,000,000. As of March 28, 2002, the current bid price was \$0.65 per share of common stock. Also, NASDAQ has informed

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

management that the Company's common stock would be delisted from the NASDAQ Small Cap Market if the bid price of the Company's common stock does not trade at at least \$1.00 per share for ten consecutive trading days prior to September 3, 2002. If the Company's common stock is de-listed from NASDAQ, the shares will be less marketable in the future and there will be a smaller potential pool of investors for the stock. This would significantly limit the ability of shareholders deciding to sell their shares to do so. If the Company is de-listed, the management of University Bancorp could opt to list its common stock on the NASDAQ Bulletin Board.

You May Not Be Able To Sell Your Shares Upon Demand

Although the Company's common stock is currently listed for trading on the NASDAQ Small-Cap Market, the trading market for University Bancorp historically has been less active than the average trading market for companies listed on the exchange. In addition, the share price of University Bancorp has been volatile and has ranged from \$0.50 to \$2.50 in the past 12 months. Factors such as the limited number of shares outstanding held by the public, the lack of earnings history and the absence of a reasonable expectation of dividends within the near future mean that there might not be an active and liquid market for the Company's common stock. Even if an active market develops, there can be no assurance that a market will continue. Purchasers of the Company's common stock should carefully consider the potentially illiquid and long-term nature of their investment in the shares.

The Company's Stock Is Controlled By Insiders Of The Company, Which May Not Provide You With The Best Possible Return On Your Investment

A majority of the shares outstanding are held by insiders of the Company. The Ranzini Group (Mr. Joseph L. Ranzini, Mr. Stephen Lange Ranzini, Mrs. Mildred Ranzini, the various Ranzini Family Trusts) beneficially owns 2,629,489, or 68.6% of the issued and outstanding shares at March 22, 2002. These individuals are able to exert a significant measure of control over University Bancorp's affairs and policies. This control could be used, for example, to help prevent an acquisition of University Bancorp, precluding shareholders from possibly realizing any possible premium which may be offered for the common stock by a potential acquirer.

Your Ownership Of The Company May Be Further Diluted If The Bank Requires Additional Capital

There can be no assurance that the Bank will not need additional capital in the near future to support the Bank's growth or to counter operating losses. Funds necessary to meet the Bank's working capital needs and to finance its expansion might not be available. If additional equity securities are needed to finance future expansion, such sale could result in significant dilution to the existing shareholders.

University Bank Has Incurred Significant Start-up Losses And May Never Achieve Profitability

University Bank's operations were relocated to Ann Arbor in 1996. University Bank has a history of losses and has incurred substantial operating losses. Shareholders are subject to the risks inherent in starting a new business. The Bank's profitability will depend primarily upon operations that might never become profitable. Management of the Bank believes that as the size of loan portfolio and retail deposits increase that the Bank should become profitable, but there is no assurance that expenses will not rise at a faster rate than expected as the Bank grows. There is no assurance that University Bank will grow to a size that will enable it to become profitable. University Bancorp had a consolidated net loss of \$306,573 during 2001 and an accumulated deficit of \$2,205,444 at December 31, 2001.

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

The Small Size Of University Bank Limits Its Ability To Compete With Larger Financial Institutions

University Bank faces strong competition for deposits, loans and other financial services from numerous Michigan and out-of-state banks, thrifts, credit unions and other financial institutions. Some of the financial institutions with which University Bank competes with are not subject to the same degree of regulation as University Bank is. Many of these financial institutions aggressively compete for business in the Ann Arbor area. Most of the Bank's competitors have been in business for many years, have established customer bases, have numerous branches, have substantially higher lending limits, and offer certain services that we do not provide. The dominant competitors in the Ann Arbor area are Great Lakes Bank, National City Bank, Comerica Bank, Bank One, Key Bank and Republic Bank. There can be no assurance that University Bank will be able to compete effectively with these competitors unless it can continue to grow its operations.

The Year Ended December 31, 2001 Compared to the Years Ended December 31, 2000 and 1999

Summary of Results of Operations

The Company's net loss from continuing operations was \$306,573 in 2001, \$914,647 in 2000 and \$723,725 in 1999. Earnings (loss) per share from continuing operations for 2001, 2000 and 1999 were \$(0.13), \$(0.45) and \$(0.36), respectively. Including both continuing operations and discontinued operations, our net loss was \$306,573 in 2001, \$914,647 in 2000 and \$915,480 in 1999.

The Operations of the Company showed significant progress in 2001 as compared to 2000. The net loss was reduced by \$608,074 to \$306,573 in 2001 from \$914,647 in 2000. The Company benefited from the declining interest rates in 2001 and increased its net interest margin by \$497,242 over the previous year. Other income rose by \$1,305,081. The operations of Midwest Loan Services contributed significantly to this category as their loan servicing and mortgage origination activity exceeded the prior year. The increase in income was offset partially by an increase in the Company's other expenses. Other expense increased by \$1,265,249 from 2000. Increased salary and benefits at Midwest accounted of the majority of the rise in other expense. Midwest hired additional personnel in 2001 to manage the higher levels of loan servicing and origination.

Barring four sizeable non-recurring items, both University Bancorp and the Bank would have made a profit for the entire 2001 year. Those non-recurring items were:

| | |
|--|---------------------|
| Midwest Servicing Rights Valuation | \$224,175 (Bank) |
| Foreclosed Real Estate Valuation | \$ 66,829 (Bank) |
| Non-cash Stock Compensation | \$ 31,200 (Bank) |
| BIDCO Loss | \$114,551 (Bancorp) |

The following non-recurring items negatively impacted the Bank's result:

1) Midwest Servicing Rights Valuation. The Bank's Midwest Loan Services subsidiary took a writedown on its servicing rights of \$224,175 because long term rates temporarily dipped to 40-year lows immediately following the terrorist attacks in September (once written down the servicing rights cannot be written up under Generally Accepted Accounting Principles even though long term rates did subsequently rise). The write-down reduced Midwest's basis in servicing rights to \$489,770 from \$713,935. The risk in the remaining rights is effectively offset by a principal-only mortgage-backed security investment that increased income during 2001 by \$120,385;

2) Foreclosed Real Estate Valuation. In early 2001, management engaged an

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

experienced real estate company to develop an other real estate owned site carried on the Bank's books. During 2001, the Bank wrote-down its investment in this property to \$200,000, incurring a \$66,829 loss. Substantially all approvals for the proposed development have been received and the Bank anticipates closing on the sale of the property by mid-Summer 2002 at the contracted price of \$300,015. This site is the only foreclosed real estate currently owned by the Bank.

3) Stock Compensation Expense. The Bank expensed \$31,200 in non-cash compensation expense related to an incentive we provided as a hiring bonus to a new executive officer in 2001.

The total of these non-recurring items is \$322,194. Without these items, the Bank's income would have been \$136,876 in 2001.

4) BIDCO Loss. In addition, the bank holding company took a write-down on its investment in Michigan BIDCO of \$114,551 to \$29,152 as a result of several factors including the writedown of one investment, and research and development expense related to two e-payment patents that were applied for during the year. The Bank's investment in the BIDCO is now \$600,000 in 7.5% cumulative preferred stock. The Bank realized no income from its equity investment in the BIDCO in 2001 (although a capital restructuring of the BIDCO reduced the Bank's investment in the BIDCO by \$600,227). Management estimates that the BIDCO preferred stock dividends and ultimate redemption of the preferred stock should increase the Bank's income in 2002 and subsequent years by \$45,000.

Including both continuing operations and discontinued operations, the loss in 2000 was similar in amount to the loss in 1999, however, the losses flowed from primarily different causes. Results in 2000 were negatively impacted by a decrease in the contribution to profit by Michigan BIDCO in 2000 from \$916,991 to \$234,740, goodwill amortization of \$139,412 related to an earn-out payment related to the acquisition of Midwest Loan Services, legal expense related to the successful defense of a lawsuit related to the sale of Varsity Mortgage of approximately \$60,000, and unusually high external auditor expenses of over \$300,000. These negative developments in 2000 overwhelmed the underlying profit improvement at the community banking operation and the increased profits at Midwest Loan Services. As a result of the trend toward improved underlying operating results, University Bank had a profit in four of the last six months of 2000. Results in 1999 were negatively impacted by losses at discontinued operations of \$191,755, losses caused by an adverse judgment in a lawsuit totaling \$192,000, losses at the community banking operation, and only break-even results at Midwest Loan Services, which were only partially offset by a record contribution from Michigan BIDCO of \$916,991.

The following table summarizes the pre-tax income (loss) of each profit center of the Company for the years ended December 31, 2001 and 2000 (in thousands):

Twelve months ended December 31, 2001 and 2000 Pre-tax Income (Loss) Summary:

| | 2001 | 2000 |
|---|----------|------------|
| Community Banking | \$ (414) | \$ (1,314) |
| Midwest Loan Services | 237 | 436 |
| Merchant Banking (Michigan BIDCO) | (115) | 235 |
| Corporate Office | (15) | (272) |
| | ---- | ---- |
| Total | \$ (307) | \$ (915) |
| | ===== | ===== |

Net Interest Income

Net interest income represents the dollar amount by which interest income generated by interest-earning assets exceeds the cost of funds. Interest-earning assets consist primarily of loans, short term investments and investment

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

securities, and the principal cost of funds is the interest paid on deposit accounts and other borrowings. Net interest income is affected by (i) the difference between the average rate of interest earned on the Bank's interest-earning assets and the average rate paid on its interest-bearing liabilities ("interest rate spread") and (ii) the relative amounts of its average interest-earning assets and interest-bearing liabilities. In order to maintain and increase earnings during periods of fluctuating interest rates, it is imperative that interest-earning assets and interest-bearing liabilities be managed effectively. Trends in net interest income provide a measure of the effectiveness by which a financial institution manages its interest rate sensitivity.

The following tables present for the average balances, the interest earned or paid, and the weighted average yield for the period indicated.

| | At | | |
|--|---------------|-----------------|---------|
| | 31-Dec-01 | | 200 |
| | Average Yield | Average Balance | Int Inc |
| Interest Earning Assets: | | | |
| Commercial Loans | 7.90% | \$16,111,575 | \$ |
| Real Estate Loans (1) | 7.29% | 15,545,774 | |
| Installment Loans | 9.61% | 4,635,651 | |
| Total Loans | 7.78% | 36,293,000 | |
| Investment Securities | 4.75% | 2,929,515 | |
| Federal Funds & Bank Deposits | 3.02% | 538,676 | |
| Total Interest Bearing Assets | 7.56% | 39,761,191 | |
| Interest Bearing Liabilities: | | | |
| Deposit Accounts: | | | |
| Demand | 1.18% | 3,346,502 | |
| Savings | 1.16% | 349,364 | |
| Time | 4.45% | 23,172,173 | |
| Money Market Accts | 2.08% | 10,273,959 | |
| Short-term Borrowings | 2.95% | 1,931,660 | |
| Long-term Borrowings | 4.58% | 699,398 | |
| Total Interest Bearing Liabilities | 3.41% | 39,773,056 | |
| Net earning assets, net interest income, and interest rate spread | 4.15% | \$(11,865) | \$ |
| Net yield on interest-earning assets | 4.63% | | |
| 1. Actual yields; not adjusted to take into account tax-equivalent yields. | | | |

NET INTEREST INCOME

| | | 200 |
|--|--------------------|------------|
| | Average Balance | Int Inc |
| Interest Earning Assets: | | |
| Commercial Loans | \$13,524,876 | \$ |
| Real Estate Loans (1) | 14,769,498 | |
| Installment Loans | 4,726,444 | |
| Total Loans | 33,020,818 | |
| Investment Securities (2) | 4,172,915 | |
| Federal Funds & Bank Deposits | 59,305 | |
| Total Interest Bearing Assets | 37,253,038 | |
| Interest Bearing Liabilities: | | |
| Deposit Accounts: | | |
| Demand | 2,838,835 | |
| Savings | 325,536 | |
| Time | 16,940,251 | |
| Money Market Accts | 12,210,290 | |
| Short-term Borrowings | 3,589,958 | |
| Long-term Borrowings | 1,457,221 | |
| Total Interest Bearing Liabilities | 37,362,091 | |
| Net earning assets, net interest income, and interest rate spread | \$ (109,053) | \$ |
| Net yield on interest-earning assets | | |

- (1) Actual yields; not adjusted to take into account tax-equivalent yields.
- (2) The convertible bonds at Michigan BIDCO were converted on May 31, 2000, resulting in the deconsolidation of BIDCO related interest earning assets and interest bearing liabilities.

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

NET INTEREST INCOME

| | 1999 |
|---|--------------------|
| | Average Balance |
| Interest Earning Assets: | |
| Commercial Loans | \$12,242,253 |
| Real Estate Loans (1) | 18,142,245 |
| Installment Loans | 4,115,908 |
| Total Loans | 34,500,406 |
| Investment Securities (2) | 3,482,913 |
| Federal Funds & Bank Deposits | 1,177,852 |
| Total Interest Bearing Assets | 39,161,171 |
| Interest Bearing Liabilities: | |
| Deposit Accounts: | |
| Demand | 3,169,317 |
| Savings | 225,017 |
| Time | 18,992,483 |
| Money Market Accts | 11,747,329 |
| Short-term Borrowings | 1,751,173 |
| Long-term Borrowings | 2,550,827 |
| Total Interest Bearing Liabilities | 38,436,146 |
| Net Earning Assets, net interest income and interest rate spread | \$725,025 |
| Net yield on interest-earning assets | |

1. Amounts for 1999 were adjusted to eliminate loans and income from discontinued operation
2. Actual yields; not adjusted to take into account tax-equivalent yields resulting from tax investments

The table above does not specify the average level of non-interest bearing

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

demand deposits, which were \$2,643,856, \$2,827,295, and \$2,306,983 for the years ended December 31, 2001, 2000 and 1999, respectively.

Net interest income increased \$.50 million to \$1.74 million in 2001 from \$1.24 million in 2000. The increase resulted from an increase in the net interest rate spread, plus an increase in earning assets. Net interest income increased primarily due to a lower rate environment in 2001 as compared to 2000. In 2001, the Federal Reserve Bank lowered the short-term interest rate numerous times in an attempt to stimulate the United States economy. The Company's positioning of rate sensitive assets and liabilities was structured to benefit from a drop in interest rates. The average yield on interest rate liabilities declined 18% from 5.55% in 2000 to 4.54% in 2001. In contrast, the average yield on interest bearing assets increased slightly from 8.90% to 8.91% in 2001. The spread between the average yield on rate sensitive assets and liabilities rose to 4.37% in 2001 from 3.35% in 2000. Additionally, the net interest income was positively affected in 2001 by higher volume of earning assets. Total interest bearing assets increased by \$2.51 million to \$39.76 million in 2001 from \$37.25 million in 2000.

Including only activity from continuing operations, net interest income increased to \$1.24 million in 2000 from \$1.23 million in 1999, mainly as a result of an increase in the yield on net interest-earning assets faster than an increase in the rate on interest-bearing liabilities. During the year ended December 31, 2000, the average interest-earning asset base fell by \$1.91 million or 4.9% from 1999, while average interest-bearing liabilities decreased by \$1.07 million or 2.8%. Due to the rise in short term interest rates, the average cost of interest-bearing deposits increased from 5.12% in 1999 to 5.55% in 2000. As a result of an increase in yield on interest-earning assets in an amount greater than the increase in the rate on interest-bearing liabilities which more than offset the decrease of interest-bearing assets at a rate greater than the decrease in interest-bearing liabilities, the net interest margin increased to 3.33% in 2000 from 3.14% in 1999. Short term interest rates bottomed in mid-year 1999, and by year-end 2000, short term interest rates were 1.75% higher. Long term interest rates hit an interim peak in 1999, but trended lower throughout 2000.

The following table presents information regarding fluctuations in our interest income and interest expense for the periods indicated. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to (1) changes in volume (changes in volume multiplied by old rate); and (2) changes in rate (changes in rate multiplied by old volume); with the rate/volume variance allocated to changes in rate:

RATE VOLUME TABLE

| | 2001 - 2000 | | |
|-------------------------------|----------------------------|--------------------------|-----------------|
| | Change Due To Volume | Change Due To Rate | Total Change |
| Interest Income: | | | |
| Commercial Loans | \$ 244,047 | \$ (87,471) | \$ 156,576 |
| Real Estate Mortgage Loans | 66,014 | (65,274) | 740 |
| Installment/Consumer Loans | (9,205) | (3,692) | (12,897) |
| Investment Securities | (74,166) | 135,741 | 61,575 |
| Federal Funds & Bank Deposits | 20,745 | 913 | 21,658 |
| | ----- | ----- | ----- |
| Total Interest Income | 247,345 | (19,783) | 227,652 |
| | ----- | ----- | ----- |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

Interest Bearing Liabilities:

| | | | |
|------------------------|------------|------------|------------|
| Demand Deposits | 12,825 | (22,692) | (9,867) |
| Savings Deposits | 456 | (964) | (508) |
| Time Deposits | 355,717 | (180,914) | 174,803 |
| Money Market Accounts | (76,501) | (127,968) | (204,469) |
| Short-term Borrowings | (90,228) | (64,250) | (154,478) |
| Long-term Borrowings | (58,923) | (16,148) | (75,071) |
| | ----- | ----- | ----- |
| Total Interest Expense | 143,346 | (412,936) | (269,590) |
| | ----- | ----- | ----- |
| Net Interest Income | \$ 104,089 | \$ 393,153 | \$ 497,242 |
| | ===== | ===== | ===== |

RATE VOLUME TABLE

2000 - 1999

| | Change Due To Volume | Change Due To Rate | Total Change |
|-------------------------------|----------------------------|--------------------------|-----------------|
| Interest Income: | | | |
| Commercial Loans | \$ 127,038 | \$ (8,334) | \$ 118,704 |
| Real Estate Mortgage Loans | (268,564) | 240,247 | (28,317) |
| Installment/Consumer Loans | 61,807 | 15,229 | 77,036 |
| Investment Securities | 35,922 | (29,427) | 6,495 |
| Federal Funds & Bank Deposits | (40,052) | (13,015) | (53,067) |
| | ----- | ----- | ----- |
| Total Interest Income | (83,849) | 204,700 | 120,851 |
| | ----- | ----- | ----- |
| Interest Bearing Liabilities: | | | |
| Demand Deposits | (9,923) | (10,460) | (20,383) |
| Savings Deposits | 2,034 | (291) | 1,743 |
| Time Deposits | (122,728) | 133,565 | 10,837 |
| Money Market Accounts | 19,672 | 28,023 | 47,695 |
| Short-term Borrowings | 123,460 | 7,077 | 130,537 |
| Long-term Borrowings | (91,622) | 29,079 | (62,543) |
| | ----- | ----- | ----- |
| Total Interest Expense | (79,107) | 186,993 | 07,886 |
| | ----- | ----- | ----- |
| Net Interest Income | \$ (4,742) | \$ 17,707 | \$ 12,965 |
| | ===== | ===== | ===== |

Loan Portfolio

Information regarding the Bank's loan portfolio as of December 31, 2001 and 2000 is set forth under Note 6 to University Bancorp's consolidated financial statements included with this report.

Provision for Loan Losses

The Bank charges to operations a provision for possible loan losses which is intended to create an allowance for future loan losses inherent in the Bank's portfolio. Each year's provision reflects management's analysis of the amount necessary to maintain the allowance for possible loan losses at a level adequate to absorb anticipated losses. In its evaluation, management considers factors like historical loan loss experience, specifically identified problem loans, composition and growth of the loan portfolio, current and projected economic conditions, and other pertinent factors. A loan is charged-off by management as a loss when deemed uncollectible, although collection efforts continue and future recoveries may occur.

Non-performing loans are defined as loans which have been placed on

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

non-accrual status and loans over 90 days past due as to principal or interest and still in an accrual status. Where serious doubt exists as to the collectibility of a loan, the accrual of interest is discontinued. See Note 6 of the Consolidated Financial Statements for additional information regarding impaired and past due loans.

Non-performing loans amounted to \$1,265,276 and \$692,219 at December 31, 2001 and 2000, respectively. The bulk of the non-performing loans at year-end 2001 are delinquent real estate loans. The following is a list of all non-performing loans over 90 days past due not secured by real estate with a combined loan to current value of 88% or less:

| Loan Collateral & Description | Value of Collateral | Loan Amount | LTV% |
|-----------------------------------|---------------------|-------------|------|
| Residential Construction 1st Mtg. | \$380,000 | \$420,000 | 90% |
| Lawn & Snow Care Equipment | \$150,000 | \$178,179 | 119% |
| Truck Loan | \$ 21,000 | \$ 24,194 | 115% |

The provision for loan losses in 2001 was \$40,000, a decrease of \$71,000 from the 2000 level, which in turn was an increase of \$18,352 from the 1999 level of \$92,648. Loans charged off net of recoveries were \$23,884, \$80,588 and \$19,064 in 2001, 2000 and 1999, respectively. The allowance for possible loan losses totaled \$579,113, \$562,997 and \$532,585 at the end of 2001, 2000 and 1999, respectively.

Analysis of the Allowance for Loan Losses (\$ amounts in thousands):
Summary of loan loss expense for the Bank for the years ended December 31

| | 2001 | 2000 | 1999 |
|--|--------|--------|--------|
| Balance at beginning of the period | \$ 563 | \$ 533 | \$ 459 |
| Chargeoffs - Domestic: | | | |
| Commercial loans | 20 | 135 | 0 |
| Real estate mortgages | 7 | 9 | 60 |
| Installment loans | 17 | 1 | 6 |
| | ----- | ----- | ----- |
| Subtotal | 44 | 145 | 66 |
| | ----- | ----- | ----- |
| Recoveries - Domestic: | | | |
| Commercial loans | 12 | 27 | 28 |
| Real estate mortgages | 2 | 21 | 0 |
| Installment loans | 6 | 16 | 19 |
| | ----- | ----- | ----- |
| Subtotal | 20 | 64 | 47 |
| | ----- | ----- | ----- |
| Net chargeoffs | 24 | 81 | 19 |
| Provision for loan losses | 40 | 111 | 93 |
| | ----- | ----- | ----- |
| Balance at end of period | \$ 579 | \$ 563 | \$ 533 |
| | ===== | ===== | ===== |
| Ratio of net chargeoffs during period to average loans outstanding during period | 0.07% | 0.24% | 0.06% |
| | ===== | ===== | ===== |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

Analysis of the Allowance for Loan Losses (\$ amounts in thousands)

| | Allocated portion of allowance at December 31 | | Percentage of loans in each category to total loans | |
|-----------------------|---|--------|---|--------|
| Loan category: | 2001 | 2000 | 2001 | 2000 |
| Domestic: | | | | |
| Commercial loans | \$ 337 | \$ 216 | 51.0% | 38.1% |
| | | | 2.9% | 2.9% |
| Real estate mortgages | 78 | 178 | 38.2% | 42.9% |
| Installment loans | 135 | 128 | 10.9% | 16.1% |
| Unallocated | 29 | 41 | N/A | N/A |
| | ----- | ----- | ----- | ----- |
| | \$ 579 | \$ 563 | 100.0% | 100.0% |
| | ===== | ===== | ===== | ===== |

| | At December 31, 2001 | At December 31, 2000 |
|-------------------------|-------------------------|-------------------------|
| | ----- | ----- |
| Total loans (1) | \$35,026,024 | \$36,206,544 |
| Reserve for loan losses | \$579,113 | \$562,997 |
| Reserve/Loans % | 1.65% | 1.55% |

(1) Excludes loans held for sale.

The Bank's overall loan portfolio is geographically concentrated in Ann Arbor and the future performance of these loans is dependent upon the performance of relatively limited geographical areas. Since the Bank has a limited experience with its loan portfolio in Ann Arbor, the Bank's historical loss ratios may be less than future loss ratios.

Management believes that the allowance for loan losses is adequate to absorb losses inherent in the loan portfolio, although the ultimate adequacy of the allowance for loan losses is dependent upon future economic factors beyond our control. A downturn in the general nationwide economy will tend to aggravate, for example, the problems of local loan customers currently facing some difficulties. A general nationwide business expansion could result in fewer loan customers being unable to repay their loans.

Other real estate owned at December 31, 2001 and December 31, 2000 includes a commercial development site in Sault Ste. Marie, Michigan. Based upon an appraisal, management believes the 16-acre site where a former loan office is located has a fair market value more than its carrying value of \$200,000 at December 31, 2001. The Bank no longer intends to utilize it for a branch location and accordingly has classified it as other real estate owned. Management has executed an agreement to sell the property to a third-party for \$300,015 subject to various contingencies. There is no assurance that a sale of the Sault Ste Marie property will be consummated.

Non-Interest Income and Non-Interest Expense

Non-interest income. For continuing operations, non-interest income increased to \$3,955,410 in 2001, from \$2,650,329 in 2000, an increase of 49.2%. The increase in 2001 was mainly the result of increased revenues from Midwest Loan Services' loan subservicing and set-up fees, which more than offset a decline in income from merchant banking (BIDCO) income, because the BIDCO's results were deconsolidated after May 1, 2000.

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

For continuing operations, non-interest income increased to \$2,650,329 in 2000, from \$2,289,126 in 1999, an increase of 15.8%. The increase in 2000 was mainly the result of increased revenues from Midwest Loan Services' loan subservicing and set-up fees, which more than offset a decline in income from merchant banking (BIDCO) income, because the BIDCO's results were deconsolidated after May 1, 2000.

Mortgage banking. Mortgage banking, servicing and origination fees increased from \$2,183,209 in 2000 to \$3,783,721 in 2001. The increase in mortgage banking fee income was the result of an increase in the number of loans subserviced at Midwest Loan Services. Likewise, mortgage banking, servicing and origination fees increased to \$2,183,209 in 2000 from \$1,151,923 in 1999. The increases in mortgage banking fee income for both 2000 and 2001 was the result of an increase in the number of loans subserviced at Midwest Loan Services.

During 2000, Midwest Loan Services increased its mortgage subservicing contracts by 280% (from \$0.5 billion to \$1.9 billion) as a result of a new business relationship with one of the top five mortgage banking firms on Wall Street. During the first half of 2001, Midwest reached a peak of \$2.7 billion in 1-4 family residential loan servicing. In the third quarter of the year, the loan servicing volume was significantly cut back as Midwest's largest customer decided to significantly scale back the amount of business it was providing to Midwest. As of July 1, 2001, 18,500 loans or 95% of the mortgages sub-serviced by Midwest for this customer had been transferred to other sub-servicers including a subsidiary of this firm with the rest transferred the following month. During 2001 Midwest increased its emphasis on mortgage loan originations through its credit union customers. Much of the increase in loan set up and other fees resulted from fee income from mortgage originations generated from member of credit unions. In 2001, Midwest originated 939 mortgage loans. Growth was consistent in each month throughout the year. In January 2001 12 mortgage loans were originated and 135 were originated in December 2001, an 1,125% increase.

The servicing rights portfolio totaled \$67,670,000 of FHLMC and FNMA mortgages at December 31, 2001, versus \$55,443,000 at December 31, 2000. All residential mortgage loan servicing in 2001 and 2000 was performed by Midwest Loan Services.

Based on recent comparable sales and indications of market value from industry brokers, management believes that the current market value of the Bank's portfolio of mortgage servicing rights equals cost. Market interest rate conditions can quickly affect the value of mortgage servicing rights in a positive or negative fashion, as long term interest rates rise and fall.

Servicing Rights Held by University Bank (\$ amounts in 000's)

| | December 31, 2001 | December 31, 2000 |
|---|-------------------|-------------------|
| Book value of servicing | \$607 | \$ 582 |
| Total loans serviced | \$67,670 | \$55,443 |
| Ratio of book value of servicing to loans serviced | .90% | 1.05% |
| Estimated market value of servicing: | | |
| Outside appraisal | \$ 607 | \$ 582 |
| Estimated excess of market over book value | \$ 0 | \$ 0 |

Additional information regarding the Bank's mortgage banking activities for the past three years is set forth in Note 4 to our consolidated financial statements.

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

Mortgage Banking (Michigan BIDCO). BIDCO invests in businesses in Michigan with the objective of capital gains while fostering job growth and economic development. As of December 31, 2001, the BIDCO had made twenty-nine investments since its inception in 1993, amounting to a total of \$16,569,800 at original cost, before repayments or participations sold. At December 31, 2001, Michigan BIDCO had total assets of \$1,109,561 versus \$3,429,226 at December 31, 2000.

The financial results of Michigan BIDCO were accounted for under the equity method of accounting until March 1999. In April 1999, \$1,850,000 of Michigan BIDCO bonds were repurchased by the BIDCO, and University Bank converted its \$27,000 of bonds into common stock, thereby increasing the Bank's equity ownership to 80.1%. Effective April 1999, Michigan BIDCO's financial results became consolidated into the results of University Bancorp. The remaining Michigan BIDCO bonds were converted into common stock on May 31, 2000, and thus diluted University Bancorp's equity ownership down to 28.8%. As a result, the BIDCO is no longer consolidated in the financial statements of University Bancorp and the investment is now accounted for under the equity method of accounting. The Company's equity share of BIDCO at December 31, 2001 is 6.10%. Income (loss) realized from the investment in the BIDCO of was \$(114,551), \$234,740 and \$916,991 in 2001, 2000, and 1999, respectively.

Securities. Proceeds from sales of marketable equity securities included in proceeds from sales of investment securities were \$0, \$98,625 and \$74,550 for the years ended December 31, 2001, 2000 and 1999, respectively. Gross gains of approximately \$0, \$20,625 and \$1,879 were realized on 2001, 2000 and 1999 sales, respectively. Gross losses of \$17,981 were realized on 1999 sales.

Proceeds from sales of available for sale debt securities were \$541,460, \$1,123,594 and \$530,763 for the years ended December 31, 2001, 2000 and 1999, respectively, excluding sales associated with the Bank's mortgage banking operation. There were gross gains of \$12,639 and \$625 on 2001 and 1999 sales, respectively and a gross loss \$2,839 on 2000 sales.

At December 31, 2001 gross unrealized losses in our available-for-sale securities were \$167,000 and gross unrealized gains were \$0. At December 31, 2000, gross unrealized losses in the available-for-sale securities were \$335,000 and gross unrealized gains were \$0. At December 31, 1999 gross unrealized losses in our available-for-sale securities were \$585,000 and gross unrealized gains were \$0.

Non-interest expense. Non-interest expense increased to \$5,960,223 in 2001 from \$4,694,974 in 2000. The increase was primarily the result of increased operational expenses at Midwest Loan Services, which more than offset cost control efforts in other areas at the Bank. During the year the retail bank division's non-interest expenses increased by just \$31,226 to \$2,676,073 from \$2,644,847. Midwest's operations were expanded in 2001 due to a substantial increase in mortgage sub-servicing and origination activity. As the volume expanded Midwest increased its workforce to perform the required tasks. Other servicing and sub-servicing related expenses, such as occupancy, supplies and postage increased also. At the Bank level, a concerted effort was made to reduce its non-interest expenses. Notable improvements were made in the legal and audit expense category. Non-interest expense was also impacted by an increase in the amortization of the mortgage servicing rights due to the low interest rate environment after September 2001.

Including only activity from continuing operations, our non-interest expense increased to \$4,694,974 in 2000 from \$4,115,712 in 1999, a 14.1% increase. During the year non-interest expenses at the retail bank division increased by \$321,522 from \$2,323,325 to \$2,644,847 primarily as a result of higher legal and audit expenses. Increases in most other areas were the result of growth at Midwest Loan Services. Data processing expenses were higher

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

primarily because of a variety of internet initiatives, including internet banking and development projects at Midwest Loan Services. University Bancorp's total non-interest expense decreased \$56,408 despite \$139,412 in goodwill amortization expense related to an earn-out payment from the Midwest Loan Services acquisition. The increase in goodwill amortization was more than offset by decreases in ESOP and legal costs.

Liquidity and Capital Resources

Our total assets at December 31, 2001 amounted to \$45.62 million compared to \$47.67 million at December 31, 2000. Loans receivable, net of reserves and including loans held for sale, increased by \$0.67 million to \$36.58 million from \$35.91 million. Cash and cash equivalents including Federal Funds sold on an overnight basis at the end of 2001 decreased by \$1.71 million from the prior year, while securities increased by \$0.32 million. At year-end 2001, the Bank had an unused line of credit from the Federal Home Loan Bank of Indianapolis of \$4.91 million, and an unused line of credit from the Federal Reserve Bank of Chicago of \$2.10 million.

University Bank, as an FDIC-insured bank, is subject to certain regulations that require the maintenance of minimum liquidity levels of cash and eligible investments. The Bank has historically exceeded this minimum as a result of its investments in federal funds sold, U.S. government and U.S. agency securities and cash. In addition, University Bancorp had \$96,045 in cash and equity securities at the end of 2001 to meet cash needs, primarily operating expenses and interest and principal reductions on the University Bancorp's note payable. The balance of the loan was \$430,000 and \$532,000 at year-end 2001 and 2000. The note is a fully amortizing loan maturing in early 2005. In an effort to maintain the Bank's Tier 1 capital to assets ratio above 7% and to increase capital through retained earnings, management does not expect that the Bank will pay dividends to University Bancorp in 2002. Management intends that the cash and securities on hand, together with cash from the sale of common stock, equity conversion notes and preferred stock to be sufficient to cover the required principal reductions during 2002 on University Bancorp's loan.

During 2001, University Bancorp raised working capital by issuing equity conversion notes, which bear interest at prime rate although all payment of interest is deferred until conversion into common stock or redemption. Notes are redeemable only through the proceeds of a future sale of common stock or preferred stock. The various equity conversion notes that were issued were converted into common stock in November 2001 as part of our rights offering of common stock, which raised \$1,659,749 through the sale of 1,659,749 shares, less offering expenses. The equity conversion notes were sold to our President, Chairman and members of their family.

The Company's total stockholders' equity at December 31, 2001 was approximately \$2.74 million (or 6.0% of total assets) compared to \$2.04 million (or 4.3% of total assets) at December 31, 2000. The Bank's regulatory capital at December 31, 2001 was \$3.72 million or 7.13% of the Bank's total regulatory assets. The risk-adjusted capital ratio of 9.16% exceeded the minimum regulatory risk-based capital requirement of 8% of the risk-adjusted assets for the Bank. The following table provides detailed information about the Bank's risk-adjusted assets and actual capital percentages:

Risk Adjusted Assets & Capital Ratios (\$ amounts in 000)

| Totals | Items Not | Allocation by Risk |
|--------|-----------|--------------------|
|--------|-----------|--------------------|

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | | Subject to Risk Weighting | 0% | 20% |
|--|--------|------------------------------|-----|-------|
| Balance Sheet Asset Categories | | | | |
| Cash and balances due from | | | | |
| depository institutions | 837 | - | 300 | 537 |
| Available for sale securities | 2,260 | (167) | 479 | 1,948 |
| Loans held for sale | 2,138 | | | |
| Loans | 35,026 | | | 166 |
| Allowance for loan losses | (579) | (579) | | |
| All other assets | 5,910 | 125 | | 848 |
| Total Assets | 45,592 | (621) | 779 | 3,499 |
| ===== | | | | |
| Risk-weighted assets | 35,927 | | - | 700 |
| Less: Excess allowance for loan losses | 130 | | | |
| | 35,848 | | | |
| ===== | | | | |
| TOTAL AVERAGE ASSETS | | | | |
| Average Total Assets for Leverage Capital Purposes | | 45,976 | | |
| Other identifiable Intangible Assets | | (125) | | |
| Total Average Assets | | 45,851 | | |
| ===== | | | | |
| TIER 1 CAPITAL | | | | |
| Total Equity Capital | | 2,924 | | |
| Less: Unrealized losses on available-for-Sale Securities | | (167) | | |
| Plus: Minority Interest | | 305 | | |
| Less: Other identifiable Intangible Assets | | 125 | | |
| Total Tier 1 Capital | | 3,271 | | |
| TIER 2 CAPITAL | | | | |
| Allowance for loans & Lease losses | | 579 | | |
| Less: Excess Allowance | | 130 | | |
| Total Tier 2 Capital | | 449 | | |
| Total Tier 1 & Tier 2 Capital | | 3,720 | | |
| ===== | | | | |
| CAPITAL RATIOS | | | | |
| Tier 1/Total Average Assets | | 7.13% | | |
| Tier 1/Total Risk-Weighted Assets | | 9.14% | | |
| Tier 1 & 2/Total Risk-Weighted Assets | | 10.39% | | |

ITEM 7A. MARKET RISK

Impact of Inflation

The primary impact of inflation on our operations is reflected in increased

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

operating costs. Since our assets and liabilities are primarily monetary in nature, changes in interest rates have a more significant impact on our performance than the general effects of inflation. However, to the extent that inflation affects interest rates, it also affects our net income.

Quantitative and Qualitative Disclosures about Market Risk

All financial institutions are significantly affected by fluctuations in interest rates commonly referred to as "interest rate risk." The principal exposure of a financial institution's earnings to interest rate risk is the difference in time between interest rate adjustments or maturities on interest-earning assets compared to the time between interest rate adjustments or maturities on interest-bearing liabilities. This difference is commonly referred to as a financial institution's "gap position." In periods when interest rates are increasing, a negative gap position will result in generally lower earnings as long-term assets are repricing upward slower than short-term liabilities. However during a declining rate environment, the opposite effect on earnings is true, with earnings rising due to long-term assets repricing downward slower than short-term liabilities.

Rising long term and short term interest rates tend to increase the value of Midwest Loan Services' investment in mortgage servicing rights and improve Midwest Loan Services' current return on these rights by lowering required amortization rates on the rights. Rising interest rates tend to decrease new mortgage origination activity, negatively impacting current income from the Bank's retail mortgage banking operations and Midwest's mortgage banking operation activities. Rising interest rates also slow Midwest Loan Services' rate of growth, but increases the duration of its existing mortgages being subserviced under contract.

The Bank's securities portfolio is designed to offset a portion of the market value risk associated with the servicing rights. During 2001, the market value of the servicing rights versus book decreased by approximately \$224,000 (the decrease was expensed as amortization expense) to \$0 while the market value of the Bank's zero coupon and PO securities increased by \$167,487 based on year-end fair market values.

The table on the following page details our interest sensitivity gap between interest-earning assets and interest bearing liabilities at December 31, 2001. Certain items in the table are based upon various assumptions that may not necessarily reflect future experience, and therefore, certain assets and liabilities may in fact mature or re-price differently from what is illustrated. The one-year static gap position at December 31, 2001 was estimated at (\$14.4 million) or (31.60%):

Asset/Liability Position Analysis as of December 31, 2001

(Dollar amounts in Thousands)
Maturing or Repricing in

| | 3 Mos or Less | 91 Days to 1 Year | 1 - 3 Years | 3 - 5 Years | Ove Yea |
|-----------|------------------|----------------------|----------------|----------------|------------|
| ASSETS | | | | | |
| Fed Funds | - | - | - | - | |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | | | | | |
|--------------------------|----------------|-----------------|-----------------|----------------|-------------|
| Loans - Net | 7,747 | 6,451 | 6,559 | 9,518 | 6,120 |
| Non-Accrual Loans | | - | - | - | |
| Securities | - | - | - | - | 3,10 |
| Other Assets | - | 600 | - | - | |
| Cash and Due from Banks | 59 | - | - | - | |
| TOTAL ASSETS | 7,806 | 7,051 | 6,559 | 9,518 | 9,22 |
| LIABILITIES | | | | | |
| CD's under \$100,000 | 9,016 | 5,982 | 2,668 | 332 | 26 |
| CD's over \$100,000 | 1,997 | 2,281 | 1,106 | - | 11 |
| MMDA | 4,818 | 4,819 | - | - | |
| NOW | - | - | 4,063 | - | |
| Demand and Escrow | - | - | - | - | |
| Savings | - | - | 340 | - | |
| Other Borrowings | 91 | 269 | 1,355 | 34 | |
| Other Liabilities | - | - | - | - | |
| Equity | - | - | - | - | |
| TOTAL LIABILITIES | 15,922 | 13,351 | 9,532 | 366 | 38 |
| GAP | (8,116) | (6,300) | (2,973) | 9,151 | 8,84 |
| CUMULATIVE GAP | (8,116) | (14,416) | (17,389) | (8,238) | 60 |
| GAP PERCENTAGE | -17.79% | -31.60% | -38.11% | -18.06% | 1.3 |

The following repricing information is provided for the Bank's investment portfolio, using book values, as of December 31, 2001:

Investment Portfolio Maturities (\$ amounts in thousands) and Yield by Type:

| | Maturity or Repricing Interval: | | |
|--|---------------------------------|----------------------|---------------------|
| | Less Than One Year | 1 Year to 5 Years | 5 Years 10 Years |
| U.S. Treasuries and Government Agencies: | | | |
| Amount | \$0 | \$0 | |
| Yield | 0% | 0% | |

Additional information regarding the Bank's investments is set forth under Note

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

5 to the consolidated financial statements.

The following information illustrates maturities and sensitivities of the Bank's loan portfolio to changes in interest rates as of December 31, 2001:

Loan Portfolio Maturities by Type (\$ amounts in thousands):

| | Maturity Interval: | | |
|--------------------------|-----------------------|----------------------|----------------------|
| | Less Than One Year | 1 Year to 5 Years | More Than 5 Years |
| Commercial | \$ 5,368 | \$ 9,787 | \$ 2,6 |
| Real Estate Mortgage (1) | \$ 757 | \$ 551 | \$ 12,0 |
| Installment/Consumer | \$ 262 | \$ 922 | \$ 2,6 |
| | ----- | ----- | ----- |
| Total | \$ 6,387 | \$ 11,260 | \$ 17,3 |
| | ===== | ===== | ===== |

| | Maturity Less Than One Year | Maturity More Than One Year | Total |
|---------------------------|-----------------------------------|-----------------------------------|--------|
| Total Variable Rate Loans | \$ 2,430 | \$ 13,028 | \$ 15, |
| Total Fixed Rate Loans | \$ 3,957 | \$ 15,611 | \$ 19, |
| | ----- | ----- | ----- |
| Total Loans (1) | \$ 6,387 | \$ 28,639 | \$ 35, |
| | ===== | ===== | ===== |

(1) Excludes loans held for sale of \$2,138 and the allowance for loan losses.

Income Taxes

Income tax expense (benefit) in 2001 and 2000 was \$0, versus \$32,524 in 1999. The effective tax (benefit) rate was 0% in 2001 and 2000, and (3.7%) in 1999. No tax benefit was realized in 2001, 2000 or 1999 due to loss carryforwards as a result of the net losses from operations.

In 1996, the Bank, through a subsidiary, purchased a \$1,000,000 interest in a partnership investment in Michigan Capital Fund for Housing Limited Partnership I, a Michigan limited partnership, which invested in federal low-income housing tax credits. The initial investment consisted of a \$50,000 equity purchase and the execution by the subsidiary of a \$950,000 promissory note held by this Partnership. Additional capital contributions are made over time to reduce the balance of the note. The purchase of the tax credits increased the deferred federal income tax assets in 2001, 2000 and 1999 and is expected to decrease the amount of federal income taxes we would otherwise pay annually through 2005.

At December 31, 2001, the Company had available federal income tax loss carryforwards that could be utilized to shelter approximately \$3,070,000 future taxable income. Realization of income tax benefits not recorded in the financial statements is dependent upon generating sufficient future taxable revenue. See footnote 14 to the financial statements

Legal Proceedings

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

At December 31, 2001 we had no outstanding legal proceedings that would have a material affect on us.

Results in the fourth quarter of 2000 were negatively impacted by legal expense to defend and settle a lawsuit related to the Bank's sale, in November 1999, of its shares in Varsity Mortgage, LLC to Paramount Bank of Farmington Hills, Michigan. Subsequent to the sale, Varsity experienced management problems and a further drop in its business resulting in substantial operating losses. On May 19, 2000, Paramount Bank filed a complaint (Case No. 00-023299-CK) in Oakland County Circuit Court against University Bank and two of its former officers. On December 14, 2000, the parties settled the suit. Total expense to defend and settle the lawsuit were approximately \$60,000, most of which was incurred in the fourth quarter of 2000.

Recent Events

Management is in advanced negotiations to sell its shares of Midwest Loan Services, Inc. in a transaction that would result in total proceeds of approximately \$2,500,000, including a capital gain of \$1,000,000, a payment of \$200,000 by year-end 2002 subject to contingencies, and ongoing fee income of 1% of the managed escrow accounts serviced by Midwest (currently, this fee income would be approx. \$100,000 per year). There is no assurance that such a transaction could be completed or that management will opt to sell its 80% stake in Midwest.

UNIVERSITY BANCORP, INC.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2001, 2000, 1999

Report of Independent Certified Public Accountants

Board of Directors and Stockholders
University Bancorp, Inc.

We have audited the accompanying consolidated statement of financial condition of University Bancorp, Inc. and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of operations, comprehensive income, stockholders' equity and cash flows for each of the two years ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the 2000 financial statements of Midwest Loan Services, Inc. an 80 percent owned subsidiary, which statements reflect total assets and revenues constituting 5 percent and 33 percent, respectively of the related consolidated totals for the year ended December 31, 2000. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Midwest Loan Services, Inc. for 2000, is based solely on the report of the other auditors. The consolidated statements of operations, comprehensive income, stockholders' equity and cash flows for the year ended December 31, 1999 were audited by other auditors whose report dated March 17, 2000, expressed an unqualified opinion on those statements.

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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other auditors, the consolidated financial statements for 2001 and 2000 referred to above present fairly, in all material respects, the consolidated financial position of University Bancorp, Inc. and subsidiaries as of December 31, 2001 and 2000, and the consolidated results of their operations and their cash flows for each of the two years then ended, in conformity with accounting principles generally accepted in the United States of America.

GRANT THORNTON LLP

Southfield, Michigan
March 15, 2002

UNIVERSITY BANCORP, INC
Consolidated Balance Sheets

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

December 31, 2001 and 2000

| | December 31, 2001 | December 31, 2000 |
|--|----------------------|----------------------|
| ASSETS | ----- | ----- |
| Cash and due from banks | \$ 837,550 | \$ 2,537,313 |
| Short term investments | -- | 9,307 |
| | ----- | ----- |
| Total cash and cash equivalents | 837,550 | 2,546,620 |
| Securities available for sale, at market | 2,260,103 | 1,944,629 |
| Federal Home Loan Bank Stock | 848,400 | 848,400 |
| Loans held for sale, at the lower of cost or market | 2,137,786 | 267,570 |
| Loans | 35,026,024 | 36,206,544 |
| Allowance for loan losses | (579,113) | (562,997) |
| | ----- | ----- |
| Loans, net | 34,446,911 | 35,643,547 |
| Premises and equipment, net | 1,787,018 | 1,375,757 |
| Investment in Michigan BIDCO Inc. | 629,258 | 1,277,384 |
| Investment in Michigan Capital Fund LPI | 456,244 | 556,904 |
| Mortgage servicing rights , net | 606,537 | 582,210 |
| Real estate owned, net | 200,000 | 340,881 |
| Accounts receivable | 862,848 | 1,639,962 |
| Accrued interest receivable | 229,417 | 307,600 |
| Prepaid expenses | 191,700 | 168,195 |
| Goodwill, net | 63,914 | 139,412 |
| Other assets | 65,045 | 31,582 |
| | ----- | ----- |
| TOTAL ASSETS | \$ 45,622,731 | \$ 47,670,653 |
| | ===== | ===== |

-Continued-

UNIVERSITY BANCORP, INC Consolidated Balance Sheets (continued) December 31, 2001 and 2000

| | December 31, 2001 | December 31, 2000 |
|--|----------------------|----------------------|
| LIABILITIES AND STOCKHOLDERS' EQUITY | ----- | ----- |
| Liabilities: | | |
| Deposits: | | |
| Demand - non interest bearing | \$ 2,390,750 | \$ 3,062,013 |
| Demand - interest bearing | 13,701,011 | 13,106,221 |
| Savings | 340,341 | 368,928 |
| Time | 23,765,478 | 21,641,561 |
| | ----- | ----- |
| Total Deposits | 40,197,580 | 38,178,723 |
| Short term borrowings | 91,566 | 4,093,954 |
| Long term borrowings | 1,657,506 | 926,130 |
| Accounts payable | 339,536 | 1,474,963 |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | | |
|---|---------------|---------------|
| Accrued interest payable | 177,407 | 426,470 |
| Other liabilities | 117,398 | 245,381 |
| | ----- | ----- |
| Total Liabilities | 42,580,993 | 45,345,621 |
| Minority Interest | 305,129 | 282,750 |
| Stockholders' equity: | | |
| Preferred stock, \$0.001 par value; | | |
| \$1,000 liquidation value; | | |
| Authorized - 500,000 shares; | | |
| Issued 725 shares in 2001 | 725,000 | |
| Common stock, \$0.01 par value; | | |
| Authorized - 5,000,000 shares; | | |
| Issued - 3,867,732 shares in 2001 and | | |
| 2,142,985 shares in 2000 | 38,677 | 21,430 |
| Additional paid-in-capital | 5,411,018 | 3,817,608 |
| Accumulated deficit | (2,205,444) | (1,846,627) |
| Treasury stock - 115,184 shares in 2001 | | |
| and 2000 | (340,530) | (340,530) |
| Accumulated other comprehensive loss, | | |
| unrealized losses on securities | | |
| available for sale, net | (167,112) | (334,599) |
| | ----- | ----- |
| Total Stockholders' Equity | 2,736,609 | 2,042,282 |
| | ----- | ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY .. | \$ 45,622,731 | \$ 47,670,653 |
| | ===== | ===== |

The accompanying notes are an integral part of the consolidated financial statements.

UNIVERSITY BANCORP, INC Consolidated Statements of Operations For the Years Ended December 31, 2001, 2000 and 1999

| | 2001 | 2000 | 1999 |
|-------------------------------------|-----------|--------------|--------------|
| | ----- | ----- | ----- |
| Interest income: | | | |
| Interest and fees on loans \$ | 3,254,088 | \$ 3,109,669 | \$ 2,942,246 |
| Interest on securities: | | | |
| U.S. Government and agencies ... | 202,357 | 129,786 | 129,495 |
| Other securities | 63,080 | 74,076 | 67,872 |
| Other interest income | 23,572 | 1,914 | 54,981 |
| | ----- | ----- | ----- |
| Total interest income | 3,543,097 | 3,315,445 | 3,194,594 |
| | ----- | ----- | ----- |
| Interest expense: | | | |
| Interest on deposits: | | | |
| Demand deposits | 401,385 | 615,721 | 588,409 |
| Savings deposits | 6,034 | 6,542 | 4,799 |
| Time certificates of deposit ... | 1,257,631 | 1,082,828 | 1,071,991 |
| Short term borrowings | 87,304 | 241,782 | 111,245 |
| Long term borrowings | 52,503 | 127,574 | 190,117 |
| | ----- | ----- | ----- |
| Total interest expense | 1,804,857 | 2,074,447 | 1,966,561 |
| | ----- | ----- | ----- |
| Net interest income | 1,738,240 | 1,240,998 | 1,228,033 |
| Provision for loan losses | 40,000 | 111,000 | 92,648 |
| | ----- | ----- | ----- |
| Net interest income after | | | |
| provision for loan losses .. | 1,698,240 | 1,129,998 | 1,135,385 |
| | ----- | ----- | ----- |
| Other income: | | | |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | | | |
|--------------------------------------|-----------|-----------|-----------|
| Loan servicing and subservicing fees | 2,145,619 | 1,073,673 | 557,285 |
| Initial loan set-up and other fees . | 1,570,900 | 1,069,778 | 528,525 |
| Gain on sale of mortgage loans | 67,202 | 39,758 | 66,113 |
| Merchant banking/ BIDCO income | (114,551) | 234,740 | 916,991 |
| Insurance & investment fee income .. | 97,489 | 71,529 | 90,185 |
| Deposit service charges and fees ... | 86,135 | 61,538 | 62,716 |
| Net security gains (losses) | 12,639 | 17,786 | (15,477) |
| Other | 89,977 | 81,527 | 82,788 |
| | ----- | ----- | ----- |
| Total other income | 3,955,410 | 2,650,329 | 2,289,126 |
| | ----- | ----- | ----- |

-Continued-

UNIVERSITY BANCORP, INC.
Consolidated Statements of Operations (continued) For the Years
Ended December 31, 2001, 2000 and 1999

| | 2001 | 2000 | 1999 |
|---|--------------|--------------|--------------|
| | ----- | ----- | ----- |
| Other expenses: | | | |
| Salaries and benefits | \$ 3,250,713 | \$ 1,928,060 | \$ 1,760,670 |
| Occupancy, net | 464,183 | 320,089 | 249,855 |
| Data processing and equipment | 286,200 | 336,016 | 306,531 |
| Legal and audit expense | 127,212 | 408,430 | 423,633 |
| Consulting fees | 231,795 | 206,313 | 119,456 |
| Mortgage banking expense | 132,832 | 150,403 | 156,467 |
| Servicing rights amortization | 325,091 | 171,129 | 214,259 |
| Goodwill amortization | 15,978 | 139,412 | 0 |
| Advertising | 111,862 | 103,177 | 145,824 |
| Memberships and training | 64,609 | 98,237 | 81,121 |
| Travel and entertainment | 104,189 | 59,565 | 112,398 |
| Supplies and postage | 333,682 | 195,449 | 133,171 |
| Insurance | 84,772 | 104,335 | 48,793 |
| Other operating expenses | 427,105 | 474,359 | 363,534 |
| | ----- | ----- | ----- |
| Total other expenses | 5,960,223 | 4,694,974 | 4,115,712 |
| | ----- | ----- | ----- |
| Loss from continuing operations before income taxes | (306,573) | (914,647) | (691,201) |
| | ----- | ----- | ----- |
| Income tax expense (benefit) | 0 | 0 | 32,524 |
| | ----- | ----- | ----- |
| Net loss from continuing operations .. | (306,573) | (914,647) | (723,725) |
| Discontinued operations (Note 2) | 0 | 0 | (191,755) |
| | ----- | ----- | ----- |
| Net loss | \$ (306,573) | \$ (914,647) | \$ (915,480) |
| | ===== | ===== | ===== |
| Preferred stock dividends | 52,244 | 3,933 | 0 |
| | ----- | ----- | ----- |
| Net loss available to common shareholders | \$ (358,817) | \$ (918,580) | \$ (915,480) |
| | ===== | ===== | ===== |
| Basic and diluted loss from continuing operations per common share | \$ (0.13) | \$ (0.45) | \$ (0.36) |
| | ===== | ===== | ===== |
| Basic and diluted loss per common share | \$ (0.13) | \$ (0.45) | \$ (0.46) |
| | ===== | ===== | ===== |
| Weighted average shares outstanding | 2,278,364 | 2,026,735 | 1,993,607 |
| | ===== | ===== | ===== |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

UNIVERSITY BANCORP, INC.
Consolidated Statements of Comprehensive Income (Loss)
For the Years Ended December 31, 2001, 2000 and 1999

| | 2001 | 2000 | 1999 |
|---|--------------|--------------|----------------|
| | ----- | ----- | ----- |
| Net loss | \$ (306,573) | \$ (914,647) | \$ (915,480) |
| Other comprehensive income (loss): | | | |
| Unrealized gains/(losses) on securities available for sale .. | 180,126 | 268,085 | (417,452) |
| Less: reclassification adjustment for accumulated (losses)/gains included in net loss | 12,639 | 17,786 | (15,477) |
| | ----- | ----- | ----- |
| Other comprehensive income/(loss) before tax effect | 167,487 | 250,299 | (401,975) |
| Income tax expense (benefit) | 0 | 0 | 62,216 |
| Other comprehensive income (loss), net of tax | 167,487 | 250,299 | (464,191) |
| | ----- | ----- | ----- |
| Comprehensive loss | \$ (139,086) | \$ (664,348) | \$ (1,379,671) |
| | ===== | ===== | ===== |

UNIVERSITY BANCORP, INC.
Consolidated Statements of Stockholders' Equity For the years ended December 31, 2001, 2000, and 1999

| | Preferred Stock \$.001 Par Value | | Common Stock \$.01 Par Value | | Treasury |
|---------------------------|-------------------------------------|--------------|---------------------------------|--------------|---------------------|
| | Number of Shares | Par Value | Number of Shares | Par Value | Number of Shares |
| | ----- | ----- | ----- | ----- | ----- |
| Balance December 31, 1998 | - | - | 2,104,323 | \$21,043 | (115,184) |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | | | | | |
|--|------------|---------------|-----------|----------|-------------|
| Issuance of shares weighted average price of \$2.125 per share | - | - | 23,662 | 237 | - |
| ===== | | | | | |
| Capital increase due to retirement of BIDCO stock | - | - | - | - | - |
| Capital increase due to conversion of BIDCO bonds to BIDCO stock | - | - | - | - | - |
| Unrealized losses on securities available for sale, net of tax | - | - | - | - | - |
| Net loss | - | - | - | - | - |
| ----- | | | | | |
| Balance December 31, 1999 | - | - | 2,127,985 | \$21,280 | (115,184) |
| Issuance of common stock at weighted average price of \$2.08 per share | - | - | 15,000 | 150 | - |
| Issuance of preferred stock at price of \$1,000 per share | 725 | 725,000 | - | - | - |
| Unrealized gain on securities available for sale, net of tax | - | - | - | - | - |
| Net loss | - | - | - | - | - |
| ----- | | | | | |
| Balance December 31, 2000 | 725 | \$ 725,000 | 2,142,985 | \$21,430 | \$(115,184) |
| Issuance of preferred stock | 733 | 733,000 | - | - | - |
| Conversion of preferred stock to common stock | \$ (1,458) | \$(1,458,000) | 1,458,000 | \$14,580 | - |
| Issuance of common stock at weighted average price of \$1.00 per share, net of expenses of \$114,090 | | | 266,747 | \$2,667 | |
| Payment of preferred dividend | | | | | |
| Unrealized gain on securities available for sale, net of tax | | | | | |
| Net loss | | | | | |
| ----- | | | | | |
| | - | \$ - | 3,867,732 | \$38,677 | \$(115,184) |
| ===== | | | | | |

UNIVERSITY BANCORP, INC.

Consolidated Statements of Stockholders' Equity

For the years ended December 31, 2001, 2000, and 1999

| | Retained Earnings | Accumulated Other Comprehensive Loss | Total Stockholders' Equity |
|--|-------------------|--------------------------------------|----------------------------|
| Balance December 31, 1998 | (16,500) | (120,707) | 3,082,78 |
| ----- | | | |
| Issuance of shares weighted average price of \$2.125 per share | - | - | 50,28 |
| Capital increase due to retirement | - | - | |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | | | |
|--|----------------|--------------|--------------|
| of BIDCO stock | | | 170,87 |
| Capital increase due to conversion of BIDCO bonds to BIDCO stock | - | - | 26,11 |
| Unrealized losses on securities available for sale, net of tax | - | (464,191) | (464,191) |
| Net loss | (915,480) | - | (915,480) |
| ----- | | | |
| Balance December 31, 1999 | \$ (931,980) | \$ (584,898) | \$ 1,950,380 |
| Issuance of common stock at weighted average price of \$2.08 per share | - | - | 31,25 |
| Issuance of preferred stock at price of \$1,000 per share | - | - | 725,00 |
| Unrealized gain on securities available for sale, net of tax | - | 250,299 | 250,29 |
| Net loss | (914,647) | - | (914,647) |
| ----- | | | |
| Balance December 31, 2000 | \$ (1,846,627) | \$ (334,599) | \$2,042,282 |
| Issuance of preferred stock | - | - | \$ 733,00 |
| Conversion of preferred stock to common stock | - | - | \$ - |
| Issuance of common stock at weighted average price of \$1.00 per share, net of expenses of \$114,090 | | | \$ 152,65 |
| Payment of preferred dividend | \$ (52,244) | | \$ (52,244) |
| Unrealized gain on securities available for sale, net of tax | | \$167,487 | \$ 167,48 |
| Net loss | \$ (306,573) | | \$ (306,573) |
| ----- | | | |
| | \$ (2,205,444) | \$ (167,112) | \$2,736,60 |
| ===== | | | |

UNIVERSITY BANCORP, INC.
Consolidated Statements of Cash
Flows For the years ended December 30,
2001, 2000 and 1999

| | 2001 | |
|---|--------------|-------|
| | ----- | ----- |
| Cash flow provided by (used in) operating activities: | | |
| Net loss | \$ (306,573) | \$ |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation | 268,529 | |
| Amortization | 441,729 | |
| Provision for loan loss | 40,000 | |
| Gain on loan sales and securitization | (67,202) | |
| Accretion on securities | (202,277) | |
| Net (gain)/loss on sale of securities | (12,639) | |
| Net change in: | | |
| Investment in Michigan BIDCO, Inc. | 0 | |
| Real estate owned | (1,662,133) | |
| Other assets | 508,431 | (|

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | | |
|--|--------------|------|
| Other liabilities | (1,490,094) | |
| Net cash provided by (used in) operating activities | (2,482,229) | |
| Cash flow provided by (used in) investing activities: | | |
| Purchase of investment securities | (474,780) | |
| Proceeds from sales of investment securities | 541,460 | |
| Proceeds from maturities/paydowns of investment securities | 249 | |
| Net change in Michigan BIDCO equity investments | 648,126 | |
| Loans granted, net of repayments | 1,156,636 | |
| Premises and equipment expenditures, net | (679,790) | |
| Net cash (used in) provided by investing activities | 1,191,901 | |
| Cash flow provided by (used in) financing activities: | | |
| Change in deposits | 2,018,857 | |
| Change in short term borrowings | (4,002,388) | |
| Issuance of long term borrowings | 1,000,000 | |
| Issuance of equity conversion notes | 212,904 | |
| Principal payments on long term borrowings | (268,624) | |
| Payment of preferred dividends | (52,244) | |
| Issuance of preferred stock | 520,096 | |
| Issuance of common stock | 152,657 | |
| Purchase of treasury stock | 0 | |
| Conversion of BIDCO bonds and buyout of minority interests | 0 | |
| Net cash provided by (used in) financing activities | (418,742) | |
| Net change in cash and cash equivalents | (1,709,070) | |
| Cash and cash equivalents: | | |
| Beginning of year | 2,546,620 | |
| End of year | \$ 837,550 | \$ 2 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | \$ 2,053,920 | \$ 1 |
| Supplemental disclosure of non-cash transactions: | | |
| BIDCO conversion of bonds to common stock | | |
| Preferred stock converted to common stock | 1,458,000 | |
| Equity conversion notes converted to preferred stock | 212,904 | |
| De-consolidation of Michigan BIDCO, Inc.: | | |
| Cash (deposits at University Bank) | | \$ (|
| Equity investments of Michigan BIDCO, Inc. | | |
| Loans | | |
| Premises & equipment | | |
| Real estate owned | | |
| Other assets | | |
| Long-term borrowings | | |
| Other Liabilities | | |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

Investment in Michigan BIDCO, Inc.

The accompanying notes are an integral part of the consolidated financial statements.

1. Summary of significant accounting policies

Principles of Consolidation and Nature of Operations The consolidated financial statements of University Bancorp, Inc. (the Company) include the operations of its wholly-owned subsidiary, University Bank (the Bank), the Bank's wholly-owned subsidiary, University Insurance & Investment Services, Inc. (Agency) and an 80% owned subsidiary, Midwest Loan Services, Inc. (Midwest). In 1999, the consolidated financial statements also include an 80% owned subsidiary, Michigan BIDCO (BIDCO). Due to the reduction in the Company's ownership percentage, this entity is accounted for using the equity method at December 31, 2001 and 2000. The accounts are maintained on an accrual basis in accordance with generally accepted accounting principles and predominant practices within the banking and mortgage banking industries. All significant intercompany balances and transactions have been eliminated in preparing the consolidated financial statements.

The Company is a bank holding company. University Bank, which is located in Michigan, is a full service community bank, which offers all customary banking services, including the acceptance of checking, savings and time deposits. The Bank also makes commercial, real estate, personal, home improvement, automotive and other installment, credit card and consumer loans, and provides fee based services such as annuity and mutual fund sales, stock brokerage and money management, life insurance, property casualty insurance and foreign currency exchange. The Bank's customer base is primarily located in the Ann Arbor, Michigan area. The Bank established its main office in Ann Arbor in February 1996, by relocating from the eastern Upper Peninsula of Michigan.

University Bank's loan portfolio is concentrated in Ann Arbor and Washtenaw County, Michigan. While the loan portfolio is diversified, the customers' ability to honor their debts is partially dependent on the local economy. The Ann Arbor area is primarily dependent on the education, healthcare, services, and manufacturing (automotive and other) industries. Most real estate loans are secured by residential or commercial real estate and business assets secure most business loans. Generally, installment loans are secured by various items of personal property.

University Insurance and Investments Services (Agency) is engaged in the sale of insurance products including life, health, property and casualty, and investment products including annuities, mutual funds, stock brokerage and money management. The Agency is located in the Bank's Ann Arbor main office. The Agency also has a limited partnership investment in low-income housing tax credits through Michigan Capital Fund for Housing Limited Partnership I with financing assistance from the General Partner, Michigan Capital Fund for Housing.

Midwest Loan Services (Midwest) is engaged in the business of servicing and subservicing residential mortgage loans. Midwest began operations in 1992 and was acquired by University Bank in December, 1995. Midwest is based in Houghton, Michigan, and is a specialist in servicing loans for itself and other financial institutions, including the Bank (See Note

4) .

1. Summary of significant accounting policies (continued)

Use of Estimates in Preparing Financial Statements: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions based upon available information. These estimates and assumptions affect the reported amounts and disclosures. Actual results could differ from those estimates.

The significant estimates incorporated into these consolidated financial statements which are more susceptible to change in the near term include the value of mortgage servicing rights, the allowance for loan losses, the identification and valuation of impaired loans, the equity interest in the fair value and the change in the fair value of investments made by the BIDCO, the fair value of financial instruments, and the valuation of deferred tax assets.

Cash flow reporting

For purposes of the Consolidated Statements of Cash Flows, cash and cash equivalents is defined to include the cash on hand, non-interest bearing deposits in other institutions, federal funds sold and other investments with a maturity of three months or less when purchased. Net cash flows are reported for customer loan and deposit transactions and interest bearing deposits with other banks.

Securities

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 and losses reported in other comprehensive income or loss. Realized gains are based on specific identification of amortized cost. Securities are written down to fair value when a decline in fair value is not temporary. Interest income includes amortization of purchase premium or discount. Other securities such as Federal Home Loan Bank stock are carried at cost.

Loans

Loans are reported at the principal balance outstanding, net of unearned interest, deferred loan fees and costs, and an allowance for loan losses. Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Interest income is not reported when full loan repayment is in doubt, typically when payments are past due over 90 days. Payments received on such loans are reported as principal reductions, unless all interest and principal payments in arrears are paid in full.

Mortgage banking activities

Mortgage banking activities include retail and servicing operations. Mortgage loans held for sale are valued at the lower of cost or market as determined by bid prices for loans in the secondary market. The loans are sold without recourse, except in the event that documentation errors are made during the origination process.

1. Summary of significant accounting policies (continued)

Allowance for loan losses

The allowance for loan losses is a valuation allowance for probable credit losses, increased by the provision for loan losses and recoveries and decreased by charge-offs. Management estimates the allowance balance required based on past loan loss experience, known and inherent risks in

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

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.

Loan impairment is reported when full payment under the loan terms is not expected. Impairment is evaluated in total for smaller-balance loans of similar nature such as residential mortgage, consumer, and credit card loans, and on an individual loan basis for other loans. 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. Loans are evaluated for impairment when payments are delayed, typically 90 days or more, or when it is probable that all principal and interest amounts will not be collected according to the original terms of the loan.

Premises and equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed primarily on the straight-line method for bank premises and the accelerated method for equipment and land improvements over their estimated useful lives. The Company uses the following useful lives as of December 31, 2001:

| | |
|---|-----------|
| Buildings and building improvements | 39 years |
| Land and leasehold improvements | 15 years |
| Furniture, fixtures, and equipment | 3-7 years |
| Software | 2-5 years |

Other real estate owned

Real estate properties acquired in collection of a loan are recorded at fair value upon acquisition. Any reduction to fair value from the carrying value of the related loan is accounted for as a loan loss. After acquisition, a valuation allowance reduces the reported amount to the lower of the initial amount or fair value less costs to sell. Expenses, gains and losses on disposition, and changes in the valuation allowance are reported in other expenses.

Servicing rights

Servicing rights represent both purchased rights and the allocated value of servicing rights retained on loans originated and sold. Servicing rights are expensed in proportion to, and over the period of, estimated net servicing revenues. Impairment is evaluated based on the fair value of the

1. Summary of significant accounting policies (continued)

rights, using grouping of the underlying loans as to type, term and interest rates. Any impairment of a grouping is reported as a valuation allowance.

Income taxes

Income tax expense/benefit is the sum of the current year estimated tax obligation or refund per the income tax return, and the change in the estimated future tax effects of temporary differences and carryforwards. Deferred tax assets or liabilities are computed by applying enacted income tax rates to the expected reversals of temporary differences between financial reporting and income tax reporting, and by considering carryforwards for operating losses and tax credits. A valuation allowance adjusts deferred tax assets to the net amount that is more likely than not to be realized.

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

Retirement plan

The Bank has a 401-k Plan that allows an employee to contribute up to 15% of salary pre-tax, to the allowable limit prescribed by the Internal Revenue Service. Management has discretion to make matching contributions to the Plan. However, the Bank made no matching contributions for the years ended December 31, 2001, 2000 and 1999.

Employees Stock Ownership Plan (ESOP)

The Company has a noncontributory ESOP covering all full-time employees who have met certain service requirements. The employees' share in the Company's contribution is based on their current compensation as a percentage of the total employee compensation. As shares are contributed to the plan they are allocated to employees and compensation expense is recorded at the shares' fair value. The Company made no contribution in 2000 and 2001.

Stock options

No expense for stock options is recorded, as the grant price equals the market price of the stock at grant date. Pro-forma disclosures show the effect on income and earnings per share had the options' fair value been recorded using an option pricing model.

Dividend restriction

Banking regulations require the maintenance of certain capital levels and may limit the amount of dividends that may be paid by the bank to the holding company or by the holding company to shareholders. In addition, the Bank cannot pay a dividend until it has net retained earnings. The accumulated deficit of the Bank was \$2,205,875 and \$1,846,627 at December 31, 2001 and 2000, respectively.

Earnings (loss) per share

Basic earnings (loss) per share is net income (loss) of the Company (after the dividend requirement for preferred stock) divided by the weighted average common shares outstanding for the year. Diluted earnings per share includes the issuance of any additional dilutive potential common shares.

1. Summary of significant accounting policies (continued)

Earnings (loss) per share and share amounts have been adjusted for stock dividends and splits.

Comprehensive Income (Loss):

Comprehensive income (loss) includes both the net loss and the change in unrealized gains and losses on securities available for sale.

Segment Reporting

The Company's segments are determined by the products and services offered, primarily distinguished between banking and mortgage banking operations. Loans, investments, and deposits provide the revenues in the banking operation, and servicing fees, underwriting fees and loan sales provide the revenues in mortgage banking. All operations are domestic.

Reclassification

Certain items in the 2000 and 1999 consolidated financial statements and notes have been reclassified to conform to the 2001 presentation.

2. Discontinued Operations

In 1999, University Bank sold its investment in two mortgage banking subsidiaries, Varsity Mortgage, LLC and Varsity Funding Services, LLC,

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

which were based in Farmington Hills, Michigan. These subsidiaries specialized in the wholesale mortgage banking business, which involved the purchase from correspondents, and the sale to the secondary market, of conforming and nonconforming residential loans, respectively. The Company sold Varsity Funding's operating subsidiary, MortgageQuest in a transaction that resulted in no gain or loss to the Company and effectively dissolved Varsity Funding. In November 1999, the Company sold Varsity Mortgage in a transaction that resulted in no gain or loss to the Company. Accordingly, the statement of operations reflects these disposals as discontinued operations for the year ended December 31, 1999. The following schedule discloses the detail of income/loss from discontinued operations:

| | 1999 |
|---|--------------|
| Interest and fees on loans | \$ 527,136 |
| Interest expense | 318,383 |
| Provision for loan losses | 0 |
| Mortgage banking income | 1,722,568 |
| Other income | 42,433 |
| Salaries and benefits | 1,153,677 |
| Occupancy | 158,758 |
| Data processing | 69,913 |
| Supplies and postage | 65,709 |
| Mortgage banking expense | 558,833 |
| Travel and entertainment | 22,537 |
| Consultant fees | 10,450 |
| Other operating expenses | 125,632 |
| Pretax income (loss) from discontinued operations | \$ (191,755) |

3. Michigan BIDCO, Inc.

BIDCO was incorporated for the purpose of providing financing to small businesses located in Michigan for the purpose of creating business and industrial development in the State of Michigan. BIDCO is licensed under the Michigan BIDCO Act, and is regulated by the Michigan Office of Financial and Insurance Services, Bank and Trust Division. The Chairman and President of the Company serve as officers and directors of BIDCO.

Upon formation, Michigan BIDCO received \$3 million from the State of Michigan (Michigan Strategic Fund or MSF). As BIDCO monitors each loan and investment, it determines the increase or retention in number of jobs and annual sales volume of each investee company. This increase or retention is then used to determine the credits earned and applied against interest and principal due to the MSF. The financial statements of BIDCO are stated using the prescribed accounting practices of investment companies. Prior to March 31, 1999, the Company's investment in BIDCO was accounted for under the equity method of accounting. On April 1, 1999, the Company increased its ownership of BIDCO to 80.1% and it became a consolidated subsidiary of the Company.

On May 31, 2000, BIDCO converted its outstanding convertible bonds into common stock (a few convertible bonds were also redeemed at that time). With the conversion of these convertible bonds, the Company's consolidated ownership in BIDCO dropped from 80.1% to 28.8%. Subsequent to May 31, 2000, the BIDCO has been excluded from the Company's consolidated financial results and the Company's investment in BIDCO is now being accounted for using the equity method of accounting. At December 31, 2000, the Company owned 31.5% of BIDCO (of which 27.1% was held by the Bank and 4.4% by the Company). At December 31, 2001, the Bank's shares in the BIDCO were redeemed by the BIDCO in exchange for cash of \$153,417 and preferred stock with a liquidation preference of \$600,000. The preferred stock pays 7.5% annual dividends, payable in

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

equal monthly installments and it can be retired at par value by the Bank, as cash is available. Total equity of BIDCO was \$480 thousand and \$2.9 million at December 31, 2001 and 2000, respectively.

4. Secondary Market Operations

Midwest Loan Services provides servicing and subservicing of real estate mortgage loans for University Bank and several other financial institutions. The unpaid principal balance of these loans was approximately \$565 million, \$2.2 billion and \$352 million as of December 31, 2001, 2000 and 1999 respectively. Custodial escrow balances maintained in connection with these respective loans was \$18.4 million, \$38.5 million, and \$6.5 million, at December 31, 2001, 2000 and 1999 respectively. The following summarizes the operations of Midwest for the years ended December 31:

4. Secondary Market Operations (continued)

| | 2001 | |
|--------------------------------------|--------------|----------|
| Loan servicing and subservicing fees | \$ 1,574,615 | \$ 1,073 |
| Loan set-up and other fees | 1,665,664 | 597 |
| Interest income | 229,625 | 415 |
| Gain on sale of loans | 60,655 | 29 |
| | ----- | ----- |
| Total income | 3,530,559 | 2,115 |
| Salaries and benefits | 1,706,795 | 773 |
| Amortization expense | 312,232 | 153 |
| Interest expense | 2,389 | 7 |
| Other operating expenses | 1,148,891 | 677 |
| Total expenses | 3,170,307 | 1,610 |
| | ----- | ----- |
| Pretax income from Midwest | \$ 360,252 | \$ 504 |
| | ===== | ===== |

University Bank sells conforming residential mortgage loans to the secondary market. These loans are owned by other institutions and are not included in the Company's consolidated balance sheets. Such mortgage loans have been sold predominately without recourse or with limited recourse. The unpaid principal balance of these loans was \$2.3 million, \$3.6 million and \$64.4 million at December 31, 2001, 2000 and 1999 respectively.

Following is an analysis of the change the Company's mortgage servicing rights:

| | 2001 | 2000 | 1999 |
|-------------------------------------|------------|------------|------------|
| Balance, January 1 | \$ 582,210 | \$ 704,164 | \$ 948,208 |
| Additions - originated | 349,348 | 49,175 | 129,905 |
| Bulk sale of servicing rights | (159,690) | | |
| Amortization expense | (325,021) | (171,129) | (214,259) |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | | | |
|----------------------------|------------|------------|------------|
| | ----- | ----- | ----- |
| Balance, December 31 | \$ 606,537 | \$ 582,210 | \$ 704,164 |
| | ===== | ===== | ===== |

There was no valuation allowance necessary at December 31, 2001, 2000 or 1999.

5. Securities available for sale

The following is a summary of the amortized cost, gross unrealized gains, gross unrealized losses and fair value of securities available for sale at December 31, 2001 and 2000:

| | December 31, 2001 | | | |
|-----------------------------|-------------------|-------|----------------------------|---------------|
| | Amortized Cost | Gains | Gross Unrealized Losses | Fair Value |
| U.S. agency mortgage-backed | \$1,948,000 | - | \$ (111,000) | \$1,837,000 |
| U.S. Treasury | 479,000 | - | (56,000) | 423,000 |
| | ----- | ----- | ----- | ----- |
| Total | \$2,427,000 | \$ - | \$ (167,000) | \$2,260,000 |
| | ===== | ===== | ===== | ===== |

| | December 31, 2000 | | | |
|-----------------------------|-------------------|-------|----------------------------|---------------|
| | Amortized Cost | Gains | Gross Unrealized Losses | Fair Value |
| U.S. agency mortgage-backed | \$1,774,000 | - | \$ (293,000) | \$1,481,000 |
| U.S. Treasury | 506,000 | - | (42,000) | 464,000 |
| | ----- | ----- | ----- | ----- |
| Total | \$2,280,000 | \$ - | \$ (335,000) | \$1,945,000 |
| | ===== | ===== | ===== | ===== |

All of the securities at December 31, 2001 and 2000 were pledged to secure certain borrowings.

| Sales of available for sale securities: | 2001 | 2000 |
|---|-----------|-------------|
| Proceeds | \$541,460 | \$1,222,219 |
| Realized gains | 12,639 | 24,126 |
| Realized losses | - | 6,340 |

The scheduled maturity date of the securities available for sale at December 31, 2001 is:

| | Amortized Cost | Fair Value |
|-----------|-------------------|---------------|
| 2002 | \$ 0 | \$ 0 |
| 2003-2006 | 0 | 0 |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | | |
|------------|-------------|-------------|
| 2007-2011 | 0 | 0 |
| After 2011 | 2,427,000 | 2,260,000 |
| | \$2,427,000 | \$2,260,000 |

6. Loans

Major classifications of loans are as follows as of December 31:

| | 2001 | 2000 |
|----------------------------|---------------|---------------|
| Commercial | \$ 15,088,956 | \$ 13,686,729 |
| Real estate - mortgage | 13,377,240 | 15,525,725 |
| Real estate - construction | 2,683,594 | 1,061,950 |
| Installment | 3,795,288 | 5,839,640 |
| Credit cards | 80,946 | 92,500 |
| | ----- | ----- |
| Gross Loans | 35,026,024 | 36,206,544 |
| Allowance for loan losses | (579,113) | (562,997) |
| | ----- | ----- |
| Net Loans | \$ 34,446,911 | \$ 35,643,547 |
| | ===== | ===== |

Changes in the allowance for loan losses were as follows:

| | 2001 | |
|---------------------------------|------------|----|
| Balance, beginning of year | \$ 562,997 | \$ |
| Provision charged to operations | 40,000 | |
| Recoveries | 20,058 | |
| Charge-offs | (43,942) | (|
| | ----- | |
| Balance, end of year | \$ 579,113 | \$ |
| | ===== | |

Past due and non-accrual loans at December 31 are summarized as follows:

| | 2001 | 2000 |
|---|------------|------------|
| Past due loans: | | |
| 90 days and more and still accruing: | | |
| Real estate | \$ 276,654 | \$ 457,486 |
| Installment loans | 24,194 | 4,059 |
| Commercial loans | 194,404 | 158,299 |
| | ----- | ----- |
| | \$ 495,252 | \$ 619,844 |
| | ===== | ===== |
| Non accrual loans: | | |
| Real estate - mortgage and construction loans | \$ 770,024 | \$ 72,375 |
| Installment loans | 0 | 0 |
| Commercial loans | 0 | 0 |
| | ----- | ----- |
| | \$ 770,024 | \$ 72,375 |
| | ===== | ===== |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

Information regarding impaired loans for the years ended December 31, is as follows:

| | | |
|---|------------|----|
| Impaired loans: | 2001 | |
| Loans with no allowance allocated | \$ 0 | \$ |
| Loans with allowance allocated | \$ 770,024 | \$ |
| Amount of allowance for loan losses allocated | \$ 76,501 | \$ |
| Impaired loans: | | |
| Average balance during the year | \$ 770,714 | \$ |
| Interest Income recognized thereon | \$ 8,454 | \$ |
| Cash-basis interest income recognized | \$ 8,454 | \$ |

7. Premises and equipment
Classifications at December 31 are summarized as follows:

| | | |
|---|--------------|--------|
| | 2001 | |
| Land | \$ 132,931 | \$ 1 |
| Buildings and improvements | 1,134,555 | 1,0 |
| Furniture, fixtures, equipment and software | 2,195,652 | 1,6 |
| Construction in process | - | - |
| | ----- | ----- |
| | 3,463,138 | 2,7 |
| Less: accumulated depreciation | (1,676,120) | (1,4 |
| | ----- | ----- |
| Net premises and equipment | \$ 1,787,018 | \$ 1,3 |
| | ===== | ===== |

Depreciation expense amounted to \$268,529, \$252,726 and \$357,647 for the years ended December 31, 2001, 2000 and 1999, respectively.

The Bank leased part of its main office in Ann Arbor to the University of Michigan. Under this lease agreement (which expired in September 2001), the Bank was reimbursed for 40.4% of its occupancy expense. The Bank leases an ATM drive-thru location in Ann Arbor for approximately \$25,000 per year and two off-site ATM locations for \$10,900 per year. Midwest leases its office space for approximately \$7,000 per year in Houghton, Michigan. Total rental expense for all operating leases was \$50,995, \$61,892 and \$131,654 in 2001, 2000 and 1999. As of December 31, 2001, the Company had no minimum rental commitments under non-cancelable operating leases.

The Bank remains contingently liable in the event that the purchaser of one of its branch locations in Sault Ste. Marie does not meet its future obligations to the lessor. As of December 31, 2001, management believes that the purchaser was in compliance with these lease terms. The annual base rent for such branch is currently \$32,000, and the future minimum rent due is \$58,000.

8. Time deposits

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

Time deposit liabilities issued in denominations of \$100,000 or more were \$5,499,041 and \$3,461,940 at December 31, 2001 and 2000 respectively.

At December 31, 2001, stated maturities of time deposits were:

| | |
|------------|--------------|
| 2002 | \$19,275,343 |
| 2003 | 3,217,449 |
| 2004 | 557,410 |
| 2005 | 4,563 |
| 2006 | 328,337 |
| Thereafter | 382,376 |
| | ----- |
| | \$23,765,478 |
| | ===== |

The Bank had issued through brokers \$10,656,000 and \$13,021,000 of time deposits as of December 31, 2001 and 2000, respectively. These time deposits have maturities ranging from one to five months and are included

8. Time deposits (continued)

in the table above. These deposits are issued in denominations of less than \$100,000.

The Bank had deposits of \$896,793 and \$1,646,812 from directors, officers and their affiliates as of December 31, 2001 and 2000, respectively.

9. Stock options

In 1993, the Board of Directors approved the grant of options to purchase 60,000 shares of common stock to the non-executive directors. The exercise price of options granted was set at \$2.08 per share, which was the then current bid price per share as reported by NASDAQ. The options are immediately exercisable and expire July 19, 2003. Under this initial grant, options to purchase 30,000 shares remain outstanding as of December 31, 2001. In 1995, the Company adopted a stock option and stock award plan (the 1995 Stock Plan), which provides for the grant of incentive stock options, as defined in Section 422(b) of the Internal Revenue Code of 1986, as amended, as well as the grant of non-qualified stock options and other stock awards. The plan provides for the grant to officers, directors and key employees of the Company, and independent contractors providing services to the Company, of options to purchase and other awards of common stock. The exercise price of options granted under the plan shall be determined by the Board of Directors, or a compensation committee thereof. Options shall expire on the date specified by the Board of Directors or such committee, but not more than 10 years from the date of grant (or five years from the date of grant for incentive stock options if the grantee owned 10% of the Company's voting stock at the date of grant). Unless amended, the 1995 Stock Plan will terminate on November 15, 2005.

The following table summarizes the activity relating to options to purchase the Company's common stock:

| | Number of Options | |
|----------------------------------|----------------------|--------|
| Outstanding at December 31, 1998 | 180,750 | \$2.83 |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | | |
|------------------------------------|----------|--------|
| Granted - 1999 (\$0.92 Fair Value) | 30,315 | 2.40 |
| Forfeited - 1999 | (60,000) | 3.00 |
| | ----- | |
| Outstanding at December 31, 1999 | 151,065 | \$2.64 |
| | ----- | |
| Granted - 2000 (\$0.65 Fair Value) | 74,594 | \$2.08 |
| Exercised - 2000 | (15,000) | 2.08 |
| Forfeited - 2000 | (45,750) | 3.11 |
| | ----- | |
| Outstanding at December 31, 2000 | 164,909 | \$2.30 |
| | ----- | |
| Granted - 2001 (\$0.65 Fair Value) | 100,000 | \$3.00 |
| Exercised - 2001 | (5,000) | 1.75 |
| Forfeited - 2001 | (8,000) | 2.00 |
| | ----- | |
| Outstanding at December 31, 2001 | 251,909 | \$2.60 |
| | ===== | |

9. Stock options (continued)

At December 31, 2001:

Number of options immediately exercisable 117,209 Weighted average exercise price of immediately exercisable options \$2.52 Range of exercise price of options outstanding \$1.75 - \$3.00 Weighted-average remaining life of options outstanding 3.1 years

SFAS No. 123 requires pro forma disclosures for companies that do not adopt the fair value accounting method for stock-based employee compensation. Accordingly, the following pro forma information presents net loss and loss per share had the Standard's fair value method been used to measure compensation cost for stock options granted since 1996. Compensation cost recognized for stock options under APB No. 25 was \$0 for 2001 and 2000, because options were granted at exercise prices equal to the underlying stock prices at date of grant. At December 31, 2001, the Company had 124,776 shares authorized for future grants.

| | 2001 | 2000 | 1999 |
|---|-------------|-------------|-------------|
| Estimated fair value stock options granted: Assumptions used: | | | |
| Risk-free interest rate | 5.43% | 5.37% | 5.75% |
| Expected option life | 2.6 years | 3.6 years | 5.3 years |
| Expected stock price | | | |
| volatility | 21.6% | 24.6% | 27.7% |
| Expected dividends | \$0 | \$0 | \$0 |
| Pro-forma net loss and loss per share, assuming FAS 123 fair value method was used for stock options: | | | |
| Net loss | \$(378,573) | \$(963,250) | \$(932,405) |
| Loss per share | \$(.016) | \$(0.46) | \$(0.46) |

10. Employee stock ownership plan (ESOP)

The employees' allocation of ESOP assets is based on their current compensation, after 1 year of service and upon reaching the age of 21. The annual contribution to the ESOP is at the discretion of the Board of Directors. For the year ended December 31, 1999, the Company made a contribution to the plan of 23,662 shares of University Bancorp common stock with an approximate fair market value at the time of the

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

contribution of \$50,282. Assets of the plan are comprised entirely of 91,462 shares of the Company's stock at December 31, 2001 and 2000, all of which were fully allocated at December 31, 2001. Upon retirement from the plan, participants can receive distributions of their allocated shares of the Company's stock. The assets of the ESOP are held in trust and were valued at approximately \$101,000, and \$172,000 at December 31, 2001 and 2000, respectively.

11. Minority Interest

The Bank owns an 80% interest in the common stock of Midwest Loan Services, with the remaining 20% owned by the President of Midwest. At December 31, 2001 and 2000, total common stockholders' equity of Midwest was \$1,525,644 and \$1,413,752 resulting in a \$305,129 and \$282,750 minority interest reflected on the Company's consolidated balance sheet, respectively. The results of Midwest's operations for 2001, 2000 and 1999 are included in the Company's consolidated statement of operations.

12. Commitments and contingencies

The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to buy, sell and fund loans, letters of credit and unused lines of credit. The Bank's exposure to credit loss in the event of non-performance is equal to or less than the contractual amount of these instruments. The Bank follows the same credit policy to make such commitments as that followed by loans recorded in the consolidated financial statements. The following is a summary of commitments as of December 31:

| | 2001 | 2000 |
|---------------------------|--------------|--------------|
| Unused lines of credit | \$ 2,808,000 | \$ 2,144,000 |
| Commitments to fund loans | \$ 3,085,000 | \$ 3,240,000 |
| Total | \$ 5,893,000 | \$ 5,384,000 |

13. Related party transactions

The Company's Chairman and President also serve as officers and directors of Michigan BIDCO. As such, the Chairman and President are actively involved in the BIDCO's operations, including investment activity and estimation of the fair value of its equity investments.

In connection with the Agency's investment in Michigan Capital Fund LPI, the Bank was not permitted by regulation to guarantee a loan from the Michigan Housing Development Authority. The loan to the Agency is personally guaranteed by the Company's Chairman and common stock of the Company held by a trust for the benefit of the President of the Company was pledged as additional security for the loan.

In July 2000, the Company's Chairman purchased equity securities from the Company for \$58,125, resulting in a gain to the Company of \$20,625.

During 2001, the Company issued \$733,000 of preferred stock, of which \$212,904 was originated from the conversion of equity conversion notes. The preferred shares were issued to the Company's Chairman, the Chairman's wife, the President and related family trusts. In November 2001, the preferred shares of \$1,458,000 were converted to common stock pursuant to the stock rights offering agreement.

In November 2000, the Company issued \$725,000 of preferred stock of which \$535,000 was originated from the conversion of equity conversion notes. The

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

13. Related party transactions (continued)

preferred shares were issued to the Company's Chairman, the Chairman's wife, the President and related family trusts

The Bank had loans of \$15,830 and \$106,291 to related officers and directors at December 31, 2001 and 2000, respectively.

14. Income taxes

Federal income taxes consist of the following:

| | 2001 | 2000 | 1999 |
|----------------------------|------|------|----------|
| Current expense (benefit) | \$ 0 | \$ 0 | \$ 0 |
| Deferred expense (benefit) | 0 | 0 | 32,524 |
| Total | \$ 0 | \$ 0 | \$32,524 |

year

The net deferred tax asset at December 31, 2001 and 2000 is comprised of the following:

| | 2001 | 2000 |
|---|--------------|--------------|
| Allowance for loan losses | 178,183 | 164,583 |
| Net operating loss carry-forward | 582,669 | 616,834 |
| Tax credit carryforward | 743,749 | 670,934 |
| Donation carryforward | 76,666 | 75,183 |
| Other | 44,816 | 36,243 |
| Deferred tax assets | 1,626,083 | 1,563,777 |
| Servicing rights | (206,223) | (197,951) |
| Deferred tax liabilities | (206,223) | (197,951) |
| Net deferred tax asset | \$ 1,419,860 | \$ 1,365,826 |
| Valuation allowance for deferred tax assets | (1,419,860) | (1,365,826) |
| Net deferred tax asset | \$ 0 | \$ 0 |

The Company has net operating loss carryforwards of approximately \$1,714,000 which expire beginning in 2012; and general business credit carryforwards of approximately \$744,000 which expire beginning in 2011. In addition, the Company has an alternative minimum tax (AMT) credit carryforward of approximately \$115,000. Under current tax regulations, the AMT credit can be carried forward indefinitely. Management has established an allowance against deferred tax assets that are not considered realizable at December 31, 2001 and 2000.

Financial statement tax expense amounts differ from the amounts computed by applying the statutory federal tax rate of 34% to pretax income because of

14. Income taxes (continued)

operating losses and valuation allowances recorded to reduce deferred tax assets as noted above.

15. Short Term Borrowings

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

The Bank has a line of credit available from the Federal Home Loan Bank (the FHLB) in the amount of \$5 million and \$6 million at December 31, 2001 and 2000, respectively. At December 31, 2001, borrowings are secured by the pledge of specific mortgage loans held for investment with unpaid principal balances of \$6.8 million and available-for-sale securities with a balance of \$2.3 million.

The Bank has a line of credit available from the Federal Reserve Bank of Chicago (the FRB) in the amount of \$2.1 million. There were no amounts outstanding on this line from the FRB at December 31, 2001 and 2000. Borrowings are secured by the pledge of specific commercial loans held for investment with unpaid principal balances of \$3.0 million. The following information provides a summary of short-term borrowings for the years indicated:

| | 2001 | 2000 |
|---|-------------------|-------------------|
| Amount outstanding at the end of the year and interest rate | \$ 91,566 2.95% | \$4,093,954 5.70% |
| Maximum amount of borrowing outstanding at any month end during the year | \$3,505,607 | \$5,852,017 |
| Average amount outstanding during the year and weighted average interest rate | \$1,931,660 4.52% | \$3,589,958 .73% |

16. Long Term Borrowings

The Company has a note payable to North Country Bank & Trust (NCB&T) secured by the stock of the Bank with a balance of \$430,000 and \$532,000 at December 31, 2001 and 2000, respectively. The note has a maturity date of February 15, 2005. Interest is payable quarterly at the prime rate (5.75%) of NCB&T plus 1.00 percent. Principal payments required are as follows:

| | |
|-------|-----------|
| 2002 | \$132,000 |
| 2003 | \$132,000 |
| 2004 | \$132,000 |
| 2005 | \$ 34,000 |
| Total | \$430,000 |

Dividends by the Bank to the holding company in excess of the prior year's annual net income are not permitted without prior permission from NCB&T under the terms of the Company's credit facility.

16. Long Term Borrowings (continued)

University Insurance and Investment Services Inc. has an obligation of \$227,506 and \$364,130 at December 31, 2001 and 2000, respectively, payable to the Michigan Capital Fund for Housing Nonprofit Housing Corporation in connection with its investment in a low-income housing limited partnership. Payments are due on demand, but are expected to be funded as follows:

| | |
|-------|-----------|
| 2002 | \$136,624 |
| 2003 | \$ 90,882 |
| Total | \$227,506 |

In December 2001, the Federal Home Loan Bank advanced the Company a \$1,000,000, two year fixed rate bullet loan. The loan carries an

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

interest rate of 3.62%

University Bancorp issued equity conversion notes in the amount of \$212,904 and \$231,000 during 2001 and 2000, respectively. In both years, the notes were redeemed from the proceeds of the sale of convertible preferred stock. No conversion notes were issued by the Company as of December 31, 2001 and 2000.

The following summarizes the expected maturity of long-term borrowings at December 31, 2001 :

| | |
|-------|-------------|
| 2002 | \$268,624 |
| 2003 | \$1,222,882 |
| 2004 | \$132,000 |
| 2005 | \$ 34,000 |
| Total | \$1,657,506 |

17. Earnings (loss) per common share

Due to the net losses in 2001, 2000 and 1999 the stock options outstanding were considered anti-dilutive and are not included in loss per share calculations. As a result, both basic and diluted earnings per share available to common are equal to net loss divided by weighted average common shares outstanding.

18. Regulatory matters

University Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by regulators about components, risk weightings, and other factors.

18. Regulatory matters (continued)

The Bank is also subject to prompt corrective action capital requirement regulations set forth by the FDIC. The FDIC requires the Bank to maintain a minimum of total capital and Tier 1 capital (as defined) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average total assets (as defined). Management believes, as of December 31, 2001, that the Bank meets all capital adequacy requirements to which it is subject. As of December 31, 2001, the most recent guidelines from the FDIC categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. At December 31, 2000 the Bank was classified as "adequately capitalized." To be categorized as "well capitalized," the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category.

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | Actual [GRAPHIC OMITTED] | | To be Adequately Capitalized Under Prompt Corrective Action Provisions [GRAPHIC OMITTED] | |
|------------------------------------|-----------------------------|--------|---|-------|
| | Amount | Ratio | Amount | Ratio |
| As of December 31, 2001: | | | | |
| Total capital (to risk weighted | | | | |
| assets) | \$3,720,000 | 10.4 % | \$2,870,000 | 8.0 |
| Tier I capital (to risk weighted | | | | |
| assets) | 3,271,000 | 9.1 % | 1,431,000 | 4.0 |
| Tier I capital (to average assets) | 3,271,000 | 7.1 % | 1,834,000 | 4.0 |
| As of December 31, 2000: | | | | |
| Total capital (to risk weighted | | | | |
| assets) | \$3,557,000 | 9.6 % | \$2,948,000 | 8.0 |
| Tier I capital (to risk weighted | | | | |
| assets) | 3,096,000 | 8.4 % | 1,474,000 | 4.0 |
| Tier I capital (to average assets) | 3,096,000 | 6.5 % | 1,598,000 | 4.0 |

The Bank presently has an agreement with its regulators that no dividends to the Company will be declared without the ratio of Tier 1 capital to average assets at 7% or more and regulatory approval. At December 31, 2001, the Bank met this requirement.

19. Management's Plan Regarding Continuing Operations

At December 31, 2001, University Bancorp had an accumulated deficit of \$2,205,444 and recurring losses from operations for the past 5 years. Future operations of University Bancorp are intended to continue. Management has reviewed operating results, prepared projections of possible future results, performed other analyses of its operations to reduce operating costs and divested certain of its unprofitable subsidiaries. Management of the Company has developed a plan to improve core earnings by adding low-cost deposits, adjusting fees, growing the loan portfolio of the Bank, and eliminating inefficient or redundant costs at the Bank level. Both the Bank and Midwest Loan Services are projected to have profits in 2002, however, the Company's continued existence is dependent upon its ability to achieve profitable operations and maintain adequate capital levels.

20. Fair Value of Financial Instruments

The following methods and assumptions were used to estimate fair values for financial instruments. The carrying amount is considered to estimate fair value for cash and short-term instruments, demand deposits, short-term borrowings, accrued interest, and variable rate loans or deposits that reprice frequently and fully. Securities fair values are based on quoted market prices or, if no quotes are available, on the rate and term of the security and on information about the issuer. For fixed rate loans or deposits and for variable rate loan or deposits with infrequent repricing or repricing limits, the fair value is estimated by the discounted cash flow analysis using current market rates for the estimated life and credit risk. Fair values for impaired loans are estimated using discounted cash flow analyses of underlying collateral values, where applicable. Fair value of loans held for sale is based on market estimates. Fair value of mortgage servicing rights is estimated

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

using discounted cash flows based on current market interest rates net of estimated costs of servicing loans. Fair value of mortgage subservicing rights is based on a multiple of servicing contract revenue. The fair value of debt is based on currently available rates for similar financing. The fair value of off-balance sheet items is based on the fees or cost that would normally be charged to enter into or terminate such agreements. Fair value of unrecognized financial instruments include commitments to extend credit and the fair value of letters of credit are considered immaterial.

20. Fair Value of Financial Instruments (continued)

The carrying amounts and fair values of the Company's financial instruments were as follows:

| | December 31, 2001 | |
|---------------------------------|-------------------|--------------|
| | Carrying Amount | Fair Value |
| Financial Assets | | |
| Cash and short term investments | \$ 838,000 | \$ 838,000 |
| Securities available for sale | 2,427,000 | 2,260,000 |
| Federal Home Loan Bank stock | 848,000 | 848,000 |
| Loans held for sale | 2,138,000 | 2,138,000 |
| Loans, net | 34,447,000 | 36,549,000 |
| Mortgage servicing rights | 607,000 | 607,000 |
| Accrued interest receivable | 863,000 | 863,000 |
| Financial Liabilities | | |
| Deposits | 40,198,000 | 40,855,000 |
| Short term borrowings | 92,000 | 92,000 |
| Long term borrowings | 1,658,000 | 1,658,000 |
| Accrued interest payable | 177,000 | 177,000 |
| | | |
| | December 31, 2000 | |
| | Carrying Amount | Fair Value |
| Financial Assets | | |
| Cash and short term investments | \$ 2,546,000 | \$ 2,546,000 |
| Securities available for sale | 1,945,000 | 1,945,000 |
| Federal Home Loan Bank stock | 848,000 | 848,000 |
| Loans held for sale | 268,000 | 268,000 |
| Loans, net | 35,644,000 | 34,946,000 |
| Mortgage servicing rights | 582,000 | 582,000 |
| Accrued interest receivable | 308,000 | 308,000 |
| Financial Liabilities | | |
| Deposits | 38,179,000 | 38,157,000 |
| Short term borrowings | 4,094,000 | 4,094,000 |
| Long term borrowings | 926,000 | 926,000 |
| Accrued interest payable | 426,000 | 426,000 |

21. Segment Reporting

The Company's operations include three primary segments: retail banking, mortgage banking, and merchant banking. Through its banking subsidiary's branch in Ann Arbor, the Company provides traditional community banking services such as accepting deposits, making loans, and providing cash management services to individuals and local businesses. Mortgage banking activities includes servicing of residential mortgage loans for others and discontinued operations have been excluded for 1999 (See Note 2). Merchant banking is conducted entirely through Michigan BIDCO, which makes loans to growing businesses. As additional consideration for the loans it makes, BIDCO typically receives equity or options in each

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

business. (See Note 3)

21. Segment Reporting (continued)

The Company's three reportable segments are strategic business units that are separately managed as they offer different products and services and have different marketing strategies. In addition, both the merchant banking segment and mortgage banking segment service a different customer base from that of the retail banking segment.

The segment financial information provided below has been derived from the internal profitability reporting system used by management to monitor and manage the financial performance of the Company. The accounting policies of the three segments are the same as those described in the summary of significant accounting policies. The Company evaluates segment performance based on profit or loss before income taxes, not including nonrecurring gains and losses. Certain indirect expenses have been allocated based on actual volume measurements and other criteria, as appropriate. The Company accounts for transactions between segments at current market prices. Segment profit is measured before allocation of corporate overhead and income tax expense.

Information about reportable segments for the year ended December 31, 2001 follows:

| | Retail Banking | Mortgage Banking | Merchan Bankin |
|----------------------------------|-------------------|---------------------|-------------------|
| Interest income | \$3,313,473 | \$ 229,624 | |
| Other non-interest income | 769,026 | 3,300,935 | \$ (114,551) |
| Interest expense | 1,804,856 | 0 | |
| Provision for loan losses | 40,000 | 0 | |
| Salaries and benefits | 1,543,918 | 1,706,795 | |
| Occupancy | 336,109 | 128,074 | |
| Data processing | 247,338 | 38,862 | |
| Legal and audit | 102,028 | 25,184 | |
| Advertising | 85,006 | 26,856 | |
| Other operating expense | 442,635 | 1,277,420 | |
| Income (loss) before tax expense | (552,275) | 360,253 | (114,551) |
| Income tax expense (benefit) | (122,830) | 122,830 | |
| Segment profit (loss) | (429,445) | 237,423 | (114,551) |
| Segment assets | 43,955,154 | 1,667,577 | |
| Capital expenditures | 288,753 | 391,037 | |
| Depreciation | 159,332 | 109,197 | |
| Amortization | 129,497 | 312,233 | |

21. Segment Reporting (continued)

Information about reportable segments for the year ended December 31, 2000 follows:

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | Retail Banking | Mortgage Banking | Merchan Bankin |
|----------------------------------|-------------------|---------------------|-------------------|
| Interest income | \$3,229,954 | \$ 21,977 | \$ 63,51 |
| Other non-interest income | 474,721 | 1,940,712 | 234,89 |
| Interest expense | 2,025,162 | 7,661 | 41,62 |
| Provision for loan losses | 111,000 | 0 | |
| Salaries and benefits | 1,065,556 | 773,569 | 88,93 |
| Occupancy | 231,873 | 82,403 | 5,81 |
| Data processing | 276,937 | 55,438 | 3,64 |
| Legal and audit | 368,267 | 23,758 | 16,40 |
| Advertising | 59,903 | 42,252 | 1,02 |
| Other operating expense | 1,098,755 | 473,588 | 26,88 |
| Income (loss) before tax expense | (1,532,778) | 504,050 | 114,08 |
| Income tax expense (benefit) | (204,523) | 165,485 | 39,03 |
| Segment profit (loss) | (1,328,255) | 338,565 | 75,04 |
| Segment assets | 45,271,725 | 2,398,928 | |
| Capital expenditures | 168,214 | 105,783 | |
| Depreciation | 123,826 | 82,935 | 6,55 |
| Amortization | 17,959 | 153,170 | |

Information about reportable segments for the year ended December 31, 1999 follows:

| | Retail Banking | Mortgage Banking | Mercha Bankin |
|----------------------------------|-------------------|---------------------|------------------|
| Interest income | \$2,642,275 | \$ 570,403 | \$ 190,66 |
| Other non-interest income | 282,600 | 2,874,491 | 897,03 |
| Interest expense | 1,488,019 | 366,817 | 111,72 |
| Provision for loan losses | 90,000 | 2,648 | |
| Salaries, wages & benefits | 888,497 | 1,829,907 | 192,72 |
| Occupancy | 262,116 | 136,392 | 10,10 |
| Data processing | 285,817 | 82,877 | 7,75 |
| Legal and audit | 191,663 | 215,885 | 16,08 |
| Advertising | 116,101 | 28,292 | 2,54 |
| Other operating expense | 204,155 | 1,606,714 | 203,59 |
| Income (loss) before tax expense | (601,492) | (824,638) | 543,17 |
| Income tax expense (benefit) | (171,546) | (26,961) | 231,03 |
| Segment profit (loss) | (429,946) | (797,677) | 312,14 |
| Segment assets | 35,997,640 | 1,596,457 | 3,228,44 |
| Capital expenditures | 195,409 | 39,626 | 7,68 |
| Depreciation | 202,579 | 151,427 | 3,64 |
| Amortization | 60,923 | 153,336 | |

22. Quarterly Financial Data -Unaudited

The following tables represent summarized data for each of the quarters in 2001 and 2000 (in thousands, except loss per share data).

| | 2001 | |
|------------------|------------------|------------------|
| Quarter Ended | Quarter Ended | Quarter Ended |
| March 31 | June 30 | September 30 |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | | | |
|---|-----------|-----------|-----------|
| Interest income | \$ 944 | \$ 831 | \$ 1,015 |
| Interest expense | 553 | 505 | 418 |
| Net interest income | 391 | 326 | 597 |
| Provision for losses | 22 | 22 | 22 |
| Net interest income after Provision for losses | 369 | 304 | 575 |
| Loan set-up and other fees | 494 | 630 | 199 |
| Loan servicing and subservicing fees | 580 | 751 | 358 |
| Gain on sale of loans | 9 | 22 | 19 |
| Merchant banking/BIDCO | - | - | - |
| Other non-interest income | 54 | 69 | 64 |
| Non-interest expense | 1,480 | 1,720 | 1,418 |
| Income tax expense | - | - | - |
| Earnings (loss) from continuing operations | 26 | 56 | (204) |
| Preferred stock requirements | 11 | 16 | 18 |
| Net earnings (loss) available to common shareholders | \$ 15 | \$ 40 | \$ (222) |
| Basic and diluted loss per share | \$ 0.01 | \$ 0.02 | \$ (0.11) |
| Weighted average shares outstanding | 2,027,801 | 2,062,878 | 2,092,312 |

22. Quarterly Financial Data -Unaudited (continued)

| | Quarter Ended March 31 | 2000 Quarter Ended June 30 | Quarter Ended September 30 |
|---|------------------------------|-------------------------------------|----------------------------------|
| Interest income | \$ 772 | \$ 819 | \$ 844 |
| Interest expense | 462 | 480 | 533 |
| Net interest income | 310 | 339 | 311 |
| Provision for losses | 1 | 65 | 22 |
| Net interest income after Provision for losses | 309 | 274 | 289 |
| Loan set-up and other fees | 132 | 173 | 342 |
| Loan servicing and subservicing fees | 156 | 235 | 293 |
| Gain on sale of loans | 7 | 12 | 18 |
| Merchant banking/BIDCO | 210 | 25 | 0 |
| Other non-interest income | 48 | 52 | 92 |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | | | |
|--|-----------|-----------|-----------|
| Non-interest expense | 1,028 | 1,146 | 1,031 |
| Income tax expense | 9 | (4) | (1) |
| Earnings (loss) from continuing operations | (175) | (371) | 4 |
| Preferred stock requirements | 0 | 0 | 0 |
| Net earnings (loss) available to common shareholders | \$ (175) | \$ (371) | \$ 4 |
| Basic and diluted loss per share | \$ (0.09) | \$ (0.18) | \$ 0.00 |
| Weighted average shares outstanding | 2,023,515 | 2,027,801 | 2,027,801 |

23. Recently issued Accounting Standards

In June of 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 141, "Business Combinations." Statement 141 requires that the purchase method of accounting be used for business combinations initiated after June 30, 2001. In June of 2001, the FASB also issued Statement No. 142, "Goodwill and Other Intangible Assets" which is effective generally beginning January 1, 2002. Statement 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized but, instead, tested for impairment at least annually in accordance with the provisions of the statement. The Company has \$63,914 of goodwill at December 31, 2001, therefore the adoption of these statements is not expected to materially impact the Company's results of operations or financial position.

In June of 2001, the FASB issued Statement No. 143, "Accounting for Asset Retirement Obligations." Statement 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes the cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period and the capitalized cost is depreciated over the remaining useful

23. Recently issued Accounting Standards (continued)

life of the related asset. Upon settlement of the liability, the entity either settles the obligation for the amount recorded or incurs a gain or loss. Statement 143 is effective for fiscal years beginning after June 15, 2002. Adoption of this statement is not expected to impact the Company's results of operations or financial position.

In August of 2001, the FASB issued Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Statement 144 supersedes certain previously issued accounting pronouncements. The statement was issued to establish a single accounting model for long-lived assets to be disposed of by sale. It broadens the presentation of discontinued operations in the income statement to include a component of an entity (rather than a segment of a business). A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Statement 144 also requires that discontinued operations be measured at the lower of the carrying amount

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

or fair value less cost to sell. The statement is effective prospectively for fiscal years beginning after December 15, 2001 and will only impact the Bank if future transactions occur that involve disposal of long-lived assets.

24. Parent Company Only Condensed Financial Information

| Condensed Balance Sheet | | |
|---|----------------------|----------------------|
| | December 31, 2001 | December 31, 2000 |
| <hr/> | | |
| ASSETS | | |
| Cash and cash equivalents | \$ 96,045 | \$ 15,860 |
| Securities available for sale | 233 | 233 |
| Investment in University Bank | 2,923,596 | 2,493,426 |
| Investment in Michigan BIDCO | 29,152 | 77,157 |
| Goodwill, net | - | 139,412 |
| Receivable from University Bank | 286,196 | 149,572 |
| Other assets | 3,107 | 58,602 |
| | <hr/> | |
| Total Assets | \$ 3,338,329 | \$ 2,934,262 |
| | <hr/> | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Notes payable | \$ 430,000 | \$ 562,000 |
| Accounts payable | 168,631 | 318,601 |
| Accrued interest payable | 3,196 | 11,379 |
| | <hr/> | |
| Total Liabilities | 601,827 | 891,980 |
| Stockholders' Equity | 2,736,502 | 1,950,380 |
| | <hr/> | |
| Total Liabilities and Stockholders' Equity | \$ 3,338,329 | \$ 2,842,360 |
| | <hr/> | |

24. Parent Company Only Condensed Financial Information (continued)

Condensed Statements of Income

| | 2001 |
|---------------------------------------|-----------|
| <hr/> | |
| INCOME: | |
| Interest and dividends on investments | \$ 407 |
| Net security gains | - |
| Other income | (122,465) |
| | <hr/> |
| Total Income | (122,058) |
| | |
| EXPENSES: | |
| Interest | 52,503 |
| Amortization of goodwill | (139,412) |
| Salaries and benefits | - |
| Public listing | 45,902 |
| Professional fees | 43,330 |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | |
|---|--------------|
| Other miscellaneous | 4,788 |
| | ----- |
| Total Expense | 7,111 |
| Loss before federal income taxes | |
| (benefit) and equity in undistributed | |
| net loss of subsidiaries | (129,169) |
| Federal income taxes (benefit) | - |
| | ----- |
| Loss before equity in | |
| undistributed net loss of subsidiaries | (129,169) |
| Equity in undistributed net loss | |
| of subsidiaries. | (185,318) |
| | ----- |
| Net loss from continuing operations | (314,487) |
| Discontinued Operations: | |
| Income (loss) from Varsity Mortgage and | |
| Varsity Funding) | - |
| | ----- |
| Net loss | \$ (314,487) |
| | ===== |

24. Parent Company Only Condensed Financial Information (continued)

Condensed Statement of Cashflows

| | |
|---|--------------|
| | 2001 |
| | ----- |
| Cash flow provided by (used in) investing activities: | |
| Net Income (Loss) | \$ (314,487) |
| Adjustments to reconcile net loss to net cash provided by | |
| (used in) operating activities: | |
| Amortization of goodwill | 139,412 |
| Loss (gain) on sale of investments | 0 |
| Decrease/(Increase) in receivable from affiliate | (136,624) |
| Decrease/(Increase) in other assets | 55,495 |
| Increase(Decrease) in other liabilities | (158,153) |
| Decrease(Increase) investment in subsidiaries | 185,317 |
| Decrease(Increase) investment in Michigan BIDCO | 122,465 |
| | ----- |
| Net cash provided by (used in) operating activities | (106,575) |
| | ----- |
| Cash flow from investing activities: | |
| Purchase of available for sale securities | (66,652) |
| Proceeds from sale of available for sale securities | 0 |
| | ----- |
| Net cash provided by (used in) investing activities | (66,652) |
| | ----- |
| Cash flow from financing activities: | |
| Principal payment on notes payable | (132,000) |
| Issuance of equity conversion bonds | |
| ----- I | 184,082 |

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | |
|--|-------------|
| Conversion of equity conversion bonds | (184,082) |
| Issuance of preferred stock | 733,000 |
| Conversion of preferred stock | (1,458,000) |
| Payment of preferred dividend | (52,244) |
| Issuance of common stock | 1,162,656 |
| Capital increase from buy-out of minority interest in BIDCO | - |
| | ----- |
| Net cash provided by (used in) financing activities | 253,412 |
| | ----- |
| Net changes in cash and cash equivalents | 80,185 |
| Cash and cash equivalents: | |
| Beginning of year | 15,860 |
| | ----- |
| End of year | \$ 96,045 |
| | ===== |
| Supplemental disclosure of cash flow information: Cash paid during the year for: | |
| Interest | \$ 60,686 |

Item 8. - Financial Statements and Supplementary Data

The financial statements provided pursuant to this item are listed under Item 14(a) below and appear beginning on page 44.

Item 9. - Changes in and Disagreements with Accountants on Accounting and Financial Disclosures.

None

PART III.

Item 10. - Directors and Executive Officers of the Registrant

The information required by this item is incorporated by reference herein from the portions of the Company's Proxy Statement for its 2002 Annual Meeting (the "Proxy Statement") to be under the captions:

Election of Directors
Executive Officers
Section 16(a) Beneficial Ownership Reporting Compliance

Item 11. - Executive Compensation

The information required by this item is incorporated by reference herein from the portions of the Company's Proxy Statement to be under the captions:

Executive Compensation
Compensation Plans

Item 12. - Security Ownership of Certain Beneficial Owners and Management

The information required by this item is incorporated by reference herein from the portion of the Company's Proxy Statement to be under the caption:

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

Security Ownership of Certain Beneficial Owners and Management

Item 13. - Certain Relationships and Related Transactions

The information required by this item is incorporated by reference herein from the portion of the Company's Proxy Statement to be under the caption:

Certain Relationships and Related Transactions

PART IV.

Item 14. - Exhibits, Financial Statement Schedules and Report on Form 8-K

(a) Index of Financial Statements:

The following statements are filed as part of this Report:

Audited consolidated balance sheets as of December 31, 2001 and December 31, 2000, and consolidated statements of operations, comprehensive income (loss), stockholders' equity and cash flows for the years ended December 31, 2001, 2000, and 1999, of the Company.

(b) Reports on Form 8-K:

None

(c) Exhibits:

(3) Certificate of Incorporation and By-laws:

3.1 Composite Certificate of Incorporation of the Company, as amended (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1996).

3.1.1 Certificate of Amendment, dated June 10, 1998, of the Company's Certificate of Incorporation (incorporated by reference to Exhibit 3.1.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1998).

3.2 Composite By-laws of the Company (incorporated by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989).

(10) Material Contracts.

10.1 Loan Agreement and Promissory Note dated December 31, 1997 issued to North Country Bank & Trust (incorporated by reference to Exhibit 10.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997).

10.2 University Bancorp, Inc. Employee Stock Ownership Plan (the "ESOP"), as amended November 27, 1990 (incorporated by reference to Exhibit 10.2 to the Company's Annual

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

Report on Form 10-K for the year ended December 31, 1990).
*

- 10.2.1 Amendment to the ESOP, effective as of December 31, 1991 (incorporated by reference to Exhibit 10.2.A to the Company's Annual Report on Form 10-K for the year ended December 31, 1991). *
- 10.3 University Bank 401(k) Profit Sharing Plan, adopted August 1, 1996, effective as of January 1, 1996 (incorporated by reference to Exhibit 10.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 1996). *
- 10.4 Letter regarding grant of options to outside directors, dated as of July 20, 1993 (incorporated by reference to Exhibit 10.6 to the Company's Annual Report on Form 10-K for year ended December 31, 1993).*
- 10.5 1995 Stock Plan of the Company (incorporated by reference to Exhibit A to the definitive Proxy Statement of the Company for 1996 Annual Meeting of Stockholders). *
- 10.5.1 Form of Stock Option Agreement related to the 1995 Stock Plan (incorporated by reference to Exhibit 10.7.1 to the Annual Report on Form 10-K for the year ended December 31, 1995). *
- 10.6 Letter, dated December 1, 1989, from Federal Reserve Bank of Minneapolis (incorporated by reference to Exhibit 10.9).
- 10.7 Lease Agreement (the "Cascade Lease Agreement") between RG Properties, Inc., as agent for Sault Associates, a Michigan Limited Partnership, and University Bank, dated September 30, 1992 (incorporated by reference to exhibit 10.9 to the Company's Annual Report on Form 10-K for the year ended December 31, 1992).
- 10.7.1 First Amendment to the Cascade Lease Agreement, dated January 5, 1993 (incorporated by reference exhibit 10.9.1).
- 10.8 Federal Income Tax Allocation Agreement Between Newberry State Bank and Newberry Holding Inc. dated March 21, 1992 (incorporated by reference to Exhibit 10.11).
- 10.8.1 Federal Income Tax Allocation Agreement Between Newberry Holding Inc. and University Bancorp, Inc. dated May 21, 1991 (incorporated by reference to Exhibit 10.11.1).
- 10.9 Purchase and Sale Agreement, dated November 1, 1995, concerning common stock of Midwest Loan Services, Inc., among its stockholders and University Bank and Newberry Bancorp, Inc (incorporated by reference to Exhibit 10.16 of the Company's Annual Report on Form 10-K for the year ended December 31, 1995).
- 21 Subsidiaries of Registrant: List of subsidiaries filed herewith.
- 23 Report of Independent Auditors, Crowe, Chizek and Company, LLP, dated March 17, 2000 regarding the audit of the

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

consolidated financial statements of University Bancorp, Inc. for the year ended December 31, 1999.

23.1 Report of Independent Auditors, Richard C. Woodbury, P.C., dated March 8, 2001 regarding Midwest Loan Services, Inc.

* Denotes a management compensatory plan or arrangement.

SIGNATURES

Pursuant to the requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

UNIVERSITY BANCORP, INC.

By: /s/Stephen Lange Ranzini
Stephen Lange Ranzini,
President

Date: March 29, 2002

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|--|----------------------------------|----------------|
| /s/Stephen Lange Ranzini Stephen Lange Ranzini | Director, President, | March 29, 2002 |
| /s/Joseph L. Ranzini Joseph L. Ranzini | Director, Secretary, Chairman | March 29, 2002 |
| /s/Keith Brenner Keith E. Brenner | Director | March 29, 2002 |
| /s/Michael Talley Michael Talley | Director | March 29, 2002 |
| /s/Robert Goldthorpe Robert Goldthorpe | Director | March 29, 2002 |
| /s/Dr. Joseph L. Ranzini Dr. Joseph Lange Ranzini | Director | March 29, 2002 |
| /s/Paul Lange Ranzini Paul Lange Ranzini | Director | March 29, 2002 |

Index of Exhibits

| Exhibit Number and Description | Sequentially Numbered Page |
|--------------------------------|-------------------------------|
|--------------------------------|-------------------------------|

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

- (3) Certificate of Incorporation and By-laws:
 - 3.1 Composite Certificate of Incorporation of the Company, as amended (incorporated by reference to Exhibit 3.1 to the June 30, 1996 10-Q).
 - 3.1.1 Certificate of Amendment, dated June 10, 1998, of the Company's Certificate of Incorporation (incorporated by reference to Exhibit 3.1.1 to the June 30, 1998 10-Q).
 - 3.2 Composite By-laws of the Company (incorporated by reference to Exhibit 3.2 to the 1989 10-K).
- (10) Material Contracts.
 - 10.1 Loan Agreement and Promissory Note dated December 31, 1997 issued to North Country Bank & Trust (incorporated by reference to Exhibit 10.1 to the 1997 10-K)).
 - 10.2 University Bancorp, Inc. Employee Stock Ownership Plan (the "ESOP"), as amended November 27, 1990 (incorporated by reference to Exhibit 10.2 to the 1990 10-K).
 - 10.2.1 Amendment to the ESOP, effective as of December 31, 1991 (incorporated by reference to Exhibit 10.2.A to the 1991 10-K).
 - 10.3 University Bank 401(k) Profit Sharing Plan, adopted August 1, 1996, effective as of January 1, 1996 (incorporated by reference to Exhibit 10.3 to the 1996 10-K).
 - 10.4 Letter regarding grant of options to outside directors, dated as of July 20, 1993 (incorporated by reference to Exhibit 10.6 to the Company's Annual Report on Form 10-K for the year ended December 31, 1993 (the "1993 10-K")).
 - 10.5 1995 Stock Plan of the Company (incorporated by reference to Exhibit A to the definitive Proxy Statement of the Company for the 1996 Annual Meeting of Stockholders (the "1996 Proxy").
 - 10.5.1 Form of Stock Option Agreement related to the 1995 Stock Plan (incorporated by reference to Exhibit 10.7.1 to the the 1995 10-K).
 - 10.6 Letter, dated December 1, 1989, from Federal Reserve Bank of Minneapolis (incorporated by reference to Exhibit 10.9 to the 1989 10-K).
 - 10.7 Lease Agreement (the "Cascade Lease Agreement") between RG Properties, Inc., as agent for Sault Associates, a Michigan Limited Partnership, and University Bank, dated September 30, 1992 (incorporated by reference to exhibit 10.9 to the 1992 10-K).
 - 10.7.1 First Amendment to the Cascade Lease Agreement, dated January 5, 1993 (incorporated by reference exhibit 10.9.1 to the 1992 10-K).
 - 10.8 Federal Income Tax Allocation Agreement Between Newberry State Bank and Newberry Holding Inc. dated March 21, 1992 (incorporated by reference to Exhibit 10.11 to the 1991 10-K).

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

| | | |
|--------|--|----|
| 10.8.1 | Federal Income Tax Allocation Agreement Between Newberry Holding Inc. and University Bancorp, Inc. dated May 21, 1991 (incorporated by reference to Exhibit 10.11.1 to the 1991 10-K). | |
| 10.9 | Purchase and Sale Agreement, dated November 1, 1995, concerning Common Stock of Midwest Loan Services, Inc., among its stockholders and University Bank and Newberry Bancorp, Inc (incorporated by reference to Exhibit 10.16 of the 1995 10-K). | |
| 21 | Subsidiaries of Registrant. | 85 |
| 23 | Report of Independent Auditors, Crowe, Chizek and Company, LLP | 86 |
| 23.1 | Report of Independent Auditors, Richard C. Woodbury, P.C. | 87 |

Exhibit 21. Subsidiaries of Registrant.

University Bank, a Michigan state chartered bank.

University Insurance & Investment Services, Inc., a Michigan Corporation
(100% owned by Bank)

Midwest Loan Services, Inc., a Michigan Corporation (80% owned by
University Bank)

Exhibit 23. Report of Independent Auditors.

REPORT OF INDEPENDENT AUDITORS

Board of Directors and Shareholders
University Bancorp, Inc.
Ann Arbor, Michigan

We have audited the accompanying consolidated statements of operations, comprehensive income (loss), stockholders' equity and cash flows of University Bancorp, Inc. for the year ended December 31, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of University Bancorp, Inc. for the year ended December 31, 1999 in conformity with generally accepted accounting principles.

Crowe, Chizek and Company LLP

Grand Rapids, Michigan
March 17, 2000

Exhibit 23.1 Report of Independent Auditors.

Board of Directors
Midwest Loan Services, Inc.
Houghton, MI 49931

We have audited the accompanying balance sheet of Midwest Loan Services, Inc. as of December 31, 2000 and 1999, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the 2000 and 1999 financial statements referred to above present fairly, in all material respects, the financial position of Midwest Loan Services, Inc., as of December 31, 2000 and 1999, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental information included in the report (shown on pages 15-22) is presented for the purpose of additional analysis and is not a required part of the basic financial statements of Midwest Loan Services, Inc. Such information has been submitted to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

In accordance with Government Auditing Standards, we have also issued a report dated March 8, 2001 on our consideration of Midwest Loan Services, Inc.,

Edgar Filing: UNIVERSITY BANCORP INC /DE/ - Form 10-K

internal controls and the reports dated December 31, 2000 and 1999 on its compliance with laws and regulations.

[OBJECT OMITTED]

Richard C. Woodbury, CPA

March 8, 2001