O'Beirne Colin P
Form 4
February 28, 2019

FORM 4

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

OMB APPROVAL

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STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
O'Beirne Colin P

(Last) (First) (Middle)

10000 ENERGY DRIVE, P. O. BOX 12359

(Street)

SPRING, TX 77391

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
SOUTHWESTERN ENERGY CO [SWN]

3. Date of Earliest Transaction (Month/Day/Year)
02/26/2019

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
Vice President and Controller

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	02/27/2019		M		9,015	A	$ 0 (1)	35,121	D	
Common Stock	02/27/2019		D		9,015	D	$ 4.29	26,106	D	
Common Stock								2,353.7529	I	by 401K

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

displays a currently valid OMB control number.

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)	
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares
Restricted Stock Unit	$ 0 (1)	02/27/2019		M			9,015	(2)	(2)	Common Stock	9,015
Restricted Stock Unit	(3)	02/26/2019		A		53,580		(4)	(4)	Common Stock	53,580

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
O'Beirne Colin P 10000 ENERGY DRIVE P. O. BOX 12359 SPRING, TX 77391			Vice President and Controller	

Signatures

/s/ Melissa D. McCarty, attorney-in-fact for Colin P. O'Beirne	02/28/2019
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Each Restricted Stock Unit ("RSU") has the economic equivalent of one share of Southwestern Energy Company ("SWN") common stock. The RSUs vesting on February 27, 2019 were settled in cash based on the closing price of SWN common stock on the vesting date.

(2) On February 27, 2018, the reporting person was granted 36,060 RSUs, vesting in four equal installments beginning on the first anniversary of the grant date, or immediately upon death, disability, retirement at age 65 with required years of service, or a change in control. Vesting RSUs will be settled in shares of SWN common stock, cash, or a combination of shares of SWN common stock and cash.

(3) Each RSU represents a contingent right to receive one share of SWN common stock or an amount in cash equal to the Fair Market Value of one share of SWN common stock.

(4) On February 26, 2019, the reporting person was granted RSUs, vesting in four equal installments beginning on the first anniversary of the grant date, or immediately upon death, disability, retirement at age 65 with the required years of service, or a change in control. Vesting RSUs will be settled in shares of SWN common stock, cash, or a combination of shares of SWN common stock and cash.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.

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	2017	2016	2015
	(In Thousands)		
Maximum month-end balance:			
FHLB advances	$ 49,000	$ 45,500	$ 29,000

Stockholders' Equity

As of December 31, 2017, stockholders' equity was $169.3 million, or 9.4% of total assets, compared to stockholders' equity of $161.7 million, or 9.1% of total assets, as of December 31, 2016. Stockholders' equity increased by $7.6 million during the year ended December 31, 2017 attributable to net income of $11.9 million for the year ended December 31, 2017, partially offset by dividend declarations of $4.5 million.

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Non-bank Consolidated Subsidiaries

First Madison Investment Corp. FMIC is a wholly-owned operating subsidiary of FBB incorporated in the State of Nevada in 1993. FMIC was organized for the purpose of managing a portion of FBB's investment portfolio. FMIC invests in marketable securities. As an operating subsidiary, FMIC's results of operations are consolidated with FBB's for financial and regulatory purposes. FBB's investment in FMIC was $154.3 million at December 31, 2017, gross loans outstanding were $29.9 million and net income for the year ended December 31, 2017 was $1.8 million. This compares to a total investment of $153.0 million, no gross loans and net income of $1.6 million at and for the year ended December 31, 2016.

First Business Capital Corp. FBCC is a wholly-owned subsidiary of FBB formed in 1995 and headquartered in Madison, Wisconsin. FBCC is an asset-based financing company established to meet the financing needs of companies that are generally unable to obtain traditional commercial lending products. FBCC underwrites its loans with additional emphasis placed on collateral coverage as the companies it finances are growing rapidly, highly leveraged or undergoing a turn-around period. Through its FBF division, FBCC purchases accounts receivable on a full recourse basis as one additional alternative to meet the financing needs of its client base. FBB's investment in FBCC at December 31, 2017 was $38.7 million, gross loans outstanding were $147.1 million and net income for the year ended December 31, 2017 was $3.1 million. This compares to a total investment of $35.5 million, gross loans of $151.7 million and net income of $4.6 million at and for the year ended December 31, 2016.

First Business Equipment Finance, LLC. FBEF, headquartered in Madison, Wisconsin, was formed in 1998 for the purpose of originating leases and extending credit in the form of loans to small- and medium-sized companies nationwide and is a wholly-owned subsidiary of FBB. FBB's total investment in FBEF at December 31, 2017 was $7.1 million, gross loans and leases outstanding were $40.4 million and a net loss of $55,000 for the year ended December 31, 2017. This compares to a total investment of $7.1 million, gross loans and leases outstanding of $42.5 million and net loss of $98,000 at and for the year ended December 31, 2016.

Rimrock Road Investment Fund, LLC. Rimrock, formerly known as FBB Real Estate, LLC, is a wholly-owned subsidiary of FBB and was originally formed in 2009 for the purpose of holding and liquidating real estate and other assets acquired through foreclosure or other legal proceedings. In 2014, Rimrock's purpose was changed to reflect its qualified equity investment in a Madison, Wisconsin community development project, including the financing and ownership of a property that generates federal new market tax credits. FBB's total investment in Rimrock at December 31, 2017 was $2.8 million and Rimrock had net income of $15,000 for the year ended December 31, 2017. This compares to a total investment of $2.8 million and net income of $1,000 at and for the year ended December 31, 2016.

BOC Investment, LLC. BOC is a wholly-owned subsidiary of FBB and was formed in 2015 for the purpose of holding its equity investment in a Madison, Wisconsin historic development project. The investment provided federal historic tax credits upon the completion of the restoration project. FBB's total investment in BOC at December 31, 2017 was $4.0 million and BOC had net income of $131,000 for the year ended December 31, 2017. This compares to a total investment of $3.9 million and a net income of $422,000 at and for the year ended December 31, 2016.

Mitchell Street Apartments Investment, LLC. Mitchell is a wholly-owned subsidiary of FBB and was formed in 2016 for the purpose of holding its equity investment in a Milwaukee, Wisconsin historic development project. The investment provided federal and state historic tax credits upon the completion of the restoration project. FBB's total investment in Mitchell at December 31, 2017 was $1.4 million and Mitchell had $803,000 net income for the year ended December 31, 2017. This compares to a total investment of $563,000 and a no net income at and for the year ended December 31, 2016.

ABKC Real Estate, LLC. ABKCRE is a wholly-owned subsidiary of FBB and was formed for the purpose of holding and liquidating real estate and other assets acquired by FBB through foreclosure or other legal proceedings. ABKCRE was established in 2017. FBB's total investment in ABKCRE at December 31, 2017 was $1.2 million and a net loss of $238,000 for the year ended December 31, 2017.

FBB Tax Credit Investment, LLC. FBB Tax Credit, formerly known as FBB-Milwaukee Real Estate, LLC, is a wholly-owned subsidiary of FBB and was originally formed in 2012 for the purpose of holding and liquidating real estate and other assets acquired by FBB through foreclosure or other legal proceedings. In 2017, FBB Tax Credit's

purpose was changed to facilitate investments in federal and state tax credits.
LIQUIDITY AND CAPITAL RESOURCES
We expect to meet our liquidity needs through existing cash on hand, established cash flow sources, our third party senior line of credit and dividends received from the Bank. While the Bank is subject to certain regulatory limitations regarding their ability to pay dividends to the Corporation, we do not believe that the Corporation will be adversely affected by these dividend limitations. The Corporation’s principal liquidity requirements at December 31, 2017 were the interest payments due on subordinated and junior subordinated notes. During 2017 and 2016, FBB declared and paid dividends totaling $13.5 million and $7.0 million, respectively. The capital ratios of the Corporation and its subsidiaries met all applicable regulatory capital adequacy requirements in effect on December 31, 2017, and continue to meet the heightened requirements imposed by Basel III, including the capital conservation buffer that went into effect January 1, 2016. The Corporation’s and the Bank’s respective Boards of Directors and management teams adhere to the appropriate regulatory guidelines on decisions which affect their capital positions, including but not limited to, decisions relating to the payment of dividends and increasing indebtedness.
The Bank maintains liquidity by obtaining funds from several sources. The Bank’s primary source of funds are principal and interest payments on loans receivable and mortgage-related securities, deposits and other borrowings, such as federal funds and FHLB advances. The scheduled payments of loans and mortgage-related securities are generally a predictable source of funds. Deposit flows and loan prepayments, however, are greatly influenced by general interest rates, economic conditions and competition.
We view on-balance-sheet liquidity as a critical element to maintaining adequate liquidity to meet our cash and collateral obligations. We define our on-balance-sheet liquidity as the total of our short-term investments, our unencumbered securities available-for-sale and our unencumbered pledged loans. As of December 31, 2017 and 2016, our immediate on-balance-sheet liquidity was $401.1 million and $543.1 million, respectively. At December 31, 2017 and 2016, the Bank has $17.7 million and $40.9 million on deposit with the FRB recorded in short-term investments, respectively. Any excess funds not used for loan funding or satisfying other cash obligations were maintained as part of our on-balance-sheet liquidity in our interest-bearing accounts with the FRB, as we value the safety and soundness provided by the FRB. We plan to utilize excess liquidity to fund loan and lease portfolio growth, pay down maturing debt, allow run off of maturing wholesale certificates of deposit or invest in securities to maintain adequate liquidity at an improved margin. The decline in on-balance-sheet liquidity is primarily attributable to the decrease in cash held on deposit with the FRB and the increased use of FHLB advances.
We had $491.5 million of outstanding wholesale funds at December 31, 2017, compared to $450.3 million of wholesale funds as of December 31, 2016, which represented 31.2% and 28.6%, respectively, of ending balance total bank funding. Wholesale funds include FHLB advances, brokered certificates of deposit and deposits gathered from internet listing services. Total bank funding is defined as total deposits plus FHLB advances. We are committed to raising in-market deposits while maintaining our overall target mix of wholesale funds and in-market deposits. Wholesale funds continue to be an efficient and cost effective source of funding for the Bank and allows it to gather funds across a larger geographic base at price levels and maturities that are more attractive than local time deposits when required to raise a similar level of in-market deposits within a short time period. Access to such deposits and borrowings allows us the flexibility to refrain from pursuing single service deposit relationships in markets that have experienced unfavorable pricing levels. In addition, the administrative costs associated with wholesale funds are considerably lower than those that would be incurred to administer a similar level of local deposits with a similar maturity structure. During the time frames necessary to accumulate wholesale funds in an orderly manner, we will use short-term FHLB advances to meet our temporary funding needs. The short-term FHLB advances will typically have terms of one week to one month to cover the overall expected funding demands.
Our in-market relationships remain stable; however, deposit balances associated with those relationships will fluctuate. We expect to establish new client relationships and continue marketing efforts aimed at increasing the balances in existing clients’ deposit accounts. Nonetheless, we will continue to use wholesale funds in specific maturity periods, typically three to five years, needed to effectively mitigate the interest rate risk measured through our asset/liability management process or in shorter time periods if in-market deposit balances decline. In order to provide for ongoing liquidity and funding, all of our wholesale funds are certificates of deposit which do not allow for withdrawal at the option of the depositor before the stated maturity (with the exception of deposits accumulated through the internet listing service which have the same early withdrawal privileges and fees as do our other in-market

deposits) and FHLB advances with contractual maturity terms and no call provisions. The Bank limits the percentage of wholesale funds to total bank funds in accordance with liquidity policies approved by its Board of Directors. The Corporation’s overall operating range of wholesale funds to total bank funds is 30%-40%. The Bank was in compliance with its policy limits as of December 31, 2017.

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The Bank was able to access the wholesale funding market as needed at rates and terms comparable to market standards during the year ended December 31, 2017. In the event that there is a disruption in the availability of wholesale funds at maturity, the Bank has managed the maturity structure, in compliance with our approved liquidity policy, so at least one year of maturities could be funded through on-balance-sheet liquidity. These potential funding sources include deposits maintained at the FRB or Federal Reserve Discount Window utilizing currently unencumbered securities and acceptable loans as collateral. As of December 31, 2017, the available liquidity was in excess of the stated policy minimum. We believe the Bank will also have access to the unused federal funds lines, cash flows from borrower repayments and cash flows from security maturities. The Bank also has the ability to raise local market deposits by offering attractive rates to generate the level required to fulfill its liquidity needs.

The Bank is required by federal regulation to maintain sufficient liquidity to ensure safe and sound operations. We believe that the Bank has sufficient liquidity to match the balance of net withdrawable deposits and short-term borrowings in light of present economic conditions and deposit flows.

During the year ended December 31, 2017, operating activities resulted in a net cash inflow of $22.4 million. Operating cash flows included net income of $11.9 million and a provision for loan and leases losses of $6.2 million. Net cash used in investing activities for the year ended December 31, 2017 was $46.4 million which consisted of cash outflows to fund net loan growth and reinvestment of cash flows within purchases of additional securities, partially offset by cash inflows from maturities, redemptions and paydowns of available-for-sale and held-to-maturity securities. Net cash used in financing activities for the year ended December 31, 2017 was $1.0 million.

Refer to Note 10 - Stockholders' Equity and Regulatory Capital for a summary of the Corporation's and the Bank's capital ratios and the ratios required by their federal regulators at December 31, 2017 and 2016.

OFF-BALANCE-SHEET ARRANGEMENTS

Commitments

As of December 31, 2017, the Bank had outstanding commitments to originate $498.0 million of loans and commitments to extend funds to or on behalf of clients pursuant to standby letters of credit of $13.8 million. As of December 31, 2017, the Bank had $283.9 million of commitments to extend funds which extend beyond one year. We do not expect any losses as a result of these funding commitments. We have evaluated outstanding commitments associated with loans that were identified as impaired loans and concluded that there are no additional losses required to be recorded with these unfunded commitments as of December 31, 2017. We believe that additional commitments will not be granted or additional collateral will be provided to support any additional funds advanced. The Bank also utilizes interest rate swaps for the purposes of interest rate risk management, as described further in Note 17 – Derivative Financial Instruments to the Consolidated Financial Statements.

Additionally the Corporation has remaining commitments of $960,000 to Aldine Capital Fund, LP ("Aldine") and $1.5 million to Aldine Capital Fund II, LP ("Aldine II"), which are private equity mezzanine funding limited partnerships in which we have invested. Aldine began its operations in October 2006 and Aldine II began its operations in March 2013.

We believe adequate capital and liquidity are available from various sources to fund projected commitments.

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Contractual Obligations

The following table summarizes our contractual cash obligations at December 31, 2017:

	Payments Due by Period				
	Less than 1 Year	1-3 Years	4-5 Years	More than 5 Years	Total
	(In Thousands)				
Operating lease obligations	$1,648	$3,121	$2,807	$4,820	$12,396
Time deposits	171,972	160,930	26,295	24,987	384,184
Line of credit	10	—	—	—	10
Subordinated notes payable	—	—	—	23,713	23,713
Junior subordinated notes	—	—	—	10,019	10,019
FHLB advances	37,000	121,000	12,000	13,500	183,500
Other borrowings	—	—	—	675	675
Total contractual obligations	$210,630	$285,051	$41,102	$77,714	$614,497

SBA Recourse

In the ordinary course of business, the Corporation sells the guaranteed portions of SBA loans to third parties. In the event of a loss resulting from default and a determination by the SBA that there is a deficiency in the manner in which the loan was originated, funded or serviced by the Corporation, the SBA may require the Corporation to repurchase the loan, deny its liability under the guaranty, reduce the amount of the guaranty, or, if it has already paid under the guaranty, seek recovery of the principal loss related to the deficiency from the Corporation. The Corporation must comply with applicable SBA regulations in order to maintain the guaranty.

Management has assessed the estimated losses inherent in the outstanding guaranteed portions of SBA loans sold in accordance with ASC 450, Contingencies, and determined a recourse reserve based on the probability of future losses for these loans to be $2.8 million at December 31, 2017. The recourse reserve is reported in accrued interest payable and other liabilities on the Consolidated Balance Sheets. See Note 18 – Commitments and Contingencies for additional information on the SBA recourse reserve.

2016 COMPARED TO 2015

Top Line Revenue

In 2016, top line revenue increased by approximately 7.5% from the prior year primarily due to an 8.3% increase in average loans and leases and elevated recurring loan fees collected in lieu of interest. Recurring loan fees collected in lieu of interest totaled $5.1 million in 2016, compared to $3.3 million in 2015. The increase in fees collected in lieu of interest can primarily be attributed to above average prepayment activity in our asset-based lending line of business.

Return on Average Assets and Return on Average Equity

ROAA was 0.82% for the year ended December 31, 2016 compared to 0.97% for the year ended December 31, 2015. The decrease in ROAA can be attributed principally to a decrease in earnings as net income decreased 9.7% during the same time period. The decrease in net income was primarily due to both the deterioration in credit quality and related increase in the provision for loan and leases losses, and our decision to temporarily slow SBA production while making investments in the SBA platform. This decrease was partially offset by the aforementioned elevated loan fees collected in lieu of interest. ROAA is a critical metric used by us to measure the profitability of our organization and how efficiently our assets are deployed. ROAA also allows us to better benchmark our profitability to our peers without the need to consider different degrees of leverage which can ultimately influence return on equity measures.

ROAE for the year ended December 31, 2016 was 9.40% compared to 11.36% for the year ended December 31, 2015. The primary reasons for the decrease in ROAE are consistent with the net income variance explanations discussed above. We view ROAE as an important measurement for monitoring profitability and continue to focus on improving our return to our shareholders by enhancing the overall profitability of our client relationships, controlling our expenses and minimizing our costs of credit.

Efficiency Ratio

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The efficiency ratio improved to 61.12% for the year ended December 31, 2016, compared to 62.75% for the year ended December 31, 2015, and deteriorated moderately from the 60.06% for the year ended December 31, 2014. We took significant steps in 2016 toward enhancing the Corporation's long-term efficiency ratio. While loan fees are a regular part of our business model, unusually elevated loan fees and other non-recurring items meaningfully improved our efficiency ratio during 2016. A normalized level of fees and expenses would have resulted in an efficiency ratio in the mid-60% range.

Please refer to the Non-Interest Expense section below for discussion on the primary drivers of the year-over-year change in the efficiency ratio.

Net Interest Income

Net interest income increased by $4.7 million, or 8.0%, for the year ended December 31, 2016 compared to the same period in 2015. The increase in net interest income was primarily attributable to an increase in total loans and leases receivable combined with a $1.8 million increase in recurring loan fees collected in lieu of interest. These items more than offset continued competitive pricing pressure on loans and leases, a decrease in the net accretion of purchase accounting adjustments and an increase in the rate paid on wholesale funds resulting from a steeper yield curve.

The yield on average earning assets for the year ended December 31, 2016 was 4.50% compared to 4.52% for the year ended December 31, 2015. The decrease in the yield on average earning assets was principally due to a decrease in net accretion of purchase accounting adjustments, offset by above average recurring loan fees collected in lieu of interest. Excluding the impact of purchase accounting accretion in both 2015 and 2016 and the $1.8 million increase in loan fees in 2016, the yield on average earning assets for the year ended December 31, 2016 was 4.16% compared to 4.20% for the year ended December 31, 2015. Similarly, excluding net accretion in both 2015 and 2016 and the year over year increase in loan fees, the yield on the loan and lease portfolio declined five basis points to 4.95% for the year ended December 31, 2016 from 5.00% for the year ended December 31, 2015.

A significant portion of our loan and lease portfolio is comprised of fixed rate loans with terms generally from three to five years. As these loans reach their maturity they are renewed at current market rates and subject to competitive pricing pressures. As a result, the overall yield on the loan and lease portfolio, excluding purchase accounting adjustments and elevated recurring loan fees, continued to decline in 2016.

The overall weighted average rate paid on interest-bearing liabilities was 1.06% for the year ended December 31, 2016, an increase of two basis points from 1.04% for the year ended December 31, 2015. The moderate increase in the overall rate paid on interest-bearing liabilities was primarily caused by an increase in rate paid on our wholesale deposits and in-market certificates of deposit, partially offset by a reduction in the average rate paid on our money market accounts. Our continued success of attracting in-market non-interest bearing and interest-bearing demand deposits through new business relationships and increased client deposit balances mitigated the overall increase in our cost of funds driven by a steeper yield curve. The weighted average remaining maturity of our wholesale deposit portfolio remains consistent when compared to the same period in 2015, however, market rates increased moderately throughout 2016 as a result of the Federal Reserve raising rates in both December 2015 and December 2016.

Average in-market deposits - comprised of all transaction accounts, money market accounts and non-wholesale deposits - increased 7.4% to $1.124 billion for the year ended December 31, 2016 from $1.047 billion for the year ended December 31, 2015.

Provision for Loan and Lease Losses

We recorded a provision for loan and lease losses in the amount of $7.8 million for the year ended December 31, 2016 as compared to $3.4 million for the year ended December 31, 2015. Provision for the year ended December 31, 2016 primarily reflected $8.2 million in specific reserves and net charge-offs related to five discrete Kansas City market loan relationships. This increase in provision for loan and leases losses was tempered by improvements in underlying credit metrics in the remaining loan and lease portfolio, as asset quality in our Wisconsin markets remained strong.

Non-Interest Income

Non-interest income, consisting primarily of fees earned for trust and investment services, gains on sale of SBA loans, service charges on deposits and loan fee income, increased by $1.0 million, or 5.7%, to $18.0 million for the year ended December 31, 2016, from $17.0 million for the year ended December 31, 2015. Total non-interest income accounted for 22.1% of our total revenues in 2016 compared to 22.5% in 2015.

Trust and investment services fee income increased by $402,000, or 8.1%, to $5.4 million for the year ended December 31, 2016 compared to $5.0 million for the year ended December 31, 2015. Trust and investment services fee income is primarily driven by the amount of assets under management and administration as well as the mix of business at

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different fee structures and can be positively or negatively influenced by the timing and magnitude of volatility within the capital markets. At December 31, 2016, our trust assets under management were $977.0 million, or 19.5% more than the trust assets under management of $817.9 million at December 31, 2015, while our assets under administration increased approximately 11.9%, to $227.4 million at December 31, 2016 from $203.2 million at December 31, 2015.

Gain on sale of SBA loans for the year ended December 31, 2016 totaled $4.4 million, an increase of $401,000, or 10.0%, from the same period in 2015, primarily attributable to greater than expected production in the first and second quarters of 2016.

Service charges on deposits increased by $178,000, or 6.3%, to $3.0 million for the year ended December 31, 2016, compared to $2.8 million for the year ended December 31, 2015. The increase in service charges on deposits is primarily due to our success of attracting in-market fee generating non-interest bearing and interest-bearing demand deposits through new business relationships and increased client deposit balances.

Loan fees increased by approximately $243,000, or 11.1%, to $2.4 million for the year ended December 31, 2016 from $2.2 million for the year ended December 31, 2015. The increase in loan fees is primarily attributable to an increase in fees commensurate with SBA production, specifically the fee income generated from servicing and packaging SBA loans. This increase was partially offset by a decrease in fees earned for issuing letters of credit on behalf of our clients.

Other non-interest income decreased by $122,000 to $1.2 million for the year ended December 31, 2016, compared to $1.4 million for the year ended December 31, 2015. The decrease in other non-interest income was primarily due to a decrease in the gains recognized on the termination of leased assets. This decrease was partially offset by income recognized from our investment in various Community Development Entities.

Non-Interest Expense

Non-interest expense increased by $9.1 million, or 19.1%, to $56.4 million for the year ended December 31, 2016 from $47.4 million for the comparable period of 2015. The increase in non-interest expense was primarily due to an increase in compensation expense, impairment of tax credit investments (which resulted from the recognition of $4.2 million of tax credit benefits) and establishment of a SBA recourse reserve. The increase was partially offset by a decrease in professional fees, marketing costs and collateral liquidation costs.

Compensation expense increased by $3.0 million, or 10.5%, to $31.5 million for the year ended December 31, 2016 from $28.5 million for the year ended December 31, 2015. The increase reflects growth in compensation costs related to our strategic investment in new employees to meet our existing and future growth objectives, annual merit increases and employee benefit costs. Full time equivalent employees as of December 31, 2016 were 257, up 6.2% from 242 at December 31, 2015.

Professional fees expense decreased by $862,000, or 17.6%, to $4.0 million for the year ended December 31, 2016 from $4.9 million for the year ended December 31, 2015. The decrease was consistent with management’s expectations as technology platforms introduced in 2015 were largely put in place in 2016. Management will evaluate additional technology platforms and expand the capabilities of existing platforms going forward as we continue to strategically focus on scaling the Corporation to efficiently execute our growth strategy. For the year ended December 31, 2016, professional fees and fees paid to outside service providers specifically related to information technology (“IT”) projects decreased $508,000 and $439,000, respectively. In addition, fees paid for audit assurance and tax compliance decreased by $126,000. These decreases in professional fees were partially offset by a $391,000 increase in consulting services related to SBA strategic planning and loan review, and website development.

Data processing expense increased by $920,000, or 38.7%, to $3.3 million for the year ended December 31, 2016 from $2.4 million for the year ended December 31, 2015. The increase is principally due to a one-time fee of $794,000 to terminate FBB-KC’s existing core banking system vendor agreement.

Marketing expense decreased by $247,000, or 9.6%, to $2.3 million for the year ended December 31, 2016 from $2.6 million for the year ended December 31, 2015. The favorable variance is primarily due to a purposeful reduction of certain advertising initiatives as management continues to align expense growth with revenue production.

FDIC insurance expense increased by $552,000, or 60.0%, to $1.5 million for the year ended December 31, 2016 from $920,000 for the year ended December 31, 2015. The increase in FDIC insurance expense is commensurate with the pricing changes made effective by the FDIC on July 1, 2016 (which negatively impacts FDIC-insured institutions with brokered deposits greater than 10% of total assets) and reflective of the Corporation's growth in criticized and risk-weighted assets.

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During 2016, in accordance with the applicable accounting guidance, the Corporation recognized $3.3 million in nonrecurring expense due to impairment of a historic tax credit investment, which corresponded with the recognition of $3.8 million in tax credits, providing a net benefit to after-tax earnings of $450,000 for the year ended December 31, 2016. In addition, 2016 expenses included the recognition of $2.1 million in SBA recourse provision for estimated losses in the outstanding guaranteed portions of SBA loans sold. As a result of negative trends in credit quality, the Corporation performed a proactive and rigorous eligibility review of its SBA loan guarantees during 2016. No SBA recourse provision was recognized for the same period in 2015.

Income Taxes

Income tax expense was $2.2 million for the year ended December 31, 2016, compared to $8.4 million for the year ended December 31, 2015 primarily due to the aforementioned recognition of a historic tax credit, as well as lower pre-tax income. The effective tax rate for the year ended December 31, 2016 was 12.6% compared to 33.7% for the year ended December 31, 2015. The Corporation's effective tax rate may fluctuate as it is impacted by the level and timing of the Corporation's utilization of tax credits, level of pre-tax income and the extent of tax-exempt investments and loans.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. By their nature, changes in these assumptions and estimates could significantly affect the Corporation's financial position or results of operations. Actual results could differ from those estimates. Discussed below are certain policies that are critical to the Corporation. We view critical accounting policies to be those which are highly dependent on subjective or complex judgments, estimates and assumptions, and where changes in those estimates and assumptions could have a significant impact on the financial statements.

Allowance for Loan and Lease Losses. The allowance for loan and lease losses represents our recognition of the risks of extending credit and our evaluation of the quality of the loan and lease portfolio and as such, requires the use of judgment as well as other systematic objective and quantitative methods which may include additional assumptions and estimates. The risks of extending credit and the accuracy of our evaluation of the quality of the loan and lease portfolio are neither static nor mutually exclusive and could result in a material impact on our Consolidated Financial Statements. We may over-estimate the quality of the loan and lease portfolio, resulting in a lower allowance for loan and lease losses than necessary, overstating net income and equity. Conversely, we may under-estimate the quality of the loan and lease portfolio, resulting in a higher

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allowance for loan and lease losses than necessary, understating net income and equity. The allowance for loan and lease losses is a valuation allowance for probable credit losses, increased by the provision for loan and lease losses and decreased by charge-offs, net of recoveries. We estimate the allowance reserve balance required and the related provision for loan and lease losses based on monthly evaluations of the loan and lease portfolio, with particular attention paid to loans and leases that have been specifically identified as needing additional management analysis because of the potential for further problems. During these evaluations, consideration is also given to such factors as the level and composition of impaired and other non-performing loans and leases, historical loss experience, results of examinations by regulatory agencies, independent loan and lease reviews, our estimate of the fair value of the underlying collateral taking into consideration various valuation techniques and qualitative adjustments to inputs to those estimates of fair value, the strength and availability of guarantees, concentration of credits and other factors. Allocations of the allowance may be made for specific loans or leases, but the entire allowance is available for any loan or lease that, in our judgment, should be charged off. Loan and lease losses are charged against the allowance when we believe that the uncollectability of a loan or lease balance is confirmed. See Note 1 – Nature of Operations and Summary of Significant Accounting Policies in the Consolidated Financial Statements for further discussion of the allowance for loan and lease losses.

We also continue to exercise our legal rights and remedies as appropriate in the collection and disposal of non-performing assets, and adhere to rigorous underwriting standards in our origination process in order to achieve strong asset quality. Although we believe that the allowance for loan and lease losses was appropriate as of December 31, 2017 based upon the evaluation of loan and lease delinquencies, non-performing assets, charge-off trends, economic conditions and other factors, there can be no assurance that future adjustments to the allowance will not be necessary. If the quality of loans or leases deteriorates, then the allowance for loan and lease losses would generally be expected to increase relative to total loans and leases. If loan or lease quality improves, then the allowance would generally be expected to decrease relative to total loans and leases.

Goodwill Impairment Assessment. Goodwill is not amortized but, instead, is subject to impairment tests on at least an annual basis, and more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount, including goodwill. The Corporation conducted its annual impairment test on July 1, 2017, utilizing a qualitative assessment, and concluded that it is more likely than not that FBB-KC’s estimated fair value exceeded its carrying value. Due to management’s decision to temporarily slow SBA production while investments to enhance the platform were made and the slower than expected ramp up of production during the fourth quarter, management elected to again assess goodwill on November 30, 2017 by comparing the fair value of FBB-KC to its carrying value. Based on this assessment, management concluded that there was no evidence of goodwill impairment. There were no events since the November 2017 impairment test that have changed the Corporation's impairment assessment conclusion. Although no goodwill impairment was noted, there can be no assurances that future goodwill impairment will not occur. See Note 1 – Nature of Operations and Summary of Significant Accounting Policies for the Corporation's accounting policy on goodwill and see Note 6 – Goodwill and Other Intangible Assets in the Consolidated Financial Statements for a detailed discussion of the factors considered by management in the assessment.

Income Taxes. The Corporation and its wholly owned subsidiaries file a consolidated federal income tax return, a combined Wisconsin state tax return and a Kansas state tax return. Deferred income taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. The determination of current and deferred income taxes is based on complex analysis of many factors, including the interpretation of federal and state income tax laws, the difference between the tax and financial reporting basis of assets and liabilities (temporary differences), estimates of amounts currently due or owed, such as the timing of reversals of temporary differences, and current accounting standards. We apply a more likely than not approach to each of our tax positions when determining the amount of tax benefit to record in our Consolidated Financial Statements. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred taxes is recognized in income in the period that includes the enactment date. Effective January 1, 2018, the enactment of the Act reduced the corporate federal income tax rate to 21% from 35%, which required the Corporation to revalue its deferred taxes as of December 31, 2017. The revaluation resulted in an additional $629,000 income tax expense during the fourth quarter of 2017.

We have made our best estimate of valuation allowances utilizing available evidence and evaluation of sources of taxable income including tax planning strategies and expected reversals of timing differences to determine if valuation allowances were needed for deferred tax assets. Realization of deferred tax assets over time is dependent on our ability to generate sufficient taxable earnings in future periods and a valuation allowance may be necessary if management determines that it is more likely than not that the deferred asset will not be utilized. These estimates and assumptions are subject to change. Changes in these estimates and assumptions could adversely affect future consolidated results of operations. The Corporation believes the tax assets and liabilities are properly recorded in the Consolidated Financial Statements. See also Note 16 – Income Taxes in the Consolidated Financial Statements.

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The federal and state taxing authorities who make assessments based on their determination of tax laws may periodically review our interpretation of federal and state income tax laws. Tax liabilities could differ significantly from the estimates and interpretations used in determining the current and deferred income tax liabilities based on the completion of examinations by taxing authorities.

SBA Recourse Reserve. The SBA recourse reserve represents management's estimate of losses associated with the guaranteed portions of sold SBA loans. In the event of a loss resulting from default and a determination by the SBA that there is a deficiency in the manner in which the loan was originated, funded or serviced by the Corporation, the SBA may require the Corporation to repurchase the loan, deny its liability under the guaranty, reduce the amount of the guaranty, or, if it has already paid under the guaranty, seek recovery of the principal loss related to the deficiency from the Corporation. The Corporation must comply with applicable SBA regulations in order to maintain the guaranty. We estimate the SBA recourse reserve balance and the related SBA recourse provision by individually analyzing the eligibility of the guaranty for impaired loans that present a collateral shortfall, as well as by evaluating several factors to estimate probable losses within the remaining performing portion of the sold portfolio.

Although we believe that the SBA recourse reserve was appropriate as of December 31, 2017, future adjustments may be necessary based on changes to impaired loans, the fair value estimate of the underlying collateral and the Corporation's ability to originate, fund or service sold SBA loans in accordance with SBA regulations. In addition, the SBA's ultimate conclusion on the eligibility of a guaranty may be inconsistent with management's best estimate. See Note 1 - Nature of Operations and Summary of Significant Accounting Policies in the Consolidated Financial Statements for further discussion of the SBA recourse reserve.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Our primary market risk is interest rate risk, which arises from exposure of our financial position to changes in interest rates. It is our strategy to reduce the impact of interest rate risk on net interest margin by maintaining a favorable match between the maturities and repricing dates of interest-earning assets and interest-bearing liabilities. This strategy is monitored by the Bank's Asset/Liability Management Committee, in accordance with policies approved by the Bank's Board. The committee meets regularly to review the sensitivity of the Bank's assets and liabilities to changes in interest rates, liquidity needs and sources, and pricing and funding strategies.

We use two techniques to measure interest rate risk. The first is simulation of earnings. In this measurement technique the balance sheet is modeled as an ongoing entity whereby future growth, pricing and funding assumptions are implemented. These assumptions are modeled under different rate scenarios that include a parallel, instantaneous and sustained change in interest rates. Key assumptions include:

- the behavior of interest rates and pricing spreads;
- the changes in product balances; and
- the behavior of loan and deposit clients in different rate environments.

This analysis incorporates several assumptions, the most material of which relate to the re-pricing characteristics and balance fluctuations of deposits with indeterminate or non-contractual maturities.

The sensitivity analysis included below is measured as a percentage change in net interest income for the next 12 months due to instantaneous movements in benchmark interest rates from a baseline scenario. Estimated changes set forth below are dependent upon material assumptions such as those previously discussed. The reduction in expected benefit from instantaneous rate changes is principally due to the assumption that the Bank's deposit price sensitivity will be greater in 2018 than it was in 2017.

	Impact on Net Interest Income as of December 31,	
Instantaneous Rate Change in Basis Points	2017	2016
Down 50	(0.16)%	0.01 %
No Change	— %	— %
Up 100	1.38 %	5.34 %
Up 200	3.01 %	10.95%

The earnings simulation analysis does not incorporate any management actions that may be used to mitigate negative consequences of actual interest rate movement. For that reason and others, they do not reflect the likely actual results but serve as conservative estimates of interest rate risk. This simulation analysis is not comparable to actual results disclosed elsewhere or directly predictive of future values of other measures provided.

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The second measurement technique used is static gap analysis. Gap analysis involves measurement of the difference in asset and liability repricing on a cumulative basis within a specified time frame. In general, a positive gap indicates that more interest-earning assets than interest-bearing liabilities reprice/mature in a time frame and a negative gap indicates the opposite. As shown in the cumulative gap position in the table presented below, at December 31, 2017, our interest-bearing liabilities have the general characteristics that will allow them to reprice faster than interest-earning assets over the next 12 months while our interest-earning assets will reprice faster than interest-bearing-liabilities thereafter. In addition to the gap position, other determinants of net interest income are the shape of the yield curve, general rate levels and the corresponding effect of contractual interest rate floors, reinvestment spreads, balance sheet growth and mix, and interest rate spreads. Our success in attracting in-market deposits adds to the interest rate liability sensitivity of the organization.

We manage the structure of interest-earning assets and interest-bearing liabilities by adjusting their mix, yield, maturity and/or repricing characteristics based on market conditions. Wholesale certificates of deposit and FHLB advances are a significant source of our funding and we use a variety of maturities to augment our management of interest rate exposure. In addition, management has the authorization, as permitted within applicable approved policies, and ability to utilize various derivative instruments should they be appropriate to manage interest rate exposure.

The following table illustrates our static gap position at December 31, 2017.

	Estimated Maturity or Repricing at December 31, 2017				
	Within 3 Months	3-12 Months	1-5 Years	After 5 Years	Total
	(Dollars in Thousands)				
Assets:					
Short-term investments	$35,481	$—	$—	$—	$35,481
Investment securities	6,544	26,503	93,744	37,872	164,663
Commercial loans	218,017	28,088	75,968	6,283	328,356
Real estate loans	333,742	86,250	385,445	177,524	982,961
Asset-based loans	145,388	—	—	—	145,388
Lease receivables	878	5,297	13,824	2,234	22,233
Consumer loans	2,008	337	499	—	2,844
Total earning assets(1)	$742,058	$146,475	$569,480	$223,913	$1,681,926
Liabilities:					
Interest-bearing transaction	$217,625	$—	$—	$—	$217,625
Money market accounts	515,078	—	—	—	515,078
Time deposits under $250,000	14,854	149,610	182,068	24,988	371,520
Time deposits $250,000 and over	998	6,509	5,157	—	12,664
FHLB advances	5,000	10,000	133,000	35,500	183,500
Short-term borrowings	10	—	—	—	10
Long-term debt(2)	—	—	15,675	19,405	35,080
Total interest-bearing liabilities	$753,565	$166,119	$335,900	$79,893	$1,335,477
Interest rate gap	$(11,507)	$(19,644)	$233,580	$144,020	$346,449
Cumulative interest rate gap	$(11,507)	$(31,151)	$202,429	$346,449	
Cumulative interest rate gap to total earning assets	(0.68)%	(1.85)%	12.04%	20.60%	

(1) Excludes non-interest sensitive balances and balances with indeterminate maturities.
(2) Excludes debt issuance costs.

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The following table illustrates our static gap position at December 31, 2016.

	Estimated Maturity or Repricing at December 31, 2016				
	Within 3 Months	3-12 Months	1-5 Years	After 5 Years	Total
	(Dollars in Thousands)				
Assets:					
Short-term investments	$61,941	$—	$980	$—	$62,921
Investment securities	8,395	16,536	143,267	16,148	184,346
Commercial loans	211,799	28,226	83,867	10,296	334,188
Real estate loans	343,584	92,890	365,379	120,853	922,706
Asset-based loans	151,872	—	—	—	151,872
Lease receivables	829	3,864	13,907	1,216	19,816
Consumer loans	1,217	337	655	—	2,209
Total earning assets(1)	$779,637	$141,853	$608,055	$148,513	$1,678,058
Liabilities:					
Interest-bearing transaction	$183,992	$—	$—	$—	$183,992
Money market accounts	627,090	—	—	—	627,090
Time deposits under $250,000	23,611	116,461	295,313	31,647	467,032
Time deposits $250,000 and over	2,516	2,554	3,033	—	8,103
FHLB advances	78	19,500	14,000	—	33,578
Short-term borrowings	1,010	—	—	—	1,010
Long-term debt(2)	9,841	—	15,675	10,315	35,831
Total interest-bearing liabilities	$848,138	$138,515	$328,021	$41,962	$1,356,636
Interest rate gap	$(68,501)	$3,338	$280,034	$106,551	$321,422
Cumulative interest rate gap	$(68,501)	$(65,163)	$214,871	$321,422	
Cumulative interest rate gap to total earning assets	(4.08)%	(3.88)%	12.80%	19.15%	

(1) Excludes non-interest sensitive balances and balances with indeterminate maturities.
(2) Excludes debt issuance costs.

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Item 8. Financial Statements and Supplementary Data

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS OF FIRST BUSINESS FINANCIAL SERVICES

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First Business Financial Services, Inc.
Consolidated Balance Sheets

	December 31, 2017	December 31, 2016
	(In Thousands, Except Share Data)	
Assets		
Cash and due from banks	$ 17,059	$ 14,596
Short-term investments	35,480	62,921
Cash and cash equivalents	52,539	77,517
Securities available-for-sale, at fair value	126,005	145,893
Securities held-to-maturity, at amortized cost	37,778	38,612
Loans held for sale	2,194	1,111
Loans and leases receivable, net of allowance for loan and lease losses of $18,763 and $20,912, respectively	1,482,832	1,429,763
Premises and equipment, net	3,156	3,772
Foreclosed properties	1,069	1,472
Bank-owned life insurance	40,323	39,048
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	5,670	2,131
Goodwill and other intangible assets	12,652	12,773
Accrued interest receivable and other assets	29,848	28,607
Total assets	$ 1,794,066	$ 1,780,699
Liabilities and Stockholders' Equity		
Deposits	$ 1,394,331	$ 1,538,855
Federal Home Loan Bank advances and other borrowings	207,898	59,676
Junior subordinated notes	10,019	10,004
Accrued interest payable and other liabilities	12,540	10,514
Total liabilities	1,624,788	1,619,049
Stockholders' equity:		
Preferred stock, $0.01 par value, 2,500,000 shares authorized, none issued or outstanding	—	—
Common stock, $0.01 par value, 25,000,000 shares authorized, 9,021,985 and 8,959,239 shares issued, 8,763,539 and 8,715,856 shares outstanding at December 31, 2017 and 2016, respectively	90	90
Additional paid-in capital	78,620	77,542
Retained earnings	98,906	91,317
Accumulated other comprehensive loss	(1,238)	(522)
Treasury stock, 258,446 and 243,383 shares at December 31, 2017 and 2016, respectively, at cost	(7,100)	(6,777)
Total stockholders' equity	169,278	161,650
Total liabilities and stockholders' equity	$ 1,794,066	$ 1,780,699

See accompanying Notes to Consolidated Financial Statements.

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First Business Financial Services, Inc.
Consolidated Statements of Income

	For the Year Ended December 31,		
	2017	2016	2015
	(In Thousands, Except Share Data)		
Interest income			
Loans and leases	$71,960	$74,627	$69,135
Securities	3,148	2,845	2,962
Short-term investments	703	645	374
Total interest income	75,811	78,117	72,471
Interest expense			
Deposits	10,805	11,716	10,877
Federal Home Loan Bank advances and other borrowings	3,285	1,958	1,842
Junior subordinated notes	1,112	1,115	1,112
Total interest expense	15,202	14,789	13,831
Net interest income	60,609	63,328	58,640
Provision for loan and lease losses	6,172	7,818	3,386
Net interest income after provision for loan and lease losses	54,437	55,510	55,254
Non-interest income			
Trust and investment service fees	6,670	5,356	4,954
Gain on sale of Small Business Administration loans	1,591	4,400	3,999
Gain on sale of residential mortgage loans	26	590	729
Service charges on deposits	3,013	2,990	2,812
Loan fees	1,988	2,430	2,187
Increase in cash surrender value of bank-owned life insurance	1,250	974	960
Net (loss) gain on sale of securities	(403)	10	—
Swap fees	909	76	7
Other non-interest income	1,621	1,162	1,363
Total non-interest income	16,665	17,988	17,011
Non-interest expense			
Compensation	31,663	31,545	28,543
Occupancy	2,088	2,019	1,973
Professional fees	4,063	4,031	4,893
Data processing	2,701	3,298	2,378
Marketing	2,109	2,338	2,585
Equipment	1,211	1,189	1,230
Computer software	2,723	2,160	1,649
FDIC insurance	1,388	1,472	920
Collateral liquidation costs	829	262	472
Net (gain) loss on foreclosed properties	(143)	122	(171)
Impairment of tax credit investments	2,784	3,691	—
SBA recourse provision	2,240	2,068	—
Other non-interest expense	3,215	2,238	2,902
Total non-interest expense	56,871	56,433	47,374
Income before income tax expense	14,231	17,065	24,891
Income tax expense	2,326	2,156	8,377

Net income	$11,905	$14,909	$16,514
Earnings per common share:			
Basic	$1.36	$1.71	$1.90
Diluted	1.36	1.71	1.90
Dividends declared per share	0.52	0.48	0.44

See accompanying Notes to Consolidated Financial Statements.

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First Business Financial Services, Inc.
Consolidated Statements of Comprehensive Income

	For the Year Ended December 31,		
	2017	2016	2015
	(In Thousands)		
Net income	$11,905	$14,909	$16,514
Other comprehensive loss, before tax			
Securities available-for-sale:			
Unrealized securities losses arising during the period	(1,156)	(902)	(719)
Reclassification adjustment for net loss (gain) realized in net income	403	(10)	—
Securities held-to-maturity:			
Amortization of net unrealized losses transferred from available-for-sale	102	159	233
Interest rate swaps:			
Unrealized losses on interest rate swaps arising during the period	(122)	—	—
Income tax benefit	279	311	188
Total other comprehensive loss	(494)	(442)	(298)
Comprehensive income	$11,411	$14,467	$16,216

See accompanying Notes to Consolidated Financial Statements.

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First Business Financial Services, Inc.
Consolidated Statements of Changes in Stockholders' Equity

	Common Shares Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
	(In Thousands, Except Share Data)						
Balance at December 31, 2014	8,671,854	$ 45	$ 74,963	$ 67,886	$ 218	$ (5,364)	$ 137,748
Net income	—	—	—	16,514	—	—	16,514
Other comprehensive income	—	—	—	—	(298)	—	(298)
Common stock dividends	—	44	(44)	—	—	—	—
Exercise of stock options	24,000	—	300	—	—	—	300
Share-based compensation - restricted shares	45,347	—	1,063	—	—	—	1,063
Share-based compensation - tax benefits	—	—	267	—	—	—	267
Cash dividends ($0.44 per share)	—	—	—	(3,816)	—	—	(3,816)
Treasury stock purchased	(41,791)	—	—	—	—	(946)	(946)
Balance at December 31, 2015	8,699,410	89	76,549	80,584	(80)	(6,310)	150,832
Net income	—	—	—	14,909	—	—	14,909
Other comprehensive loss	—	—	—	—	(442)	—	(442)
Share-based compensation - restricted shares	36,864	1	993	—	—	—	994
Cash dividends ($0.48 per share)	—	—	—	(4,176)	—	—	(4,176)
Treasury stock purchased	(20,418)	—	—	—	—	(467)	(467)
Balance at December 31, 2016	8,715,856	90	77,542	91,317	(522)	(6,777)	161,650
Net income	—	—	—	11,905	—	—	11,905
Other comprehensive loss	—	—	—	—	(494)	—	(494)
Share-based compensation - restricted shares	62,746	—	1,078	—	—	—	1,078
Cash dividends ($0.52 per share)	—	—	—	(4,538)	—	—	(4,538)
Treasury stock purchased	(15,063)	—	—	—	—	(323)	(323)
Deferred tax revaluation adjustment	—	—	—	222	(222)	—	—
Balance at December 31, 2017	8,763,539	$ 90	$ 78,620	$ 98,906	$ (1,238)	$ (7,100)	$ 169,278

See accompanying Notes to Consolidated Financial Statements.

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First Business Financial Services, Inc.
Consolidated Statements of Cash Flows

	For the Year Ended December 31,		
	2017	2016	2015
	(In Thousands)		
Operating activities			
Net income	$11,905	$14,909	$16,514
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred income taxes, net	1,747	(1,108)	1,158
Impairment of tax credit investments	2,784	3,691	—
Provision for loan and lease losses	6,172	7,818	3,386
Depreciation, amortization and accretion, net	1,562	1,515	(90)
Share-based compensation	1,078	994	1,063
Net loss (gain) on sale of available-for-sale securities	403	(10)	—
Gain on sale of historic development entity state tax credit	(210)	—	—
Increase in value of bank-owned life insurance policies	(1,250)	(974)	(960)
Origination of loans for sale	(69,966)	(71,965)	(70,254)
Sale of loans originated for sale	70,500	78,546	77,333
Gain on sale of loans originated for sale	(1,617)	(4,990)	(4,728)
Net (gain) loss on foreclosed properties, including impairment valuation	(143)	122	(171)
Excess tax benefit from share-based compensation	(66)	(142)	—
Returns on investments in limited partnerships	459	250	—
Net increase in accrued interest receivable and other assets	(2,857)	(3,861)	(1,033)
Net increase in accrued interest payable and other liabilities	1,907	1,367	1,002
Net cash provided by operating activities	22,408	26,162	23,220
Investing activities			
Proceeds from maturities, redemptions and paydowns of available-for-sale securities	38,241	43,745	42,899
Proceeds from maturities, redemptions and paydowns of held-to-maturity securities	3,808	3,882	4,349
Proceeds from sale of available-for-sale securities	40,144	5,227	—
Purchases of available-for-sale securities	(60,399)	(56,356)	(40,721)
Purchases of held-to-maturity securities	(3,016)	(5,191)	—
Proceeds from sale of foreclosed properties	1,659	83	528
Net increase in loans and leases	(59,033)	(22,385)	(155,204)
Investments in limited partnerships	(500)	(750)	—
Returns of investments in limited partnerships	97	541	459
Investment in historic development entities	(5,312)	(3,456)	(578)
Proceeds from sale of historic development entity state tax credit	2,764	—	—
Investment in Federal Home Loan Bank and Federal Reserve Bank Stock	(16,275)	(1,308)	(1,352)
Proceeds from the sale of Federal Home Loan Bank Stock	12,736	2,020	849
Purchases of leasehold improvements and equipment, net	(1,242)	(584)	(789)
Purchases of bank owned life insurance policies	—	(9,750)	—
Premium payment on bank owned life insurance policies	(25)	(26)	(25)
Net cash used in investing activities	(46,353)	(44,308)	(149,585)
Financing activities			
Net (decrease) increase in deposits	(144,486)	(38,256)	139,469
Repayment of Federal Home Loan Bank advances	(656,916)	(4,500)	(1,000)
Proceeds from Federal Home Loan Bank advances	806,916	30,000	—
Net (decrease) increase in short-term borrowed funds	(1,000)	(1,500)	1,500

Net (decrease) increase in long-term borrowed funds	(1,901)	998	918
Proceeds from issuance of subordinated notes payable	9,090	—	—
Repayment of subordinated notes payable	(7,875)	—	—
Excess tax benefit from share-based compensation	—	—	267
Cash dividends paid	(4,538)	(4,176)	(3,816)

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First Business Financial Services, Inc.
Consolidated Statements of Cash Flows

	For the Year Ended December 31,		
	2017	2016	2015
	(In Thousands)		
Exercise of stock options	—	—	300
Purchase of treasury stock	(323)	(467)	(946)
Net cash (used in) provided by financing activities	(1,033)	(17,901)	136,692
Net (decrease) increase in cash and cash equivalents	(24,978)	(36,047)	10,327
Cash and cash equivalents at the beginning of the period	77,517	113,564	103,237
Cash and cash equivalents at the end of the period	$52,539	$77,517	$113,564
Supplementary cash flow information			
Cash paid during the period for:			
Interest paid on deposits and borrowings	$14,872	$14,790	$13,639
Income taxes paid	2,160	5,554	5,668
Non-cash investing and financing activities:			
Transfer of loans from held-to-maturity to held-for-sale	12,896	11,504	4,336
Transfer from premises and equipment to foreclosed properties	1,113	—	—

See accompanying Notes to Consolidated Financial Statements.

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First Business Financial Services, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Note 1 – Nature of Operations and Summary of Significant Accounting Policies
Nature of Operations. The accounting and reporting practices of First Business Financial Services, Inc. (the “Corporation”), through our wholly-owned subsidiary, First Business Bank (“FBB”, or the “Bank”), has been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”). FBB operates as a commercial banking institution primarily in the Wisconsin and greater Kansas City markets. FBB also offers trust and investment services through First Business Trust & Investments (“FBTI”), a division of FBB. The Bank provides a full range of financial services to businesses, business owners, executives, professionals and high net worth individuals. The Bank is subject to competition from other financial institutions and service providers and is also subject to state and federal regulations. FBB has the following wholly-owned subsidiaries: First Business Capital Corp. (“FBCC”), First Madison Investment Corp. (“FMIC”), First Business Equipment Finance, LLC (“FBEF”), ABKC Real Estate, LLC (“ABKC”), Rimrock Road Investment Fund, LLC (“Rimrock Road”), BOC Investment, LLC (“BOC”), Mitchell Street Apartments Investment, LLC (“Mitchell Street”), and FBB Tax Credit Investment LLC (“FBB Tax Credit”). FMIC is located in and was formed under the laws of the state of Nevada.
Basis of Financial Statement Presentation. The Consolidated Financial Statements include the accounts of the Corporation and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. In accordance with the provisions of Accounting Standards Codification (“ASC”) Topic 810, the Corporation’s ownership interest in FBFS Statutory Trust II (“Trust II”) has not been consolidated into the financial statements.
Management of the Corporation is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements as well as reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. Material estimates that could significantly change in the near-term include the value of securities, level of the allowance for loan and lease losses, lease residuals, property under operating leases, goodwill, level of the Small Business Administration (“SBA”) recourse reserve and income taxes. Certain amounts in prior periods may have been reclassified to conform to the current presentation. Subsequent events have been evaluated through the date of the issuance of the Consolidated Financial Statements. No significant subsequent events have occurred through this date requiring adjustment to the financial statements or disclosures.
Cash and Cash Equivalents. The Corporation considers federal funds sold, interest-bearing deposits and short-term investments that have original maturities of three months or less to be cash equivalents.
Securities. The Corporation classifies its investment and mortgage-related securities as available-for-sale, held-to-maturity and trading. Debt securities that the Corporation has the positive intent and ability to hold to maturity are classified as held-to-maturity and are stated at amortized cost. Debt and equity securities bought expressly for the purpose of selling in the near term are classified as trading securities and are measured at fair value with unrealized gains and losses reported in earnings. Debt and equity securities not classified as held-to-maturity or as trading are classified as available-for-sale. Available-for-sale securities are measured at fair value with unrealized gains and losses reported as a separate component of stockholders’ equity, net of tax. Realized gains and losses, and declines in value deemed to be other than temporary, are included in the consolidated statements of income as a component of non-interest income. The cost of securities sold is based on the specific identification method. The Corporation did not hold any trading securities at December 31, 2017 or 2016.
Discounts and premiums on securities are accreted and amortized into interest income using the effective yield method over the weighted average life of the securities.
Declines in the fair value of investment securities (with certain exceptions for debt securities noted below) that are deemed to be other-than-temporary are charged to earnings as a realized loss and a new cost basis for the securities is established. In evaluating other-than-temporary impairment, management considers the length of time and extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer and the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value in the near term. Declines in the fair value of debt securities below amortized cost

are deemed to be other-than-temporary in circumstances where: (1) the Corporation has the intent to sell a security; (2) it is more likely than not that the Corporation will be required to sell the security before recovery of its amortized cost basis; or (3) the Corporation does not expect to recover the entire amortized cost basis of the security. If the Corporation intends to sell a security or if it is more likely than not that the Corporation will be required to sell the security before recovery, an other-than-temporary impairment write-down is recognized in earnings equal to the difference between the security's amortized cost basis and its fair value. If the Corporation does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the other-than-temporary impairment write-down is separated into an amount representing credit loss, which is recognized in earnings, and an amount related to all other factors, which is recognized in other comprehensive income.

Loans Held for Sale. Residential real estate loans and the guaranteed portions of SBA loans which are originated and intended for sale in the secondary market are classified as held for sale. These loans are carried at the lower of cost or fair value in the aggregate. Unrealized losses on such loans are recognized through a valuation allowance by a charge to other non-interest income. Gains and losses on the sale of loans are also included in other non-interest income. As assets specifically originated for sale, the origination of, disposition of, and gain/loss on these loans are classified as operating activities in the statement of cash flows. Fees received from the borrower and direct costs to originate the loans are deferred and recognized as part of the gain or loss on sale. There was $2.2 million and $1.1 million in loans held for sale outstanding at December 31, 2017 and 2016, respectively.

Loans and Leases. Loans and leases which management has the intent and ability to hold for the foreseeable future or until maturity are reported at their outstanding principal balance with adjustments for partial charge-offs, the allowance for loan and lease losses, deferred fees or costs on originated loans and leases and unamortized premiums or discounts on any purchased loans.

A loan or a lease is accounted for as a troubled debt restructuring if the Corporation, for economic or legal reasons related to the borrower’s financial condition, grants a concession to the borrower that it would not otherwise consider. A troubled debt restructuring may involve the receipt of assets from the debtor in partial or full satisfaction of the loan or lease or a modification of terms, such as a reduction of the stated interest rate or face amount of the loan or lease, a reduction of accrued interest, an extension of the maturity date at a stated interest rate lower than the current market rate for a new loan or lease with similar risk or some combination of these concessions. Restructured loans can involve loans remaining on non-accrual, moving to non-accrual or continuing on accrual status, depending on individual facts and circumstances. Non-accrual restructured loans are included and treated with all other non-accrual loans. In addition, all accruing restructured loans are reported as troubled debt restructurings which are considered and accounted for as impaired loans. Generally, restructured loans remain on non-accrual until the borrower has attained a sustained period of repayment performance under the modified loan terms (generally a minimum of six months). However, performance prior to the restructuring, or significant events that coincide with the restructuring, are considered in assessing whether the borrower can meet the new terms and whether the loan should be returned to or maintained on accrual status. If the borrower’s ability to meet the revised payment schedule is not reasonably assured, the loan remains on non-accrual.

Interest on non-impaired loans and leases is accrued and credited to income on a daily basis based on the unpaid principal balance and is calculated using the effective interest method. Per policy, a loan or a lease is considered impaired and placed on non-accrual status when it becomes 90 days past due or it is doubtful that contractual principal and interest will be collected in accordance with the terms of the contract. A loan or lease is determined to be past due if the borrower fails to meet a contractual payment and will continue to be considered past due until all contractual payments are received. When a loan or lease is placed on non-accrual, the interest accrual is discontinued and previously accrued but uncollected interest is deducted from interest income. If collectability of the contractual principal and interest is in doubt, payments received are first applied to reduce the loan principal. If collectability of the contractual payments is not in doubt, payments may be applied to interest for interest amounts due on a cash basis. As soon as it is determined with certainty that the principal of an impaired loan or lease is uncollectable, either through collections from the borrower or disposition of the underlying collateral, the portion of the carrying balance that exceeds the estimated measurement value of the loan or lease is charged off. Loans or leases are returned to accrual status when they are brought current in terms of both principal and accrued interest due, have performed in accordance with contractual terms for a reasonable period of time and when the ultimate collectability of total contractual principal and interest is no longer doubtful.

Transfers of assets, including but not limited to the guaranteed portions of SBA loans and participation interests in other originated loans, that upon completion of the transfer satisfy the conditions to be reported as a sale, including legal isolation, are derecognized from the Consolidated Financial Statements. Transfers of assets that upon completion of the transfer do not meet the conditions of a sale are recorded on a gross basis with a secured borrowing identified to reflect the amount of the transferred interest.

Loan and lease origination fees as well as certain direct origination costs are deferred and amortized as an adjustment to loan yields over the stated term of the loan or lease. Loans or leases that result from a refinance or restructuring, other than a troubled debt restructuring, where terms are at least as favorable to the Corporation as the terms for comparable loans to other borrowers with similar collection risks and result in an essentially new loan or lease, are accounted for as a new loan or lease. Any unamortized net fees, costs or penalties are recognized when the new loan or lease is originated. Unamortized net loan or lease fees or costs for loans and leases that result from a refinance or restructure with only minor modifications to the original loan or lease contract are carried forward as a part of the net investment in the new loan or lease. For troubled debt

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restructurings, all fees received in connection with a modification of terms are applied as a reduction of the loan or lease and any related costs, including direct loan origination costs, are charged to expense as incurred.

The Corporation purchased an individual loan in 2013 and a group of loans in connection with the Alterra acquisition which have shown evidence of credit deterioration since origination. These purchased loans are recorded at fair value, such that there is no carryover of the seller's allowance for loan losses. Such purchased loans are accounted for individually. At acquisition, the Corporation estimates the amount and timing of expected cash flows for each purchased loan and the expected cash flows in excess of fair value are recorded as interest income over the remaining life of the loan (accretable yield). The excess of the loan's contractual principal and interest over expected cash flows at acquisition is not recorded (nonaccretable difference).

Over the life of the loan, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, losses are recognized by an increase in the allowance for loan losses. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Allowance for Loan and Lease Losses. The allowance for loan and lease losses is maintained at a level that management deems appropriate to absorb probable and estimable losses inherent in the loan and lease portfolios. The methodology applied for determining inherent losses stems from current risk characteristics of the loan and lease portfolio, an assessment of individual impaired loans and leases, actual loss experience and adverse situations that may affect the borrower's ability to repay. The methodology also focuses on evaluation of several factors for each portfolio category, including but not limited to: management's ongoing review and grading of the loan and lease portfolios, consideration of delinquency experience, changes in the size of the loan and lease portfolios, existing economic conditions, level of loans and leases subject to more frequent review by management, changes in underlying collateral, concentrations of loans to specific industries and other qualitative and quantitative factors that could affect credit losses. Impaired and other loans and leases have risk characteristics that are unique to an individual borrower and the loss must be estimated on an individual basis. Loans and leases that are not individually reviewed and measured for impairment are aggregated and historical loss statistics are primarily used to determine the risk of loss. The measurement of the estimate of loss is reliant upon historical experience, information about the ability of the individual debtor to pay and the appraisal of loan collateral in light of current economic conditions. An estimate of loss is an approximation of what portion of all amounts receivable, according to the contractual terms of that receivable, is deemed uncollectible. Determination of the allowance is inherently subjective because it requires estimation of amounts and timing of expected future cash flows on impaired loans and leases, estimation of losses on types of loans and leases based on historical losses and consideration of current economic trends, both local and national. Based on management's periodic review using all previously mentioned pertinent factors, a provision for loan and lease losses is charged to expense when it is determined an increase in the allowance for loan and lease losses is appropriate. A negative provision for loan and lease losses may be recognized if management determines a reduction in the level of allowance for loan and lease losses is appropriate. Loan and lease losses are charged against the allowance and recoveries are credited to the allowance.

The allowance for loan and lease losses contains specific allowances established for expected losses on impaired loans and leases. Impaired loans and leases are defined as loans and leases for which, based on current information and events, it is probable that the Corporation will be unable to collect scheduled principal and interest payments according to the contractual terms of the loan or lease agreement. Loans and leases subject to impairment are defined as non-accrual and restructured loans and leases.

Impaired loans and leases are evaluated on an individual basis to determine the amount of specific reserve or charge-off required, if any. Smaller balance (individually less than $50,000) loans and leases are collectively evaluated for impairment as allowed under applicable accounting standards.

The measurement value of impaired loans and leases is determined based on the present value of expected future cash flows discounted at the loan's effective interest rate (the contractual interest rate adjusted for any net deferred loan fees or costs, premium or discount existing at the origination or acquisition of the loan), the market price of the loan or lease or the fair value of the underlying collateral less costs to sell, if the loan or lease is collateral dependent. A loan or lease is collateral dependent if repayment is expected to be provided principally by the underlying collateral. A loan's effective interest rate may change over the life of the loan based on subsequent changes in rates or indices or may be fixed at the rate in effect at the date the loan was determined to be impaired.

Subsequent to the initial impairment, any significant change in the amount or timing of an impaired loan or lease's future cash flows will result in a reassessment of the valuation allowance to determine if an adjustment is necessary. Measurements based on observable market price or fair value of the collateral may change over time and require a reassessment of the allowance if there is a significant change in either measurement base. Any increase in the present value of expected future cash flows attributable to the passage of time is recorded as interest income accrued on the net carrying amount of the loan or lease at the

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effective interest rate used to discount the impaired loan or lease's estimated future cash flows. Any change in present value attributable to changes in the amount or timing of expected future cash flows is recorded as loan loss expense in the same manner in which impairment was initially recognized or as a reduction of loan loss expense that otherwise would be reported. Where the level of loan or lease impairment is measured using observable market price or fair value of collateral, any decrease in the observable market price of an impaired loan or lease or fair value of the collateral of an impaired collateral-dependent loan or lease is recorded as loan loss expense in the same manner in which impairment was initially recognized. Any increase in the observable market value of the impaired loan or lease or fair value of the collateral of an impaired collateral-dependent loan or lease is recorded as a reduction in the amount of loan loss expense that otherwise would be reported.

Net Investment in Direct Financing Leases. The net investment in direct financing lease agreements represents total undiscounted payments plus estimated unguaranteed residual value (approximating 3% to 20% of the cost of the related equipment) and is recorded as lease receivables when the lease is signed and the leased property is delivered to the client. The excess of the minimum lease payments and residual values over the cost of the equipment is recorded as unearned lease income. Unearned lease income is recognized over the term of the lease on a basis which results in an approximate level rate of return on the unrecovered lease investment. Lease payments are recorded when due under the lease contract. Residual values are established at lease inception equal to the estimated value to be received from the equipment following termination of the initial lease and such estimated value considers all relevant information and circumstances regarding the equipment. In estimating the equipment's fair value at lease termination, the Corporation relies on internally or externally prepared appraisals, published sources of used equipment prices and historical experience adjusted for known current industry and economic trends. The Corporation's estimates are periodically reviewed to ensure reasonableness; however, the amounts the Corporation will ultimately realize could differ from the estimated amounts. When there are other than temporary declines in the Corporation's carrying amount of the unguaranteed residual value, the carrying value is reduced and charged to non-interest expense.

Operating Leases. Machinery and equipment are leased to clients under operating leases and are recorded at cost. Equipment under such leases is depreciated over the estimated useful life or term of the lease, if shorter. The impairment loss, if any, would be charged to expense in the period it becomes evident. Rental income is recorded on the straight-line accrual basis as other non-interest income.

Premises and Equipment, net. The cost of buildings and capitalized leasehold improvements is amortized on the straight-line method over the lesser of the term of the respective lease or estimated economic life. Equipment is stated at cost less accumulated depreciation and amortization which is calculated by the straight-line method over the estimated useful lives of three to ten years. Maintenance and repair costs are charged to expense as incurred. Improvements which extend the useful life are capitalized and depreciated over the remaining useful life of the assets.

Foreclosed Properties. Property acquired by repossession, foreclosure or by deed in lieu of foreclosure is carried at the lower of the recorded investment in the loan at the time of acquisition or the fair value of the underlying property, less costs to sell. Any write-down in the carrying value of a loan or lease at the time of acquisition is charged to the allowance for loan and lease losses. Any subsequent write-downs to reflect current fair value, as well as gains and losses on disposition and revenues are recorded in non-interest expense. Costs relating to the development and improvement of the property are capitalized while holding period costs are charged to other non-interest expense.

Bank-Owned Life Insurance. Bank-owned life insurance ("BOLI") is reported at the amount that would be realized if the life insurance policies were surrendered on the balance sheet date. BOLI policies owned by the Bank are purchased with the objective to fund certain future employee benefit costs with the death benefit proceeds. The cash surrender value of such policies is recorded in bank-owned life insurance on the Consolidated Balance Sheets and changes in the value are recorded in non-interest income. The total death benefit of all BOLI policies was $97.7 million and $97.3 million as of December 31, 2017 and 2016, respectively. There are no restrictions on the use of BOLI proceeds nor are there any contractual restrictions on the ability to surrender the policy. As of each of December 31, 2017 and 2016, there were no borrowings against the cash surrender value of the BOLI policies.

Federal Home Loan Bank and Federal Reserve Bank Stock. The Bank is required to maintain Federal Home Loan Bank ("FHLB") stock as members of the FHLB, and in amounts as required by these institutions. Alterra, previously as a state chartered member of the Federal Reserve Bank of Kansas City, was required to own shares of Federal Reserve

Bank ("FRB") stock. These equity securities are "restricted" in that they can only be sold back to the respective institutions or another member institution at par. Therefore, they are less liquid than other marketable equity securities and their fair value is equal to cost. At December 31, 2017 and 2016, the Bank had FHLB stock of $1.1 million and $1.8 million, respectively. Alterra had FRB stock of $1.1 million at December 31, 2016. The Corporation periodically evaluates its holding in FHLB and FRB stock for impairment. Should the stock be impaired, it would be written down to its estimated fair value. There were no impairments recorded on FHLB and FRB stock during the year ended December 31, 2017 or 2016.

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Goodwill and Other Intangible Assets. Goodwill and other intangible assets consist primarily of goodwill, core deposit intangibles and loan servicing rights. Core deposit intangibles have estimated finite lives and are amortized on an accelerated basis to expense over a period of seven years. Loan servicing rights, when purchased, are initially recorded at fair value and subsequently amortized in proportion to and over the period of estimated net servicing income. The Corporation reviews other intangible assets for impairment at least annually, or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, in which case an impairment charge would be recorded.

Goodwill is not amortized but is subject to impairment tests on at least an annual basis, and more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount (including goodwill). An initial qualitative evaluation is made to assess the likelihood of impairment and determine whether further quantitative testing to calculate the fair value is necessary. When the qualitative evaluation indicates that impairment is more likely than not, quantitative testing is required whereby the fair value of each reporting unit is calculated and compared to the recorded book value, “step one.” If the calculated fair value of the reporting unit exceeds its carrying value, goodwill is not considered impaired and “step two” is not considered necessary. If the carrying value of a reporting unit exceeds its calculated fair value, the impairment test continues (“step two”) by comparing the carrying value of the reporting unit’s goodwill to the implied fair value of goodwill. The implied fair value is computed by adjusting all assets and liabilities of the reporting unit to current fair value with the offset adjustment to goodwill. The adjusted goodwill balance is the implied fair value of the goodwill. An impairment charge is recognized if the carrying value of goodwill exceeds the implied fair value of goodwill. See Note 6 for additional information on goodwill and other intangible assets.

SBA Recourse Reserve. The Corporation establishes SBA recourse reserves on the guaranteed portions of sold SBA loans when it is probable that the guarantee may be ineligible. The recourse reserve is reported in accrued interest payable and other liabilities on the Consolidated Balance Sheets and consists of two components: (1) specific reserves for individually evaluated impaired loans that present a collateral shortfall where the guaranty associated with the sold portion of the SBA loan is determined to most likely be ineligible; and (2) general reserves for estimated probable losses on the remaining sold portfolio. The general reserve methodology is based on the evaluation of several factors, including but not limited to: credit quality trends within the SBA portfolio, changes in underlying collateral and the Corporation’s ability to originate, fund or service sold SBA loans in accordance with SBA regulations.

In the ordinary course of business, the Corporation sells the guaranteed portions of SBA loans to third parties. The Corporation has a continuing involvement in each of the transferred lending arrangements by way of relationship management, servicing the loans, as well as being subject to normal and customary requirements of the SBA loan program; however, there are no further obligations to the third-party participant required of the Corporation, other than standard representations and warranties related to sold amounts. In the event of a loss resulting from default and a determination by the SBA that there is a deficiency in the manner in which the loan was originated, funded or serviced by the Corporation, the SBA may require the Corporation to repurchase the loan, deny its liability under the guaranty, reduce the amount of the guaranty, or, if it has already paid under the guaranty, seek recovery of the principal loss related to the deficiency from the Corporation. The Corporation must comply with applicable SBA regulations in order to maintain the guaranty. In addition, the Corporation retains the option to repurchase the sold guaranteed portion of an SBA loan if the loan defaults. See Note 18 for additional information on the SBA recourse reserve.

Other Investments. The Corporation owns certain equity investments in other corporate organizations which are not consolidated because the Corporation does not own more than a 50% interest or exercise control over the organization. Investments in corporations representing at least a 20% interest are generally accounted for using the equity method and investments in corporations representing less than 20% interest are generally accounted for at cost. Investments in limited partnerships representing from at least a 3% up to a 50% interest in the entity are generally accounted for using the equity method and investments in limited partnerships representing less than 3% are generally accounted for at cost. All of these investments are periodically evaluated for impairment. Should an investment be impaired, it would be written down to its estimated fair value. The equity investments are reported in other assets and the income and expense from such investments, if any, is reported in non-interest income and non-interest expense.

Derivative Instruments. The Corporation uses derivative instruments to protect against the risk of adverse price or interest rate movements on the value of certain assets, liabilities, future cash flows and economic hedges for written client derivative contracts. Derivative instruments represent contracts between parties that usually require little or no initial net investment and result in one party delivering cash to the other party based on a notional amount and an underlying variable, as specified in the contract, and may be subject to master netting agreements.

Market risk is the risk of loss arising from an adverse change in interest rates, exchange rates or equity prices. The Corporation's primary market risk is interest rate risk. Instruments designed to manage interest rate risk include interest rate swaps, interest rate options and interest rate caps and floors with indices that relate to the pricing of specific assets and liabilities. The nature and volume of the derivative instruments used to manage interest rate risk depend on the level and type of

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assets and liabilities on the balance sheet and the risk management strategies for the current and anticipated rate environments. Counterparty risk with respect to derivative instruments occurs when a counterparty to a derivative contract with an unrealized gain fails to perform according to the terms of the agreement. Counterparty risk is managed by limiting the counterparties to highly rated dealers, requiring collateral postings when values are in deficit positions, applying uniform credit standards to all activities with credit risk and monitoring the size and the maturity structure of the derivative portfolio.

All derivative instruments are to be carried at fair value on the Consolidated Balance Sheets. The accounting for the gain or loss due to changes in the fair value of a derivative instrument depends on whether the derivative instrument qualifies as a hedge. If the derivative instrument does not qualify as a hedge, the gains or losses are reported in earnings when they occur. However, if the derivative instrument qualifies as a hedge, the accounting varies based on the type of risk being hedged. In 2017 and 2016, the Corporation utilized interest rate swaps offered directly to qualified commercial borrowers, which did not qualify for hedge accounting, and therefore, all changes in fair value and gains and losses on these instruments were reported in earnings as they occurred. The effects of netting arrangements are disclosed within the Notes of the Consolidated Financial Statements.

During the fourth quarter of 2017, the Corporation also entered into an interest rate swap to manage interest rate risk and reduce the cost of match-funding certain long-term fixed rate loans. This derivative contract was designated as a cash flow hedge as the receipt of floating interest from the counterparty is used to manage interest rate risk associated with forecasted issuances of short-term FHLB advances. The change in fair value of the hedging instrument was recorded in accumulated other comprehensive income.

Income Taxes. Deferred income tax assets and liabilities are computed for temporary differences in timing between the financial statement and tax basis of assets and liabilities that result in taxable or deductible amounts in the future based on enacted tax law and rates applicable to periods in which the differences are expected to affect taxable income. The effect of a change in tax rates on deferred taxes is recognized in income in the period that includes the enactment date. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversals of deferred tax liabilities, appropriate tax planning strategies and projections for future taxable income over the period which the deferred tax assets are deductible. When necessary, valuation allowances are established to reduce deferred tax assets to the realizable amount. Management believes it is more likely than not that the Corporation will realize the benefits of these deductible differences, net of the existing valuation allowances.

Income tax expense or benefit represents the tax payable or tax refundable for a period, adjusted by the applicable change in deferred tax assets and liabilities for that period. The Corporation also invests in certain development entities that generate federal and state historic tax credits. The tax benefits associated with these investments are accounted for under the flow-through method and are recognized when the respective project is placed in service. The Corporation and its subsidiaries file a consolidated federal income tax return and separate state income tax returns. Tax sharing agreements allocate taxes to each legal entity for the settlement of intercompany taxes. The Corporation applies a more likely than not standard to each of its tax positions when determining the amount of tax expense or benefit to record in its financial statements. Unrecognized tax benefits are recorded in other liabilities. The Corporation recognizes accrued interest relating to unrecognized tax benefits in income tax expense and penalties in other non-interest expense.

Other Comprehensive Income or Loss. Comprehensive income or loss, shown as a separate financial statement, includes net income or loss, changes in unrealized holding gains and losses on available-for-sale securities, changes in deferred gains and losses on investment securities transferred from available-for-sale to held-to-maturity, if any, changes in unrealized gains and losses associated with cash flow hedging instruments, if any, and the amortization of deferred gains and losses associated with terminated cash flow hedges, if any. For the year ended December 31, 2017, realized securities losses of $403,000 were reclassified out of accumulated other comprehensive income. Realized securities gains of $10,000 were reclassified out of accumulated other comprehensive income for the year ended December 31, 2016.

Earnings Per Common Share. Earnings per common share (“EPS”) is computed using the two-class method. Basic EPS is computed by dividing net income allocated to common shares by the weighted average number of common shares

outstanding for the period, excluding any participating securities. Participating securities include unvested restricted shares. Unvested restricted shares are considered participating securities because holders of these securities receive non-forfeitable dividends at the same rate as the holders of the Corporation's common stock. Diluted EPS is computed by dividing net income allocated to common shares adjusted for reallocation of undistributed earnings of unvested restricted shares by the weighted average number of common shares determined for the basic EPS plus the dilutive effect of common stock equivalents using the treasury stock method based on the average market price for the period.
Segments and Related Information. The Corporation is required to report each operating segment based on materiality thresholds of ten percent or more of certain amounts, such as revenue. Additionally, the Corporation is required to report separate operating segments until the revenue attributable to such segments is at least 75 percent of total consolidated revenue.

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The Corporation provides a broad range of financial services to individuals and companies in the Midwest. These services include demand, time and savings products, the sale of certain non-deposit financial products and commercial and retail lending, leasing and trust services. While the Corporation's chief decision-maker monitors the revenue streams of the various products, services and locations, operations are managed and financial performance is evaluated on a corporate-wide basis. The Corporation's business units have similar basic characteristics in the nature of the products, production processes and type or class of client for products or services; therefore, these business units are considered one operating segment.

Share-Based Compensation. As noted below within the "Recent Accounting Pronouncements" section, the Corporation early adopted ASU No. 2016-09 on October 1, 2016 with an effective date of January 1, 2016. Upon vesting of restricted share awards subject to ASU No. 2016-09, the benefit of tax deductions in excess of recognized compensation expense is reflected as an income tax benefit in the Consolidated Statements of Income. Excess tax benefits are included in other operating activities and taxes paid related to net share settlement of equity awards in financing activities within the Consolidated Statements of Cash Flows. The Corporation elected to account for forfeitures as they occur. While restricted stock is subject to forfeiture, restricted stock participants may exercise full voting rights and will receive all dividends and other distributions paid with respect to the restricted shares. Restricted stock units do not have voting rights and are provided dividend equivalents. The restricted stock granted under the Plan is typically subject to a vesting period. Compensation expense is recognized over the requisite service period of generally four years for the entire award on a straight-line basis. See Note 12 for additional information on share-based compensation.

Recent Accounting Pronouncements.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)," with an original effective date for annual reporting periods beginning after December 15, 2016. The ASU is a converged standard between the FASB and the IASB that provides a single comprehensive revenue recognition model for all contracts with customers across transactions and industries. The primary objective of the ASU is revenue recognition that represents the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU No. 2015-14, which defers the effective date of ASU 2014-09 to annual and interim reporting periods in fiscal years beginning after December 15, 2017. Earlier application is permitted only as of annual and interim reporting periods in fiscal years beginning after December 15, 2016. In March 2016, the FASB issued ASU No. 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net." The ASU intends to improve the operability and understandability of the implementation guidance of ASU 2014-09 on principal versus agent considerations. In April, May and December 2016, the FASB also issued ASU No. 2016-10, No. 2016-12 and No. 2016-20, respectively, related to Topic 606. The amendments do not change the core principals of the previously issued guidance, but instead further clarify and provide implementation guidance for certain aspects of the original ASU. The Corporation intends to adopt the accounting standards during the first quarter of 2018, as required. The Corporation conducted its assessment of the primary contracts subject to the guidance, including trust and asset management fees, brokerage commissions and deposit service charges. The Corporation has concluded that the adoption of the accounting standard will not have a material impact on the Corporation's existing revenue recognition practices or on its results of operations, financial position and liquidity.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." The ASU intends to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities and disclosing key information about leasing arrangements. The ASU will require lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessees' obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The new lease guidance simplifies the accounting for sale and leaseback transactions primarily because lessees must recognize lease assets and lease liabilities. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. The ASU is effective for public companies for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The Corporation intends to adopt the accounting standard during the first quarter of 2019, as required, and is currently evaluating the impact on its results of operations, financial position and liquidity.

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments- Credit Losses (Topic 326).” The ASU replaces the incurred loss impairment methodology for recognizing credit losses with a methodology that reflects all expected credit losses. The ASU also requires consideration of a broader range of information to inform credit loss estimates, including such factors as

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past events, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The amendments affect loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, and any other financial asset not excluded from the scope that have the contractual right to receive cash. Entities will apply the amendments in the ASU through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. The ASU is effective for public companies for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted as of the fiscal years beginning after December 15, 2018. The Corporation intends to adopt the accounting standard during the first quarter of 2020, as required, and is currently evaluating the impact on its results of operations, financial position and liquidity. A cross-functional team has been established to assess and implement the standard.

In May 2017, the FASB issued ASU No. 2017-09, “Compensation- Stock Compensation (Topic 718).” The ASU provides clarity about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The ASU is effective for all entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. The Corporation is in the process of evaluating the impact of this standard but does not expect this standard to have a material impact on its results of operations, financial position and liquidity.

In August 2017, the FASB issued ASU No. 2017-12, “Derivatives and Hedging (Topic 815).” The ASU intends to better align an entity’s risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. It also expands and refines hedge accounting for both nonfinancial and financial risk components and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item. The ASU is effective for public companies for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Corporation adopted the standard in the fourth quarter of 2017 with no material impact on its results of operations, financial position and liquidity.

Note 2 – Cash and Cash Equivalents

Cash and due from banks was approximately $17.1 million and $14.6 million at December 31, 2017 and 2016, respectively. Required reserves in the form of either vault cash or deposits held at the FRB were $16.8 million and $6.4 million at December 31, 2017 and 2016, respectively. FRB balances were $17.7 million and $40.9 million at December 31, 2017 and 2016, respectively, and are included in short-term investments on the Consolidated Balance Sheets. Short-term investments, considered cash equivalents, were $35.5 million and $62.9 million at December 31, 2017 and 2016, respectively.

Note 3 – Securities

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

	As of December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Available-for-sale:				
U.S. government agency obligations - government-sponsored enterprises	$999	$ 1	$ —	$1,000
Municipal obligations	9,494	2	(82)	9,414
Collateralized mortgage obligations - government issued	22,313	149	(213)	22,249
Collateralized mortgage obligations - government-sponsored enterprises	91,480	24	(1,199)	90,305
Other securities	3,040	3	(6)	3,037
	$127,326	$ 179	$ (1,500)	$126,005

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Explanation of Responses:

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	As of December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Available-for-sale:				
U.S. government agency obligations - government-sponsored enterprises	$6,298	$ 7	$ (10)	$6,295
Municipal obligations	8,246	2	(92)	8,156
Asset-backed securities	1,116	—	(35)	1,081
Collateralized mortgage obligations - government issued	30,936	423	(146)	31,213
Collateralized mortgage obligations - government-sponsored enterprises	99,865	252	(969)	99,148
	$146,461	$ 684	$ (1,252)	$145,893

The amortized cost and fair value of securities held-to-maturity and the corresponding amounts of gross unrealized gains and losses were as follows:

	As of December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Held-to-maturity:				
U.S. government agency obligations - government-sponsored enterprises	$1,499	$ —	$ (9)	$1,490
Municipal obligations	21,680	176	(34)	21,822
Collateralized mortgage obligations - government issued	9,072	1	(130)	8,943
Collateralized mortgage obligations - government-sponsored enterprises	5,527	—	(86)	5,441
	$37,778	$ 177	$ (259)	$37,696

	As of December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Held-to-maturity:				
U.S. government agency obligations - government-sponsored enterprises	$1,497	$ 2	$ (5)	$1,494
Municipal obligations	21,173	62	(78)	21,157
Collateralized mortgage obligations - government issued	9,148	17	(38)	9,127
Collateralized mortgage obligations - government-sponsored enterprises	6,794	6	(58)	6,742
	$38,612	$ 87	$ (179)	$38,520

U.S. government agency obligations - government-sponsored enterprises represent securities issued by the Federal Home Loan Bank (“FHLB”), the Federal Home Loan Mortgage Corporation (“FHLMC”) and Federal National Mortgage Association (“FNMA”). Municipal obligations include securities issued by various municipalities located primarily within the State of Wisconsin and are primarily general obligation bonds that are tax-exempt in nature. Asset-backed securities represent securities issued by the Student Loan Marketing Association (“SLMA”) which are 97% guaranteed by the U.S. government. Collateralized mortgage obligations - government issued represent securities guaranteed by the Government National Mortgage Association. Collateralized mortgage obligations - government-sponsored enterprises include securities guaranteed by the

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FHLMC and the FNMA. Other securities represent certificates of deposit of insured banks and savings institutions with an original maturity greater than three months.

Total proceeds and gross realized gains and losses from sales of securities available-for-sale were as follows:

	For the Year Ended December 31,		
	2017	2016	2015
	(In Thousands)		
Gross gains	$92	$10	$ —
Gross losses	(495)	—	—
Net (losses) gains on sale of available-for-sale securities	$(403)	$10	$ —
Proceeds from sale of available-for-sale securities	$40,144	$5,227	$ —

At December 31, 2017 and 2016, securities with a fair value of $2.8 million and $22.4 million, respectively, were pledged to secure interest rate swap contracts, outstanding FHLB advances and additional FHLB availability.
The amortized cost and fair value of securities by contractual maturity at December 31, 2017 are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay certain obligations with or without call or prepayment penalties.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In Thousands)			
Due in one year or less	$5,090	$5,080	$1,499	$1,490
Due in one year through five years	13,506	13,416	10,673	10,704
Due in five through ten years	35,941	35,642	15,713	15,734
Due in over ten years	72,789	71,867	9,893	9,768
	$127,326	$126,005	$37,778	$37,696

The tables below show the Corporation’s gross unrealized losses and fair value of available-for-sale investments, aggregated by investment category and length of time that individual investments were in a continuous loss position at December 31, 2017 and 2016. At December 31, 2017, the Corporation held 141 available-for-sale securities that were in an unrealized loss position. Such securities have not experienced credit rating downgrades; however, they have primarily declined in value due to the current interest rate environment. At December 31, 2017, the Corporation held 50 available-for-sale securities that had been in a continuous unrealized loss position for twelve months or greater. The Corporation also has not specifically identified available-for-sale securities in a loss position that it intends to sell in the near term and does not believe that it will be required to sell any such securities. The Corporation reviews its securities on a quarterly basis to monitor its exposure to other-than-temporary impairment. Consideration is given to such factors as the length of time and extent to which the security has been in an unrealized loss position, changes in security ratings and an evaluation of the present value of expected future cash flows, if necessary. Based on the Corporation’s evaluation, it is expected that the Corporation will recover the entire amortized cost basis of each security. Accordingly, no other-than-temporary impairment was recorded in the Consolidated Statements of Income for the years ended December 31, 2017 and 2016.

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A summary of unrealized loss information for securities available-for-sale, categorized by security type and length of time for which the security has been in a continuous unrealized loss position, follows:

	December 31, 2017					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
Available-for-sale:						
Municipal obligations	$6,132	$ 43	$2,755	$ 39	$8,887	$ 82
Collateralized mortgage obligations - government issued	7,104	40	6,715	173	13,819	213
Collateralized mortgage obligations - government-sponsored enterprises	59,256	476	28,004	723	87,260	1,199
Other securities	1,954	6	—	—	1,954	6
	$74,446	$ 565	$37,474	$ 935	$111,920	$ 1,500

	December 31, 2016					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
Available-for-sale:						
U.S. government agency obligations - government-sponsored enterprises	$1,991	$ 10	$—	$ —	$1,991	$ 10
Municipal obligations	7,207	89	406	3	7,613	92
Asset-backed securities	—	—	1,081	35	1,081	35
Collateralized mortgage obligations - government issued	10,552	130	493	16	11,045	146
Collateralized mortgage obligations - government-sponsored enterprises	54,843	931	1,819	38	56,662	969
	$74,593	$ 1,160	$3,799	$ 92	$78,392	$ 1,252

The tables below show the Corporation's gross unrealized losses and fair value of held-to-maturity investments, aggregated by investment category and length of time that individual investments were in a continuous loss position at December 31, 2017 and 2016. At December 31, 2017, the Corporation held 36 held-to-maturity securities that were in an unrealized loss position. Such securities have not experienced credit rating downgrades; however, they have primarily declined in value due to the current interest rate environment. There were 16 held-to-maturity securities that had been in a continuous loss position for twelve months or greater as of December 31, 2017. It is expected that the Corporation will recover the entire amortized cost basis of each held-to-maturity security based upon an evaluation of aforementioned factors. Accordingly, no other-than-temporary impairment was recorded in the Consolidated Statements of Income for the years ended December 31, 2017 and 2016.

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A summary of unrealized loss information for securities held-to-maturity, categorized by security type and length of time for which the security has been in a continuous unrealized loss position, follows:

	December 31, 2017					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
Held-to-maturity:						
U.S. government agency obligations - government-sponsored enterprises	$—	$ —	$1,499	$ 9	$1,499	$ 9
Municipal obligations	3,723	27	259	7	3,982	34
Collateralized mortgage obligations - government issued	3,868	51	4,677	79	8,545	130
Collateralized mortgage obligations - government-sponsored enterprises	—	—	5,527	86	5,527	86
	$7,591	$ 78	$11,962	$ 181	$19,553	$ 259

	December 31, 2016					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
Held-to-maturity:						
U.S. government agency obligations - government-sponsored enterprises	$1,000	$ 5	$ —	$ —	$1,000	$ 5
Municipal obligations	9,472	78	—	—	9,472	78
Collateralized mortgage obligations - government issued	6,980	38	—	—	6,980	38
Collateralized mortgage obligations - government-sponsored enterprises	4,682	58	—	—	4,682	58
	$22,134	$ 179	$ —	$ —	$22,134	$ 179

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Note 4 – Loan and Lease Receivables, Impaired Loans and Leases and Allowance for Loan and Lease Losses

Loan and lease receivables consist of the following:

	December 31, 2017	December 31, 2016
	(In Thousands)	
Commercial real estate:		
Commercial real estate — owner occupied	$200,387	$ 176,459
Commercial real estate — non-owner occupied	470,236	473,158
Land development	40,154	56,638
Construction	125,157	101,206
Multi-family	136,978	92,762
1-4 family	44,976	45,651
Total commercial real estate	1,017,888	945,874
Commercial and industrial	429,002	450,298
Direct financing leases, net	30,787	30,951
Consumer and other:		
Home equity and second mortgages	7,262	8,412
Other	18,099	16,329
Total consumer and other	25,361	24,741
Total gross loans and leases receivable	1,503,038	1,451,864
Less:		
Allowance for loan and lease losses	18,763	20,912
Deferred loan fees	1,443	1,189
Loans and leases receivable, net	$1,482,832	$ 1,429,763

As of December 31, 2017 and 2016, the total amount of the Corporation's ownership of SBA loans on the Consolidated Balance Sheets comprised of the following:

	December 31, 2017	December 31, 2016
	(In Thousands)	
Retained, unguaranteed portions of sold SBA loans	$30,071	$ 30,418
Other SBA loans[1]	22,254	30,617
Total SBA loans	$52,325	$ 61,035

(1) Primarily consisted of SBA Express loans and impaired SBA loans that were repurchased from the secondary market, all of which were not saleable as of December 31, 2017 and December 31, 2016, respectively.

As of December 31, 2017 and 2016, $11.1 million and $5.5 million of SBA loans were considered impaired, respectively.

Loans transferred to third parties consist of the guaranteed portions of SBA loans which the Corporation sold in the secondary market, participation interests in other originated loans and residential real estate loans. The total principal amount of the guaranteed portions of SBA loans sold during the year ended December 31, 2017 and 2016 was $16.5 million and $41.2 million, respectively. Each of the transfers of these financial assets met the qualifications for sale accounting, and therefore, all of the loans transferred during the year ended December 31, 2017 and 2016 have been derecognized in the Consolidated Financial Statements. The guaranteed portions of SBA loans were transferred at their fair value and the related gain was recognized upon the transfer as non-interest income in the Consolidated Financial Statements. The total outstanding balance of sold SBA loans at December 31, 2017 and 2016 was $100.3 million and $105.1 million, respectively.

The total principal amount of transferred participation interests in other originated commercial loans during the year ended December 31, 2017 and 2016 was $63.6 million and $17.6 million, respectively, all of which were treated as sales and

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derecognized under the applicable accounting guidance at the time of transfer. No gain or loss was recognized on participation interests in other originated loans as they were transferred at or near the date of loan origination and the payments received for servicing the portion of the loans participated represents adequate compensation. The total outstanding balance of these transferred loans at December 31, 2017 and 2016 was $106.4 million and $102.7 million, respectively. As of December 31, 2017 and 2016, the total amount of the Corporation's partial ownership of these transferred loans on the Consolidated Balance Sheets was $181.7 million and $106.1 million, respectively. No loans in this participation portfolio were considered impaired as of December 31, 2017 and 2016. The Corporation does not share in the participant's portion of any potential charge-offs. The total amount of loan participations purchased on the Consolidated Balance Sheets as of December 31, 2017 and 2016 was $650,000 and $1.2 million, respectively.

The Corporation also previously sold residential real estate loans, servicing released, in the secondary market. The total principal amount of residential real estate loans sold during the year ended December 31, 2017 and 2016 was $1.6 million and $26.3 million, respectively. Each of the transfers of these financial assets met the qualifications for sale accounting, and therefore all of the loans transferred have been derecognized in the Consolidated Financial Statements. The loans were transferred at their fair value and the related gain was recognized as non-interest income upon the transfer in the Consolidated Financial Statements.

Certain of the Corporation's executive officers, directors and their related interests are loan clients of the Bank. As of December 31, 2017 and 2016, loans aggregating approximately $10.5 million and $6.3 million, respectively, were outstanding to such parties. New loans granted to such parties during the years ended December 31, 2017 and 2016 were approximately $8.3 million and $673,000 and repayments on such loans were approximately $4.1 million and $1.3 million, respectively. These loans were made in the ordinary course of business and on substantially the same terms as those prevailing at the time for comparable loans not related to the lender. None of these loans were considered impaired as of December 31, 2017 or 2016.

The following tables illustrate ending balances of the Corporation's loan and lease portfolio, including impaired loans by class of receivable, and considering certain credit quality indicators as of December 31, 2017 and 2016:

	December 31, 2017				
	Category				
	I	II	III	IV	Total
	(Dollars in Thousands)				
Commercial real estate:					
Commercial real estate — owner occupied	$166,018	$18,442	$8,850	$7,077	$200,387
Commercial real estate — non-owner occupied	441,246	27,854	1,102	34	470,236
Land development	36,470	1,057	—	2,627	40,154
Construction	121,528	757	—	2,872	125,157
Multi-family	136,978	—	—	—	136,978
1-4 family	34,598	7,735	1,220	1,423	44,976
Total commercial real estate	936,838	55,845	11,172	14,033	1,017,888
Commercial and industrial	341,875	25,344	49,453	12,330	429,002
Direct financing leases, net	28,866	342	1,579	—	30,787
Consumer and other:					
Home equity and second mortgages	7,250	8	—	4	7,262
Other	17,745	—	—	354	18,099
Total consumer and other	24,995	8	—	358	25,361
Total gross loans and leases receivable	$1,332,574	$81,539	$62,204	$26,721	$1,503,038
Category as a % of total portfolio	88.66 %	5.42 %	4.14 %	1.78 %	100.00 %

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	December 31, 2016				
	Category				
	I	II	III	IV	Total
	(Dollars in Thousands)				
Commercial real estate:					
Commercial real estate — owner occupied	$142,704	$20,294	$11,174	$2,287	$176,459
Commercial real estate — non-owner occupied	447,895	20,933	2,721	1,609	473,158
Land development	52,082	823	293	3,440	56,638
Construction	93,510	3,154	1,624	2,918	101,206
Multi-family	87,418	1,937	3,407	—	92,762
1-4 family	38,504	3,144	1,431	2,572	45,651
Total commercial real estate	862,113	50,285	20,650	12,826	945,874
Commercial and industrial	348,201	42,949	46,675	12,473	450,298
Direct financing leases, net	29,351	1,600	—	—	30,951
Consumer and other:					
Home equity and second mortgages	8,271	121	12	8	8,412
Other	15,714	—	11	604	16,329
Total consumer and other	23,985	121	23	612	24,741
Total gross loans and leases receivable	$1,263,650	$94,955	$67,348	$25,911	$1,451,864
Category as a % of total portfolio	87.04 %	6.54 %	4.64 %	1.78 %	100.00 %

Credit underwriting primarily through a committee process is a key component of the Corporation’s operating philosophy. Commercial lenders have relatively low individual lending authority limits, and thus a significant portion of the Corporation’s new credit extensions require approval from a loan approval committee regardless of the type of loan or lease, asset quality grade of the credit, amount of the credit or the related complexities of each proposal.

Each credit is evaluated for proper risk rating upon origination, at the time of each subsequent renewal, upon receipt and evaluation of updated financial information from the Corporation’s borrowers or as other circumstances dictate. The Corporation uses a nine grade risk rating system to monitor the ongoing credit quality of its loans and leases. The risk rating grades follow a consistent definition and are then applied to specific loan types based on the nature of the loan. Each risk rating is subjective and, depending on the size and nature of the credit, subject to various levels of review and concurrence on the stated risk rating. In addition to its nine grade risk rating system, the Corporation groups loans into four loan and related risk categories which determine the level and nature of review by management.

Category I — Loans and leases in this category are performing in accordance with the terms of the contract and generally exhibit no immediate concerns regarding the security and viability of the underlying collateral, financial stability of the borrower, integrity or strength of the borrowers’ management team or the industry in which the borrower operates. The Corporation monitors Category I loans and leases through payment performance, continued maintenance of its personal relationships with such borrowers and continued review of such borrowers’ compliance with the terms of their respective agreements.

Category II — Loans and leases in this category are beginning to show signs of deterioration in one or more of the Corporation’s core underwriting criteria such as financial stability, management strength, industry trends or collateral values. Management will place credits in this category to allow for proactive monitoring and resolution with the borrower to possibly mitigate the area of concern and prevent further deterioration or risk of loss to the Corporation. Category II loans are considered performing but are monitored frequently by the assigned business development officer and by subcommittees of the Bank’s Loan Committee.

Category III — Loans and leases in this category are identified by management as warranting special attention. However, the balance in this category is not intended to represent the amount of adversely classified assets held by the Bank. Category III loans and leases generally exhibit undesirable characteristics, such as evidence of adverse financial trends and conditions, managerial problems, deteriorating economic conditions within the related industry or evidence of adverse public filings and may exhibit collateral shortfall positions. Management continues to believe that it will collect all contractual principal and interest in accordance with the original terms of the contracts relating to the loans and leases in this category, and therefore

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Category III loans are considered performing with no specific reserves established for this category. Category III loans are monitored by management and subcommittees of the Bank's Loan Committee on a monthly basis and the Bank's Boards of Directors at each of their regularly scheduled meetings.

Category IV — Loans and leases in this category are considered to be impaired. Impaired loans and leases have been placed on non-accrual as management has determined that it is unlikely that the Bank will receive the contractual principal and interest in accordance with the original terms of the agreement. Impaired loans are individually evaluated to assess the need for the establishment of specific reserves or charge-offs. When analyzing the adequacy of collateral, the Corporation obtains external appraisals at least annually for impaired loans and leases. External appraisals are obtained from the Corporation's approved appraiser listing and are independently reviewed to monitor the quality of such appraisals. To the extent a collateral shortfall position is present, a specific reserve or charge-off will be recorded to reflect the magnitude of the impairment. Loans and leases in this category are monitored by management and subcommittees of the Bank's Loan Committee on a monthly basis and the Bank's Boards of Directors at each of their regularly scheduled meetings.

Utilizing regulatory classification terminology, the Corporation identified \$32.7 million and \$34.3 million of loans and leases as Substandard as of December 31, 2017 and 2016, respectively. The Corporation identified \$4.7 million of loans and leases as Doubtful as of December 31, 2017. No loans and leases were considered Doubtful as of December 31, 2016. Additionally, no loans were considered Special Mention or Loss as of either December 31, 2017 or 2016. The population of Substandard loans is a subset of Category III and Category IV loans.

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The delinquency aging of the loan and lease portfolio by class of receivable as of December 31, 2017 and 2016 was as follows:

	December 31, 2017					
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans and Leases
	(Dollars in Thousands)					
Accruing loans and leases						
Commercial real estate:						
Owner occupied	$—	$—	$—	$—	$193,366	$193,366
Non-owner occupied	—	—	—	—	470,202	470,202
Land development	—	—	—	—	37,528	37,528
Construction	—	196	—	196	122,089	122,285
Multi-family	—	—	—	—	136,978	136,978
1-4 family	496	—	—	496	43,319	43,815
Commercial and industrial	1,169	197	—	1,366	415,315	416,681
Direct financing leases, net	—	—	—	—	30,787	30,787
Consumer and other:						
Home equity and second mortgages	106	—	—	106	7,156	7,262
Other	—	—	—	—	17,745	17,745
Total	1,771	393	—	2,164	1,474,485	1,476,649
Non-accruing loans and leases						
Commercial real estate:						
Owner occupied	405	—	4,836	5,241	1,780	7,021
Non-owner occupied	—	—	—	—	34	34
Land development	—	—	—	—	2,626	2,626
Construction	—	—	2,872	2,872	—	2,872
Multi-family	—	—	—	—	—	—
1-4 family	—	—	948	948	213	1,161
Commercial and industrial	782	—	7,349	8,131	4,190	12,321
Direct financing leases, net	—	—	—	—	—	—
Consumer and other:						
Home equity and second mortgages	—	—	—	—	—	—
Other	—	—	345	345	9	354
Total	1,187	—	16,350	17,537	8,852	26,389
Total loans and leases						
Commercial real estate:						
Owner occupied	405	—	4,836	5,241	195,146	200,387
Non-owner occupied	—	—	—	—	470,236	470,236
Land development	—	—	—	—	40,154	40,154
Construction	—	196	2,872	3,068	122,089	125,157
Multi-family	—	—	—	—	136,978	136,978
1-4 family	496	—	948	1,444	43,532	44,976
Commercial and industrial	1,951	197	7,349	9,497	419,505	429,002
Direct financing leases, net	—	—	—	—	30,787	30,787
Consumer and other:						
Home equity and second mortgages	106	—	—	106	7,156	7,262
Other	—	—	345	345	17,754	18,099

Total	$2,958	$393	$16,350	$19,701	$1,483,337	$1,503,038
Percent of portfolio	0.20 %	0.03 %	1.09 %	1.32 %	98.68 %	100.00 %

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	December 31, 2016					
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans and Leases
	(Dollars in Thousands)					
Accruing loans and leases						
Commercial real estate:						
Owner occupied	$—	$—	$—	$—	$174,236	$174,236
Non-owner occupied	—	—	—	—	471,549	471,549
Land development	—	—	—	—	53,198	53,198
Construction	—	—	—	—	98,288	98,288
Multi-family	—	—	—	—	92,762	92,762
1-4 family	75	—	—	75	43,639	43,714
Commercial and industrial	55	468	—	523	437,312	437,835
Direct financing leases, net	—	—	—	—	30,951	30,951
Consumer and other:						
Home equity and second mortgages	—	—	—	—	8,412	8,412
Other	—	—	—	—	15,725	15,725
Total	130	468	—	598	1,426,072	1,426,670
Non-accruing loans and leases						
Commercial real estate:						
Owner occupied	—	—	1,183	1,183	1,040	2,223
Non-owner occupied	—	—	—	—	1,609	1,609
Land development	—	—	—	—	3,440	3,440
Construction	2,482	—	436	2,918	—	2,918
Multi-family	—	—	—	—	—	—
1-4 family	—	—	1,240	1,240	697	1,937
Commercial and industrial	3,345	168	6,740	10,253	2,210	12,463
Direct financing leases, net	—	—	—	—	—	—
Consumer and other:						
Home equity and second mortgages	—	—	—	—	—	—
Other	186	—	378	564	40	604
Total	6,013	168	9,977	16,158	9,036	25,194
Total loans and leases						
Commercial real estate:						
Owner occupied	—	—	1,183	1,183	175,276	176,459
Non-owner occupied	—	—	—	—	473,158	473,158
Land development	—	—	—	—	56,638	56,638
Construction	2,482	—	436	2,918	98,288	101,206
Multi-family	—	—	—	—	92,762	92,762
1-4 family	75	—	1,240	1,315	44,336	45,651
Commercial and industrial	3,400	636	6,740	10,776	439,522	450,298
Direct financing leases, net	—	—	—	—	30,951	30,951
Consumer and other:						
Home equity and second mortgages	—	—	—	—	8,412	8,412
Other	186	—	378	564	15,765	16,329
Total	$6,143	$636	$9,977	$16,756	$1,435,108	$1,451,864
Percent of portfolio	0.42 %	0.04 %	0.69 %	1.15 %	98.85 %	100.00 %

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The Corporation's total impaired assets consisted of the following at December 31, 2017 and 2016, respectively.

	December 31, 2017	December 31, 2016
	(In Thousands)	
Non-accrual loans and leases		
Commercial real estate:		
Commercial real estate — owner occupied	$7,021	$ 2,223
Commercial real estate — non-owner occupied	34	1,609
Land development	2,626	3,440
Construction	2,872	2,918
Multi-family	—	—
1-4 family	1,161	1,937
Total non-accrual commercial real estate	13,714	12,127
Commercial and industrial	12,321	12,463
Direct financing leases, net	—	—
Consumer and other:		
Home equity and second mortgages	—	—
Other	354	604
Total non-accrual consumer and other loans	354	604
Total non-accrual loans and leases	26,389	25,194
Foreclosed properties, net	1,069	1,472
Total non-performing assets	27,458	26,666
Performing troubled debt restructurings	332	717
Total impaired assets	$27,790	$ 27,383

	December 31, 2017	December 31, 2016
Total non-accrual loans and leases to gross loans and leases	1.76 %	1.74 %
Total non-performing assets to total gross loans and leases plus foreclosed properties, net	1.83	1.83
Total non-performing assets to total assets	1.53	1.50
Allowance for loan and lease losses to gross loans and leases	1.25	1.44
Allowance for loan and lease losses to non-accrual loans and leases	71.10	83.00

As of December 31, 2017 and 2016, $8.8 million and $12.8 million of the non-accrual loans and leases were considered troubled debt restructurings, respectively. There were no unfunded commitments associated with troubled debt restructured loans and leases as of December 31, 2017.

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The following table provides the number of loans modified in a troubled debt restructuring and the pre- and post-modification recorded investment by class of receivable as of December 31, 2017 and 2016:

	As of December 31, 2017			As of December 31, 2016		
	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
	(Dollars in Thousands)					
Commercial real estate:						
Commercial real estate — owner occupied	3	$ 1,065	$ 880	3	$ 1,065	$ 930
Commercial real estate — non-owner occupied	1	158	34	1	158	39
Land development	1	5,745	2,626	1	5,745	3,440
Construction	—	—	—	2	331	314
Multi-family	—	—	—	—	—	—
1-4 family	8	627	307	11	1,391	1,393
Commercial and industrial	10	8,759	4,951	10	8,094	7,058
Consumer and other:						
Home equity and second mortgage	2	37	4	1	37	8
Other	2	2,094	345	1	2,076	378
Total	27	$ 18,485	$ 9,147	30	$ 18,897	$ 13,560

All loans and leases modified as a troubled debt restructuring are measured for impairment. The nature and extent of the impairment of restructured loans, including those which have experienced a default, is considered in the determination of an appropriate level of the allowance for loan and lease losses.

As of December 31, 2017 and 2016, the Corporation’s troubled debt restructurings grouped by type of concession were as follows:

	As of December 31, 2017		As of December 31, 2016	
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
	(Dollars in Thousands)			
Commercial real estate:				
Extension of term	—	$ —	1	$ 8
Interest rate concession	12	3,793	1	52
Combination of extension of term and interest rate concession	1	54	16	6,056
Commercial and industrial:				
Combination of extension of term and interest rate concession	10	4,951	10	7,058
Consumer and other:				
Extension of term	1	328	1	378
Combination of extension of term and interest rate concession	3	21	1	8
Total	27	$ 9,147	30	$ 13,560

During the year ended December 31, 2017, four commercial and industrial loans and one consumer loan totaling $4.4 million and $17,000, respectively, were modified to a troubled debt restructuring. During the year ended December 31, 2016, three commercial and industrial loans and one commercial real estate loan totaling $675,000 and $441,000, respectively, were modified to a troubled debt restructuring.

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There were no loans and leases modified in a troubled debt restructuring during the previous 12 months which subsequently defaulted during the year ended December 31, 2017.

The following represents additional information regarding the Corporation's impaired loans and leases, including performing troubled debt restructurings, by class:

	As of and for the Year Ended December 31, 2017						
	Recorded Investment	Unpaid Principal Balance	Impairment Reserve	Average Recorded Investment(1)	Foregone Interest Income	Interest Income Recognized	Net Foregone Interest Income
	(In Thousands)						
With no impairment reserve recorded:							
Commercial real estate:							
Owner occupied	$7,077	$7,077	$ —	$ 5,549	$ 613	$ —	$ 613
Non-owner occupied	34	75	—	1,830	97	226	(129)
Land development	2,627	5,297	—	3,092	84	—	84
Construction	—	—	—	2,000	134	214	(80)
Multi-family	—	—	—	1	—	—	—
1-4 family	1,423	1,706	—	2,146	53	7	46
Commercial and industrial	5,465	6,502	—	3,634	858	7	851
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	4	3	—	7	—	—	—
Other	345	1,011	—	365	59	—	59
Total	16,975	21,671	—	18,624	1,898	454	1,444
With impairment reserve recorded:							
Commercial real estate:							
Owner occupied	—	—	—	—	—	—	—
Non-owner occupied	—	—	—	—	—	—	—
Land development	—	—	—	—	—	—	—
Construction	2,872	2,872	415	2,252	158	—	158
Multi-family	—	—	—	—	—	—	—
1-4 family	—	—	—	—	—	—	—
Commercial and industrial	6,865	8,813	4,067	12,288	639	—	639
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	—	—	—	—	—	—	—
Other	9	9	9	—	—	—	—
Total	9,746	11,694	4,491	14,540	797	—	797
Total:							
Commercial real estate:							
Owner occupied	7,077	7,077	—	5,549	613	—	613
Non-owner occupied	34	75	—	1,830	97	226	(129)
Land development	2,627	5,297	—	3,092	84	—	84
Construction	2,872	2,872	415	4,252	292	214	78
Multi-family	—	—	—	1	—	—	—
1-4 family	1,423	1,706	—	2,146	53	7	46
Commercial and industrial	12,330	15,315	4,067	15,922	1,497	7	1,490
Direct financing leases, net	—	—	—	—	—	—	—

Consumer and other:							
Home equity and second mortgages	4	3	—	7	—	—	—
Other	354	1,020	9	365	59	—	59
Grand total	$26,721	$33,365	$ 4,491	$ 33,164	$ 2,695	$ 454	$ 2,241

(1) Average recorded investment is calculated primarily using daily average balances.

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	As of and for the Year Ended December 31, 2016						
	Recorded Investment	Unpaid Principal Balance	Impairment Reserve	Average Recorded Investment[1]	Foregone Interest Income	Interest Income Recognized	Net Foregone Interest Income
	(In Thousands)						
With no impairment reserve recorded:							
Commercial real estate:							
Owner occupied	$1,788	$1,788	$ —	$ 3,577	$ 328	$ 118	$ 210
Non-owner occupied	1,609	1,647	—	1,318	91	79	12
Land development	3,440	6,111	—	3,898	107	—	107
Construction	436	438	—	291	20	—	20
Multi-family	—	—	—	—	1	134	(133)
1-4 family	2,379	2,379	—	2,755	125	94	31
Commercial and industrial	1,307	1,307	—	709	79	62	17
Direct financing leases, net	—	—	—	6	—	—	—
Consumer and other:							
Home equity and second mortgages	8	8	—	307	16	127	(111)
Other	378	1,044	—	510	71	—	71
Total	11,345	14,722	—	13,371	838	614	224
With impairment reserve recorded:							
Commercial real estate:							
Owner occupied	499	499	70	111	28	—	28
Non-owner occupied	—	—	—	—	—	—	—
Land development	—	—	—	—	—	—	—
Construction	2,482	2,482	1,790	834	45	—	45
Multi-family	—	—	—	—	—	—	—
1-4 family	193	199	39	203	5	—	5
Commercial and industrial	11,166	11,166	3,700	8,448	701	—	701
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	—	—	—	—	—	—	—
Other	226	226	—	19	—	—	—
Total	14,566	14,572	5,599	9,615	779	—	779
Total:							
Commercial real estate:							
Owner occupied	2,287	2,287	70	3,688	356	118	238
Non-owner occupied	1,609	1,647	—	1,318	91	79	12
Land development	3,440	6,111	—	3,898	107	—	107
Construction	2,918	2,920	1,790	1,125	65	—	65
Multi-family	—	—	—	—	1	134	(133)
1-4 family	2,572	2,578	39	2,958	130	94	36
Commercial and industrial	12,473	12,473	3,700	9,157	780	62	718
Direct financing leases, net	—	—	—	6	—	—	—
Consumer and other:							
Home equity and second mortgages	8	8	—	307	16	127	(111)
Other	604	1,270	—	529	71	—	71
Grand total	$25,911	$29,294	$ 5,599	$ 22,986	$ 1,617	$ 614	$ 1,003

(1) Average recorded investment is calculated primarily using daily average balances.

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	As of and for the Year Ended December 31, 2015						
	Recorded Investment	Unpaid Principal Balance	Impairment Reserve	Average Recorded Investment(1)	Foregone Interest Income	Interest Income Recognized	Net Foregone Interest Income
	(In Thousands)						
With no impairment reserve recorded:							
Commercial real estate:							
Owner occupied	$2,164	$2,164	$ —	$ 712	$ 53	$ 12	$ 41
Non-owner occupied	2,314	2,355	—	962	25	—	25
Land development	4,413	7,083	—	4,333	133	—	133
Construction	120	120	—	474	—	—	—
Multi-family	2	369	—	10	27	—	27
1-4 family	2,423	2,486	—	1,604	82	4	78
Commercial and industrial	2,546	2,590	—	544	172	6	166
Direct financing leases, net	38	38	—	4	—	—	—
Consumer and other:							
Home equity and second mortgages	500	500	—	390	23	63	(40)
Other	655	1,321	—	688	82	—	82
Total	15,175	19,026	—	9,721	597	85	512
With impairment reserve recorded:							
Commercial real estate:							
Owner occupied	814	814	20	215	7	2	5
Non-owner occupied	—	—	—	—	—	—	—
Land development	—	—	—	—	—	—	—
Construction	397	397	48	34	—	—	—
Multi-family	—	—	—	—	—	—	—
1-4 family	945	950	173	605	34	—	34
Commercial and industrial	6,603	6,603	847	810	102	—	102
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	99	99	25	58	10	—	10
Other	—	—	—	—	—	—	—
Total	8,858	8,863	1,113	1,722	153	2	151
Total:							
Commercial real estate:							
Owner occupied	2,978	2,978	20	927	60	14	46
Non-owner occupied	2,314	2,355	—	962	25	—	25
Land development	4,413	7,083	—	4,333	133	—	133
Construction	517	517	48	508	—	—	—
Multi-family	2	369	—	10	27	—	27
1-4 family	3,368	3,436	173	2,209	116	4	112
Commercial and industrial	9,149	9,193	847	1,354	274	6	268
Direct financing leases, net	38	38	—	4	—	—	—
Consumer and other:							
Home equity and second mortgages	599	599	25	448	33	63	(30)
Other	655	1,321	—	688	82	—	82
Grand total	$24,033	$27,889	$ 1,113	$ 11,443	$ 750	$ 87	$ 663

(1) Average recorded investment is calculated primarily using daily average balances.

The difference between the recorded investment of loans and leases and the unpaid principal balance of $6.6 million, $3.4 million and $3.9 million as of December 31, 2017, 2016 and 2015, respectively, represents partial charge-offs of loans and leases resulting from losses due to the appraised value of the collateral securing the loans and leases being below the carrying values of the loans and leases. Impaired loans and leases also included $332,000, $717,000 and $1.7 million of loans as of December 31, 2017, 2016 and 2015, respectively, that were performing troubled debt restructurings, and although not on non-

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accrual, were reported as impaired due to the concession in terms. When a loan is placed on non-accrual, interest accrual is discontinued and previously accrued but uncollected interest is deducted from interest income. Cash payments collected on non-accrual loans are first applied to such loan’s principal. Foregone interest represents the interest that was contractually due on the loan but not received or recorded. To the extent the amount of principal on a non-accrual loan is fully collected and additional cash is received, the Corporation will recognize interest income.

To determine the level and composition of the allowance for loan and lease losses, the Corporation categorizes the portfolio into segments with similar risk characteristics. First, the Corporation evaluates loans and leases for potential impairment classification. The Corporation analyzes each loan and lease determined to be impaired on an individual basis to determine a specific reserve based upon the estimated value of the underlying collateral for collateral-dependent loans, or alternatively, the present value of expected cash flows. The Corporation applies historical trends from established risk factors to each category of loans and leases that has not been individually evaluated for the purpose of establishing the general portion of the allowance.

A summary of the activity in the allowance for loan and lease losses by portfolio segment is as follows:

	As of and for the Year Ended December 31, 2017			
	Commercial Real Estate	Commercial and Industrial	Consumer and Other	Total
	(Dollars in Thousands)			
Beginning balance	$12,384	$ 7,970	$ 558	$20,912
Charge-offs	(127)	(8,621)	(92)	(8,840)
Recoveries	153	323	43	519
Net recoveries (charge-offs)	26	(8,298)	(49)	(8,321)
Provision for credit losses	(2,279)	8,553	(102)	6,172
Ending balance	$10,131	$ 8,225	$ 407	$18,763

	As of and for the Year Ended December 31, 2016			
	Commercial Real Estate	Commercial and Industrial	Consumer and Other	Total
	(Dollars in Thousands)			
Beginning balance	$11,220	$ 4,387	$ 709	$16,316
Charge-offs	(1,194)	(2,273)	(127)	(3,594)
Recoveries	274	91	7	372
Net charge-offs	(920)	(2,182)	(120)	(3,222)
Provision for credit losses	2,084	5,765	(31)	7,818
Ending balance	$12,384	$ 7,970	$ 558	$20,912

	As of and for the Year Ended December 31, 2015			
	Commercial Real Estate	Commercial and Industrial	Consumer and Other	Total
	(Dollars in Thousands)			
Beginning balance	$8,619	$ 5,492	$ 218	$14,329
Charge-offs	(793)	(711)	(9)	(1,513)
Recoveries	104	6	4	114
Net charge-offs	(689)	(705)	(5)	(1,399)
Provision for credit losses	3,290	(400)	496	3,386
Ending balance	$11,220	$ 4,387	$ 709	$16,316

The following tables provide information regarding the allowance for loan and lease losses and balances by type of allowance methodology.

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	As of December 31, 2017			
	Commercial Real Estate	Commercial and Industrial	Consumer and Other	Total
	(Dollars in Thousands)			
Allowance for loan and lease losses:				
Collectively evaluated for impairment	$9,716	$ 4,158	$ 398	$14,272
Individually evaluated for impairment	415	4,067	9	4,491
Loans acquired with deteriorated credit quality	—	—	—	—
Total	$10,131	$ 8,225	$ 407	$18,763
Loans and lease receivables:				
Collectively evaluated for impairment	$1,003,855	$ 447,459	$ 25,003	1,476,317
Individually evaluated for impairment	13,506	12,324	358	26,188
Loans acquired with deteriorated credit quality	527	6	—	533
Total	$1,017,888	$ 459,789	$ 25,361	$1,503,038

	As of December 31, 2016			
	Commercial Real Estate	Commercial and Industrial	Consumer and Other	Total
	(Dollars in Thousands)			
Allowance for loan and lease losses:				
Collectively evaluated for impairment	$10,485	$ 4,270	$ 558	$15,313
Individually evaluated for impairment	1,899	3,700	—	5,599
Loans acquired with deteriorated credit quality	—	—	—	—
Total	$12,384	$ 7,970	$ 558	$20,912
Loans and lease receivables:				
Collectively evaluated for impairment	$933,048	$ 468,776	$ 24,129	$1,425,953
Individually evaluated for impairment	11,222	12,452	612	24,286
Loans acquired with deteriorated credit quality	1,604	21	—	1,625
Total	$945,874	$ 481,249	$ 24,741	$1,451,864

The Corporation’s net investment in direct financing leases consists of the following:

	As of December 31,	
	2017	2016
	(In Thousands)	
Minimum lease payments receivable	$24,898	$26,096
Estimated unguaranteed residual values in leased property	8,312	7,625
Initial direct costs	76	106
Unearned lease and residual income	(2,499)	(2,876)
Investment in commercial direct financing leases	$30,787	$30,951

There were no impairments of residual value of leased property during the years ended December 31, 2017, 2016 and 2015.

The Corporation leases equipment under direct financing leases expiring in future years. Some of these leases provide for additional rents based on use in excess of a stipulated minimum number of hours and generally allow the lessees to purchase the equipment for fair value at the end of the lease term.

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Future aggregate maturities of minimum lease payments to be received are as follows:

(In Thousands)	
Maturities during year ended December 31,	
2018	$8,866
2019	6,635
2020	4,632
2021	2,301
2022	1,393
Thereafter	1,071
	$24,898

Note 5 – Premises and Equipment

A summary of premises and equipment at December 31, 2017 and 2016 is as follows:

	As of December 31,	
	2017	2016
	(In Thousands)	
Land	$—	$650
Building and leasehold improvements	2,550	3,019
Furniture and equipment	6,442	5,366
	8,992	9,035
Less: accumulated depreciation	(5,836)	(5,263)
Total premises and equipment, net	$3,156	$3,772

Depreciation expense was $744,000, $767,000 and $746,000 for the years ended December 31, 2017, 2016 and 2015, respectively.

Note 6 – Goodwill and Other Intangible Assets

Goodwill

Goodwill is not amortized, but is subject to impairment tests on an annual basis and more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount (including goodwill). At December 31, 2017 and 2016, the Corporation had goodwill of $10.7 million, which was related to the acquisition of Alterra in 2014.

The Corporation conducted its annual impairment test on July 1, 2017, utilizing a qualitative assessment, and concluded that it was more likely than not that FBB-KC’s estimated fair value exceeded its carrying value. Due to management’s decision to temporarily slow SBA production while investments to enhance the platform were made and the slower than expected ramp up of production during the fourth quarter, management elected to again assess goodwill on November 30, 2017 by comparing the fair value of FBB-KC to its carrying value. The fair value of the reporting unit was determined based on a weighted average of the income and market approaches. The income approach establishes fair value based on estimated future cash flows of the reporting unit, discounted by an estimated weighted-average cost of capital developed using the capital asset pricing model, which reflects the overall level of inherent risk of the reporting unit. The income approach uses our projections of financial performance for a four-year period and includes assumptions about future revenue growth rates, operating margins and terminal values. The market approach establishes fair value by applying cash flow multiples to the respective reporting unit’s operating performance. The multiples are derived from other publicly traded companies that are similar but not identical from an operational and economic standpoint.

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Based on this assessment, there was no evidence of goodwill impairment as of November 30, 2017. Management also assessed external and internal qualitative factors through December 31, 2017 and determined no changes to factors occurred that would negatively impact the goodwill test.

Other Intangible Assets

The Corporation has intangible assets that are amortized consisting of loan servicing rights and core deposit intangibles.

Loan servicing rights are recognized upon sale of the guaranteed portions of SBA loans with servicing rights retained. When SBA loans are sold, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Loan servicing assets are subsequently measured using the amortization method, which requires servicing rights to be amortized into interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. For the years ended December 31, 2017, 2016 and 2015, loan servicing asset amortization totaled $388,000, $639,000 and $197,000, respectively.

The estimated fair value of the Corporation's loan servicing asset was $1.8 million and $1.9 million as of December 31, 2017 and 2016, respectively. The Corporation periodically reviews this portfolio for impairment and engages a third-party valuation firm to assess the fair value of the overall servicing rights portfolio.

The core deposit intangible has a finite life and is amortized by the straight-line method over a period of seven years. The net book value of the core deposit intangible was $147,000 and $202,000 as of December 31, 2017 and 2016, respectively. For the years ended December 31, 2017, 2016 and 2015, amortization totaled $55,000, $62,000 and $71,000, respectively

Note 7 – Other Assets

The Corporation is a limited partner in several limited partnership investments. The Corporation is not the general partner, does not have controlling ownership and is not the primary beneficiary in any of these limited partnerships and thus, the limited partnerships have not been consolidated. These investments are accounted for using the equity method of accounting and are evaluated for impairment at the end of each reporting period.

Historic Rehabilitation Tax Credits

In 2015, the Corporation invested in a development entity through BOC, a wholly-owned subsidiary of FBB, to acquire, rehabilitate and operate a historic building in Madison, Wisconsin. At December 31, 2017 and 2016, the net carrying value of the investment was $174,000. The Corporation contributed an additional $2.8 million to the project in 2016. During 2016, the Corporation recognized $3.8 million in historic tax credits related to this investment and $3.3 million in impairment to the underlying investment.

In 2016, the Corporation also invested in a development entity through Mitchell Street, a wholly-owned subsidiary of FBB, to rehabilitate a historic building in Milwaukee, Wisconsin. At December 31, 2017 and 2016, the net carrying value of the investment was $570,000 and $563,000, respectively. The Corporation contributed an additional $4.9 million to the project in 2017. During 2017, the Corporation recognized $3.0 million in federal historic tax credits related to this investment and $2.3 million in impairment to the underlying investment. The Corporation also sold the state historic tax credits associated with the investment to a third parted for a pre-tax gain of $210,000.

In 2017, the Corporation also invested in a development entity through FBB Tax Credit, a wholly-owned subsidiary of FBB, to rehabilitate a historic building in Kenosha, Wisconsin. At December 31, 2017, the net carrying value of the investment was $417,000. The aggregate capital contributions to the project will depend upon the final amount of the certified project costs, but are expected to approximate $2.1 million. The credits will be taken when the project is placed in service and are subject to a five-year recapture period.

New Market Tax Credits

The Corporation invested in a community development entity ("CDE") through Rimrock Road, a wholly-owned subsidiary of FBB, to develop and operate a real estate project located in a low-income community. At December 31, 2017 and 2016, Rimrock Road had one CDE investment with a net carrying value of $6.6 million and $7.1 million respectively. The investment provides federal new market tax credits over the seven year compliance period through 2020. The remaining federal new market tax credit to be utilized over a maximum of seven years was $1.4 million as of December 31, 2017. The Corporation’s use of the federal new market tax credit during the year ended December 31, 2017 and 2016 was $450,000 and $375,000, respectively.

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Other Investments

The Corporation has an equity investment in Aldine Capital Fund, LP, a mezzanine fund, of $904,000 and $883,000 recorded as of December 31, 2017 and 2016, respectively. The Corporation's equity investment in Aldine Capital Fund II, LP, also a mezzanine fund, totaled $3.4 million and $3.1 million as of December 31, 2017 and 2016, respectively. The Corporation's share of these partnerships' income included in the Consolidated Statements of Income for the years ended December 31, 2017 and 2016 was $354,000 and $790,000, respectively.

The Corporation is the sole owner of $315,000 of common securities issued by Trust II. The purpose of Trust II was to complete the sale of $10.0 million of 10.50% fixed rate preferred securities. Trust II, a wholly owned subsidiary of the Corporation, is not consolidated into the financial statements of the Corporation. The investment in Trust II of $315,000 as of December 31, 2017 and 2016 is included in accrued interest receivable and other assets.

A summary of accrued interest receivable and other assets as of December 31, 2017 and 2016 was as follows:

	December 31, 2017	December 31, 2016
	(In Thousands)	
Accrued interest receivable	$5,019	$ 4,677
Net deferred tax asset	2,584	4,052
Investment in historic development entities	1,161	737
Investment in a CDE	6,591	7,106
Investment in limited partnerships	4,261	3,963
Investment in Trust II	315	315
Fair value of interest rate swaps	942	352
Prepaid expenses	3,091	3,074
Other assets	5,884	4,331
Total accrued interest receivable and other assets	$29,848	$ 28,607

Note 8 – Deposits

The composition of deposits at December 31, 2017 and 2016 is as follows:

	December 31, 2017			December 31, 2016		
	Balance	Average Balance	Average Rate	Balance	Average Balance	Average Rate
	(Dollars in Thousands)					
Non-interest-bearing transaction accounts	$277,445	$230,907	— %	$252,638	$246,182	— %
Interest-bearing transaction accounts	217,625	226,540	0.59	183,992	169,571	0.27
Money market accounts	515,077	583,241	0.47	627,090	642,784	0.48
Certificates of deposit	76,199	56,667	1.00	58,454	65,608	0.90
Wholesale deposits	307,985	361,712	1.70	416,681	467,826	1.62
Total deposits	$1,394,331	$1,459,067	0.74	$1,538,855	$1,591,971	0.74

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A summary of annual maturities of certificates of deposit outstanding and wholesale deposits at December 31, 2017 is as follows:

(In Thousands)	
Maturities during the year ended December 31,	
2018	$171,972
2019	74,808
2020	86,122
2021	21,482
2022	4,813
Thereafter	24,987
	$384,184

Deposits include approximately $13.4 million and $8.9 million of certificates of deposit and wholesale deposits which are denominated in amounts of $250,000 or more at December 31, 2017 and 2016, respectively.

Note 9 – FHLB Advances, Other Borrowings and Junior Subordinated Notes

The composition of borrowed funds at December 31, 2017 and 2016 is as follows:

	December 31, 2017			December 31, 2016		
	Balance	Weighted Average Balance	Weighted Average Rate	Balance	Weighted Average Balance	Weighted Average Rate
	(Dollars in Thousands)					
Federal funds purchased	$—	$66	1.22 %	$—	$178	0.92 %
FHLB advances	183,500	105,276	1.40	33,578	14,485	0.97
Line of credit	10	328	3.64	1,010	2,079	3.26
Other borrowings(1)	675	1,241	14.50	2,590	1,739	7.64
Subordinated notes payable	23,713	23,161	6.93	22,498	22,467	7.13
Junior subordinated notes	10,019	10,011	11.11	10,004	9,997	11.07
	$217,917	$140,083	3.14	$69,680	$50,945	6.03
Short-term borrowings	$37,010			$20,588		
Long-term borrowings	180,907			49,092		
	$217,917			$69,680		

(1) Weighted average rate of other borrowings reflects the cost of prepaying a secured borrowing during the second quarter of 2017.

The Corporation has a $388.2 million FHLB line of credit available for advances and open line borrowings which is collateralized by mortgage-related securities, unencumbered first mortgage loans and secured small business loans as noted below. At December 31, 2017, $204.7 million of this line remained unused. There were no advances outstanding on the Corporation's open line at December 31, 2017 and 2016. There were $183.5 million of term FHLB advances outstanding at December 31, 2017 with stated fixed interest rates ranging from 1.20% to 2.42% compared to $33.6 million of term FHLB advances outstanding at December 31, 2016 with stated fixed interest rate ranging from 0.83% to 4.43%. The term FHLB advances outstanding at December 31, 2017 are due at various dates through August 2024.

The Corporation is required to maintain as collateral, mortgage-related securities and unencumbered first mortgage loans and secured small business loans in its portfolio aggregating at least the amount of outstanding advances from the FHLB. Loans totaling approximately $388.2 million and $326.4 million were pledged as collateral at December 31, 2017 and 2016, respectively. Collateralized mortgage obligations totaling approximately $20.7 million were pledged as collateral for FHLB advances at December 31, 2016.

The Corporation has a senior line of credit with a third-party financial institution of $10.5 million. As of December 31, 2017, the line of credit carried an interest rate of LIBOR + 2.75% with an interest rate floor of 3.125% that matured on February 19, 2018 and had certain performance debt covenants of which the Corporation was in compliance. The Corporation pays a commitment fee on this senior line of credit. For the years ended December 31, 2017 and 2016 the Corporation incurred

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$13,000 additional interest expense due to this fee. On February 19, 2018, the credit line was renewed for one additional year with pricing terms of LIBOR + 2.75% with an interest rate floor of 3.125% and a maturity date of February 20, 2019. As of December 31, 2017, the outstanding balance on the line of credit was $10,000.

The Corporation has subordinated notes payable. At December 31, 2017, the amount of subordinated notes payable outstanding was $23.7 million, which qualified for Tier 2 capital. At December 31, 2017, $15.0 million bore a fixed interest rate of 6.50% with a maturity date of September 21, 2024 and $9.1 million bore a fixed interest rate of 6.00% with a maturity date of April 15, 2027. There are no debt covenants on the subordinated notes payable. The Corporation may, at its option, redeem the notes, in whole or part, at any time after the fifth anniversary of issuance. As of December 31, 2017, $377,000 of debt issuance costs remain in the subordinated notes payable balance.

In September 2008, Trust II completed the sale of $10.0 million of 10.50% fixed rate trust preferred securities (“Preferred Securities”). Trust II also issued common securities of $315,000. Trust II used the proceeds from the offering to purchase $10.3 million of 10.50% junior subordinated notes (“Notes”) of the Corporation. The Preferred Securities are mandatorily redeemable upon the maturity of the Notes on September 26, 2038. The Preferred Securities qualify under the risk-based capital guidelines as Tier 1 capital for regulatory purposes. Per the provisions of the Dodd-Frank Act, bank holding companies with total assets of less than $15 billion are not required to phase out trust preferred securities as an element of Tier 1 capital as other, larger institutions must. The Corporation used the proceeds from the sale of the Notes for general corporate purposes including providing additional capital to its subsidiaries. As of December 31, 2017, $296,000 of debt issuance costs remain reflected in junior subordinated notes on the Consolidated Balance Sheets.

The Corporation has the right to redeem the Notes at each interest payment date on or after September 26, 2013. The Corporation also has the right to redeem the Notes, in whole but not in part, after the occurrence of certain special events. Special events are limited to: (1) a change in capital treatment resulting in the inability of the Corporation to include the Notes in Tier 1 capital, (2) a change in laws or regulations that could require Trust II to register as an investment company under the Investment Company Act of 1940, as amended; and (3) a change in laws or regulations that would require Trust II to pay income tax with respect to interest received on the Notes or, prohibit the Corporation from deducting the interest payable by the Corporation on the Notes or result in greater than a de minimis amount of taxes for Trust II.

Note 10 – Regulatory Capital

The Corporation and the Bank are subject to various regulatory capital requirements administered by Federal and the State of Wisconsin banking agencies. Failure to meet minimum capital requirements can result in certain mandatory, and possibly additional discretionary actions on the part of regulators, that if undertaken, could have a direct material effect on the Bank’s assets, liabilities and certain off-balance-sheet items as calculated under regulatory practices. The Corporation’s and the Bank’s capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. The Corporation regularly reviews and updates, when appropriate, its Capital and Liquidity Action Plan, which is designed to help ensure appropriate capital adequacy, to plan for future capital needs and to ensure that the Corporation serves as a source of financial strength to the Bank. The Corporation’s and the Bank’s Boards of Directors and management teams adhere to the appropriate regulatory guidelines on decisions which affect their respective capital positions, including but not limited to, decisions relating to the payment of dividends and increasing indebtedness.

As a bank holding company, the Corporation’s ability to pay dividends is affected by the policies and enforcement powers of the Board of Governors of the Federal Reserve system (the “Federal Reserve”). Federal Reserve guidance urges financial institutions to strongly consider eliminating, deferring or significantly reducing dividends if: (i) net income available to common shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividend; (ii) the prospective rate of earnings retention is not consistent with the bank holding company’s capital needs and overall current and prospective financial condition; or (iii) the bank holding company will not meet, or is in danger of not meeting, its minimum regulatory capital ratios. Management intends, when appropriate under regulatory guidelines, to consult with the Federal Reserve Bank of Chicago and provide it with information on the Corporation’s then-current and prospective earnings and capital position in advance of declaring any cash dividends. As a Wisconsin corporation, the Corporation is subject to the limitations of the

Wisconsin Business Corporation Law, which prohibit the Corporation from paying dividends if such payment would: (i) render the Corporation unable to pay its debts as they become due in the usual course of business, or (ii) result in the Corporation's assets being less than the sum of its total liabilities plus the amount needed to satisfy the preferential rights upon dissolution of any stockholders with preferential rights superior to those stockholders receiving the dividend.

The Bank is also subject to certain legal, regulatory and other restrictions on their ability to pay dividends to the Corporation. As a bank holding company, the payment of dividends by the Bank to the Corporation is one of the sources of funds the Corporation could use to pay dividends, if any, in the future and to make other payments. Future dividend decisions by the

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Bank and the Corporation will continue to be subject to compliance with various legal, regulatory and other restrictions as defined from time to time.

Qualitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios of Total Common Equity Tier 1 and Tier 1 capital to risk-weighted assets and of Tier 1 capital to adjusted total assets. These risk-based capital requirements presently address credit risk related to both recorded and off-balance-sheet commitments and obligations.

In July 2013, the FRB and the FDIC approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks. These rules are applicable to all financial institutions that are subject to minimum capital requirements, including federal and state banks and savings and loan associations, as well as bank and savings and loan holding companies other than "small bank holding companies" (generally non-publicly traded bank holding companies with consolidated assets of less than $1 billion). Under the final rules, minimum requirements increased for both the quantity and quality of capital held by the Corporation. The rules include a new Common Equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0%, require a minimum ratio of Total Capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. The rules also permit banking organizations with less than $15 billion in assets to retain, through a one-time election, the past treatment for accumulated other comprehensive income, which did not affect regulatory capital. The Corporation elected to retain this treatment, which reduces the volatility of regulatory capital ratios. A new capital conservation buffer, comprised of Common Equity Tier 1 capital, was also established above the regulatory minimum capital requirements. This capital conservation buffer will be phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and will increase each subsequent year by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019.

As of December 31, 2017, both the Corporation's and the Bank's capital levels remained characterized as well capitalized under the new rules. The following table summarizes both the Corporation's and Bank's capital ratios and the ratios required by their federal regulators at December 31, 2017:

	Actual		Minimum Required for Capital Adequacy Purposes		For Capital Adequacy Purposes Plus Capital Conservation Buffer		Minimum Required to Be Well Capitalized Under Prompt Corrective Action Requirements	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in Thousands)							
As of December 31, 2017								
Total capital (to risk-weighted assets)								
Consolidated	$214,501	11.98%	$ 143,219	8.00 %	$165,597	9.250%	N/A	N/A
First Business Bank	207,986	11.66	142,736	8.00	165,038	9.250	$ 178,420	10.00 %
Tier 1 capital (to risk-weighted assets)								
Consolidated	$169,176	9.45	$ 107,414	6.00	$129,792	7.250%	N/A	N/A
First Business Bank	186,374	10.45	107,052	6.00	129,354	7.250	$ 142,736	8.00
Common equity tier 1 capital (to risk-weighted assets)								
Consolidated	$159,157	8.89	$ 80,561	4.50	$102,939	5.750%	N/A	N/A
First Business Bank	186,374	10.45	80,289	4.50	102,591	5.750	$ 115,973	6.50
Tier 1 leverage capital (to adjusted assets)								
Consolidated	$169,176	9.54	$ 70,920	4.00	$70,920	4.00 %	N/A	N/A

First Business Bank	186,374	10.56	70,617	4.00	70,617	4.00	$ 88,272	5.00

The following table summarizes both the Corporation’s and the Corporation’s legacy bank charters’ ratios and the ratios required by their federal regulators at December 31, 2016:

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	Actual		Minimum Required for Capital Adequacy Purposes		For Capital Adequacy Purposes Plus Capital Conservation Buffer		Minimum Required to Be Well Capitalized Under Prompt Corrective Action Requirements	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in Thousands)							
As of December 31, 2016								
Total capital (to risk-weighted assets)								
Consolidated	$204,117	11.74 %	$ 139,101	8.00 %	$149,968	8.625 %	N/A	N/A
First Business Bank	147,811	11.55	102,362	8.00	110,360	8.625	$ 127,953	10.00 %
First Business Bank – Milwaukee	24,347	11.02	17,680	8.00	19,062	8.625	22,101	10.00
Alterra Bank	31,699	13.27	19,106	8.00	20,599	8.625	23,882	10.00
Tier 1 capital (to risk-weighted assets)								
Consolidated	$160,964	9.26 %	$ 104,326	6.00 %	$115,193	6.625 %	N/A	N/A
First Business Bank	134,208	10.49	76,772	6.00	84,769	6.625	$ 102,362	8.00 %
First Business Bank – Milwaukee	22,323	10.10	13,260	6.00	14,642	6.625	17,680	8.00
Alterra Bank	28,685	12.01	14,329	6.00	15,822	6.625	19,106	8.00
Common equity tier 1 capital (to risk-weighted assets)								
Consolidated	$150,960	8.68 %	$ 78,244	4.50 %	$89,111	5.125 %	N/A	N/A
First Business Bank	134,208	10.49	57,579	4.50	65,576	5.125	$ 83,170	6.50 %
First Business Bank – Milwaukee	22,323	10.10	9,945	4.50	11,327	5.125	14,365	6.50
Alterra Bank	28,685	12.01	10,747	4.50	12,240	5.125	15,524	6.50
Tier 1 leverage capital (to adjusted assets)								
Consolidated	$160,964	9.07 %	$ 70,985	4.00 %	$70,985	4.00 %	N/A	N/A
First Business Bank	134,208	10.40	51,600	4.00	51,600	4.00	$ 64,500	5.00 %
First Business Bank – Milwaukee	22,323	9.15	9,758	4.00	9,758	4.00	12,198	5.00
Alterra Bank	28,685	10.58	10,842	4.00	10,842	4.00	13,552	5.00

The following table reconciles stockholders’ equity to federal regulatory capital at December 31, 2017 and 2016, respectively:

	As of December 31,	
	2017	2016
	(In Thousands)	
Stockholders’ equity of the Corporation	$169,278	$161,650
Net unrealized and accumulated losses on specific items	1,238	522
Disallowed servicing assets	(848)	(652)
Disallowed goodwill and other intangibles	(10,511)	(10,560)
Junior subordinated notes	10,019	10,004

Tier 1 capital	169,176	160,964
Allowable general valuation allowances and subordinated debt	45,325	43,153
Total capital	$214,501	$204,117

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Note 11 – Earnings per Common Share

Earnings per common share are computed using the two-class method. Basic earnings per common share are computed by dividing net income allocated to common shares by the weighted average number of shares outstanding during the applicable period, excluding outstanding participating securities. Participating securities include unvested restricted shares. Unvested restricted shares are considered participating securities because holders of these securities receive non-forfeitable dividends, or dividend equivalents, at the same rate as holders of the Corporation's common stock. Diluted earnings per share are computed by dividing net income allocated to common shares adjusted for reallocation of undistributed earnings of unvested restricted shares by the weighted average number of shares determined for the basic earnings per common share computation plus the dilutive effect of common stock equivalents using the treasury stock method.

	For the Year Ended December 31,		
	2017	2016	2015
	(Dollars in Thousands, Except Share Data)		
Basic earnings per common share			
Net income	$11,905	$ 14,909	$ 16,514
Less: earnings allocated to participating securities	162	219	273
Basic earnings allocated to common shareholders	$11,743	$ 14,690	$ 16,241
Weighted-average common shares outstanding, excluding participating securities	8,612,770	8,573,722	8,549,176
Basic earnings per common share	$1.36	$ 1.71	$ 1.90
Diluted earnings per common share			
Earnings allocated to common shareholders, diluted	$11,743	$ 14,690	$ 16,241
Weighted-average common shares outstanding, excluding participating securities	8,612,770	8,573,722	8,549,176
Dilutive effect of share-based awards	—	—	1,146
Weighted-average diluted common shares outstanding, excluding participating securities	8,612,770	8,573,722	8,550,322
Diluted earnings per common share	$1.36	$ 1.71	$ 1.90

Note 12 – Share-Based Compensation

The Corporation adopted the 2012 Equity Incentive Plan (the "Plan") during the quarter ended June 30, 2012. The Plan is administered by the Compensation Committee of the Board of Directors of the Corporation and provides for the grant of equity ownership opportunities through incentive stock options and nonqualified stock options, restricted stock, restricted stock units, dividend equivalent units, and any other type of award permitted by the Plan. As of December 31, 2017, 211,835 shares were available for future grants under the Plan. Shares covered by awards that expire, terminate or lapse will again be available for the grant of awards under the Plan. The Corporation may issue new shares and shares from its treasury stock for shares delivered under the Plan.

Restricted Stock

Under the Plan, the Corporation may grant restricted stock to plan participants, subject to forfeiture upon the occurrence of certain events until the dates specified in the participant's award agreement. While restricted stock is subject to forfeiture, restricted stock participants may exercise full voting rights and will receive all dividends and other distributions paid with respect to the restricted shares. Restricted stock units do not have voting rights and are provided dividend equivalents. The restricted stock granted under the Plan is typically subject to a vesting period. Compensation expense is recognized over the requisite service period of generally four years for the entire award on a straight-line basis. Upon vesting of restricted stock, the benefit of tax deductions in excess of recognized compensation expense is reflected as an income tax benefit in the Consolidated Statements of Income.

Restricted stock activity for the year ended December 31, 2017, 2016 and 2015 was as follows:

For the Year Ended December 31,

	2017		2016		2015	
	Number of Restricted Shares	Weighted Average Grant-Date Fair Value	Number of Restricted Shares	Weighted Average Grant-Date Fair Value	Number of Restricted Shares	Weighted Average Grant-Date Fair Value
Nonvested balance at beginning of year	116,245	$ 21.13	135,471	$ 20.13	154,998	$ 16.97
Granted	71,130	21.67	60,415	22.74	53,790	22.52
Vested	(48,550)	21.51	(56,090)	18.71	(64,874)	15.23
Forfeited	(8,384)	21.65	(23,551)	20.90	(8,443)	15.03
Nonvested balance as of end of year	130,441	21.43	116,245	21.13	135,471	20.13

As of December 31, 2017, the Corporation had $2.5 million of deferred unvested compensation expense, which the Corporation expects to recognize over a weighted-average period of approximately 2.9 years.
For the years ended December 31, 2017, 2016 and 2015, share-based compensation expense related to restricted stock included in the Consolidated Statements of Income was as follows:

	For the Year Ended December 31,		
	2017	2016	2015
	(In Thousands)		
Share-based compensation expense	$1,078	$994	$1,063

Note 13 – Employee Benefit Plans
The Corporation maintains a contributory 401(k) defined contribution plan covering substantially all employees. The Corporation matches 100% of amounts contributed by each participating employee, up to 3.0% of the employee's compensation. The Corporation may also make discretionary contributions up to an additional 6.0% of salary. Contributions are expensed in the period incurred and recorded in compensation expense in the Consolidated Statements of Income. The Corporation made a matching contribution of 3.0% to all eligible employees which totaled $626,000, $621,000 and $573,000 for the years ended December 31, 2017, 2016 and 2015, respectively. Discretionary contributions of 1.0%, or $183,000, 1.2%, or $207,000, and 3.3%, or $549,000, were made in 2017, 2016 and 2015, respectively.

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As of December 31, 2017, 2016 and 2015, the Corporation had a deferred compensation plan under which it provided contributions to supplement the retirement income of one executive. Under the terms of the plan, benefits to be received are generally payable within six months of the date of the termination of employment with the Corporation. The expense associated with the deferred compensation plan for the years ended December 31, 2017, 2016 and 2015 was $132,000, $124,000 and $116,000, respectively. The present value of future payments under the remaining plan of $1.1 million and $987,000 at December 31, 2017 and 2016, respectively, is included in accrued interest payable and other liabilities on the Consolidated Balance Sheets.
The Corporation owned life insurance policies on the life of the executive covered by the deferred compensation plan, which had cash surrender values and death benefits of approximately $2.4 million and $5.9 million, respectively, at December 31, 2017 and cash surrender values and death benefits of approximately $2.3 million and $5.9 million, respectively, at December 31, 2016. The remaining balance of the cash surrender value of bank-owned life insurance of $37.9 million and $36.7 million as of December 31, 2017 and 2016, respectively, is related to policies on a number of then-qualified individuals affiliated with the Bank.

Note 14 – Leases

The Corporation leases various office spaces, loan production offices and specialty financing production offices under noncancelable operating leases which expire on various dates through 2029. The Corporation’s total rent expense was $1.9 million, $1.8 million and $1.7 million for the years ended December 31, 2017, 2016 and 2015, respectively. Rent expense is recognized on a straight-line basis. The Corporation also leases other office equipment. Rental expense for these operating leases was $129,000, $136,000 and $109,000 for the years ended December 31, 2017, 2016 and 2015, respectively.

Future minimum lease payments for noncancelable operating leases for each of the five succeeding years and thereafter are as follows:

(In Thousands)	
2018	$1,648
2019	1,565
2020	1,556
2021	1,397
2022	1,410
Thereafter	4,820
	$12,396

Note 15 - Other Non-Interest Expense

A summary of other non-interest expenses for the years ended December 31, 2017, 2016 and 2015 is as follows:

	Year Ended December 31,		
	2017	2016	2015
	(In Thousands)		
General and administrative expenses	$1,905	$1,545	$1,759
Travel and other employee expenses	1,298	1,354	1,277
Partnership income [1]	—	(790)	(481)
Other expenses	12	129	347
Total other non-interest expense	$3,215	$2,238	$2,902

(1) Partnership income was recorded in other non-interest income for the year ended December 31, 2017.

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Explanation of Responses:

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Note 16 – Income Taxes

Income tax expense for the years ended December 31, 2017, 2016 and 2015 consists of the following:

	Year Ended December 31,		
	2017	2016	2015
	(In Thousands)		
Current:			
Federal	$ 131	$ 2,839	$ 5,881
State	448	425	1,338
Current tax expense	579	3,264	7,219
Deferred:			
Federal	1,657	(1,000)	1,036
State	90	(108)	122
Deferred tax expense (benefit)	1,747	(1,108)	1,158
Total income tax expense	$ 2,326	$ 2,156	$ 8,377

Deferred income tax assets and liabilities reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax basis. Deferred tax assets and liabilities are measured using enacted tax rates to apply to taxable income in the period in which the temporary differences are expected to be recovered or settled. Effective January 1, 2018, the enactment of the Tax Cuts and Jobs Act (the “Act”) reduced the corporate federal income tax rate to 21% from 35%, which required the Corporation to revalue its deferred taxes as of December 31, 2017. The revaluation resulted in a $629,000 reduction to the Corporation’s net deferred tax assets with a corresponding increase to income tax expense. Net deferred tax assets are included in accrued interest receivable and other assets in the Consolidated Balance Sheets.

On December 22, 2017, the SEC issued Staff Accounting Bulletin 118 (SAB 118), which provides guidance on accounting for the Act’s impact. SAB 118 provides a measurement period, which in no case should extend beyond one year from the Act’s enactment, during which a company acting in good faith may complete the accounting for the impacts of the Act. In accordance with SAB 118, a company will reflect the income tax effects of the Act in the reporting period in which the accounting is complete. The Corporation's accounting for the impact on its net deferred tax assets was based upon reasonable estimates of the tax effects of the Act; however, its estimates may change upon the finalization of its implementation and additional interpretive guidance from regulatory authorities. Among other things, the Corporation needs to obtain year-end partnership statements. While we currently do not expect our estimate to materially change, the Corporation will complete its accounting for the Act during 2018 as provided in SAB 118 and will reflect any adjustments to its provisional amounts as an adjustment to the provision for taxes in the reporting period in which the amounts are finally determined.

The significant components of the Corporation’s deferred tax assets and liabilities were as follows:

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	December 31, 2017	December 31, 2016
	(In Thousands)	
Deferred tax assets:		
Allowance for loan and lease losses	$4,795	$ 8,177
SBA recourse reserve	729	720
Excess book basis over tax basis for net assets acquired	96	336
Deferred compensation	482	951
State net operating loss carryforwards	615	548
Non-accrual loan interest	942	815
Capital loss carryforwards	21	32
Unrealized losses on securities	423	349
Other	354	394
Total deferred tax assets before valuation allowance	8,457	12,322
Valuation allowance	—	—
Total deferred tax assets	8,457	12,322
Deferred tax liabilities:		
Leasing and fixed asset activities	5,338	7,389
Loan servicing asset	471	780
Other	64	101
Total deferred tax liabilities	5,873	8,270
Net deferred tax asset	$2,584	$ 4,052

The tax effects of unrealized gains and losses on securities are components of other comprehensive income. A reconciliation of the change in net deferred tax assets to deferred tax expense as of December 31, 2017, 2016 and 2015 was as follows:

	December 31, 2017	December 31, 2016	December 31, 2015
	(In Thousands)		
Change in net deferred tax assets	$(1,468)	$ 1,419	$ (970)
Deferred taxes allocated to other comprehensive income	(279)	(311)	(188)
Deferred income tax (expense) benefit	$(1,747)	$ 1,108	$ (1,158)

Realization of the deferred tax asset over time is dependent upon the Corporation generating sufficient taxable earnings in future periods. In making the determination that the realization of the deferred tax was more likely than not, the Corporation considered several factors including its recent earnings history, its expected earnings in the future, appropriate tax planning strategies and expiration dates associated with operating loss carry forwards.

The Corporation had state net operating loss carryforwards of approximately $9.9 million and $10.7 million at December 31, 2017 and 2016, respectively, which can be used to offset future state taxable income. The Corporation believes it will be able to fully utilize its Wisconsin state net operating losses under this law and therefore no valuation allowance has been established as of December 31, 2017.

The provision for income taxes differs from that computed at the federal statutory corporate tax rate as follows:

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	Year Ended December 31,		
	2017	2016	2015
	(Dollars in Thousands)		
Income before income tax expense	$14,231	$17,065	$24,891
Tax expense at statutory federal rate of 35.00%, 35.00% and 34.42% applied to income before income tax expense, respectively	$4,981	$5,973	$8,568
State income tax, net of federal effect	511	206	968
Tax-exempt security and loan income, net of TEFRA adjustments	(1,045)	(1,114)	(879)
Bank-owned life insurance	(438)	(341)	(330)
Tax credits, net	(2,390)	(2,696)	(246)
Deferred tax revaluation adjustment	629	—	—
Other	78	128	296
Total income tax expense	$2,326	$2,156	$8,377
Effective tax rate	16.34 %	12.63 %	33.65 %

There were no uncertain tax positions outstanding as of December 31, 2017 and 2016. As of December 31, 2017, tax years remaining open for the State of Wisconsin tax were 2013 through 2016. Federal tax years that remained open were 2014 through 2016. As of December 31, 2017, there were also no unrecognized tax benefits that are expected to significantly increase or decrease within the next twelve months.

Note 17 – Derivative Financial Instruments

The Corporation offers interest rate swap products directly to qualified commercial borrowers. The Corporation economically hedges client derivative transactions by entering into offsetting interest rate swap contracts executed with a third party. Derivative transactions executed as part of this program are not designated as accounting hedge relationships and are marked-to-market through earnings each period. The derivative contracts have mirror-image terms, which results in the positions' changes in fair value primarily offsetting through earnings each period. The credit risk and risk of non-performance embedded in the fair value calculations is different between the dealer counterparties and the commercial borrowers which may result in a difference in the changes in the fair value of the mirror-image swaps. The Corporation incorporates credit valuation adjustments to appropriately reflect both its own non-performance risk and the counterparty's risk in the fair value measurements. When evaluating the fair value of its derivative contracts for the effects of non-performance and credit risk, the Corporation considered the impact of netting and any applicable credit enhancements such as collateral postings, thresholds and guarantees.

At December 31, 2017, the aggregate amortizing notional value of interest rate swaps with various commercial borrowers was $53.4 million. The Corporation receives fixed rates and pays floating rates based upon LIBOR on the swaps with commercial borrowers. These interest rate swaps mature between September 2018 and May 2034. Commercial borrower swaps are completed independently with each borrower and are not subject to master netting arrangements. These commercial borrower swaps were reported on the Consolidated Balance Sheets as a derivative asset of $942,000, included in accrued interest receivable and other assets as of December 31, 2017. In the event of default on a commercial borrower interest rate swap by the counterparty, a right of offset exists to allow for the commercial borrower to set off amounts due against the related commercial loan. As of December 31, 2017, no interest rate swaps were in default and therefore all values for the commercial borrower swaps are recorded on a gross basis on the Consolidated Balance Sheets.

At December 31, 2017, the aggregate amortizing notional value of interest rate swaps with dealer counterparties was also $53.4 million. The Corporation pays fixed rates and receives floating rates based upon LIBOR on the swaps with dealer counterparties. These interest rate swaps mature in September 2018 through May 2034. Dealer counterparty swaps were reported on the Consolidated Balance Sheets as a net derivative liability of $942,000, included in accrued interest payable and other liabilities as of December 31, 2017. The gross amount of dealer counterparty swaps was $942,000 as no right of offset existed with the dealer counterparty swaps as of December 31, 2017.

The table below provides information about the balance sheet location and fair value of the Corporation's derivative instruments to qualified commercial borrowers as of December 31, 2017 and 2016.

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	Interest Rate Swap Contracts			
	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
	(In Thousands)			
Derivatives not designated as hedging instruments				
December 31, 2017	Accrued interest receivable and other assets	$ 942	Accrued interest payable and other liabilities	$ 942
December 31, 2016	Accrued interest receivable and other assets	$ 352	Accrued interest payable and other liabilities	$ 352

These derivative instruments held by the Corporation for the year ended December 31, 2017 were not considered hedging instruments. All changes in the fair value of these instruments are recorded in other non-interest income. Given the mirror-image terms of the outstanding derivative portfolio, the change in fair value for the years ended December 31, 2017, 2016 and 2015 had an insignificant impact to the Consolidated Statements of Income.

During the fourth quarter of 2017, the Corporation also entered into an interest rate swap to manage interest rate risk and reduce the cost of match-funding certain long-term fixed rate loans. This derivative contract involves the receipt of floating rate interest from a counterparty in exchange for the Corporation making fixed-rate payments over the life of the agreement, without the exchange of the underlying notional value. This instrument is designated as a cash flow hedge as the receipt of floating rate interest from the counterparty is used to manage interest rate risk associated with forecasted issuances of short-term FHLB advances. The change in the fair value of this hedging instrument is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the period that the hedged transaction affects earnings.

As of December 31, 2017, the Corporation had one outstanding interest rate swap designated as a cash flow hedge with an aggregate notional value of $22.0 million. This interest rate swap matures in December 2027. A pre-tax unrealized loss of $122,000 was recognized in accumulated other comprehensive income for the year ended December 31, 2017 and there was no ineffective portion of this hedge. No interest rate swaps designated as cash flow hedges were outstanding during 2016.

Note 18 – 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 clients. These financial instruments include commitments to extend credit and standby letters of credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the Consolidated Financial Statements. The contract amounts reflect the extent of involvement the Bank has in these particular classes of financial instruments.

In the event of non-performance, the Bank’s exposure to credit loss for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Bank uses the same credit policies in making commitments and conditional obligations as they do for instruments reflected in the Consolidated Financial Statements. An accrual for credit losses on financial instruments with off-balance-sheet risk would be recorded separate from any valuation account related to any such recognized financial instrument. As of December 31, 2017 and 2016, there were no accrued credit losses for financial instruments with off-balance-sheet risk.

Financial instruments whose contract amounts represent potential credit risk at December 31, 2017 and 2016, respectively, are as follows:

	At December 31,	
	2017	2016
	(In Thousands)	
Commitments to extend credit, primarily commercial loans	$497,993	$539,146
Standby letters of credit	13,845	11,771

Commitments to extend credit are agreements to lend to a client as long as there is no violation of any condition in the contract. Commitments generally have fixed expiration dates or other termination clauses and may have a fixed interest rate or a rate

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which varies with the prime rate or other market indices and may require payment of a fee. Since some commitments expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements of the Bank. The Bank evaluates the creditworthiness of each client on a case-by-case basis and generally extends credit only on a secured basis. Collateral obtained varies but consists primarily of commercial real estate, accounts receivable, inventory, equipment and securities. There is generally no market for commercial loan commitments, the fair value of which would approximate the present value of any fees expected to be received as a result of the commitment. These are not considered to be material to the financial statements.
Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a client to a third party. Generally, standby letters of credit expire within one year and are collateralized by accounts receivable, equipment, inventory and commercial properties. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to clients. The fair value of standby letters of credit is recorded as a liability when the standby letter of credit is issued. The fair value has been estimated to approximate the fees received by the Bank for issuance. The fees are recorded into income and the fair value of the guarantee is decreased ratably over the term of the standby letter of credit.

In the ordinary course of business, the Corporation sells the guaranteed portions of SBA loans, as well as participation interests in other originated loans, to third parties. The Corporation has a continuing involvement in each of the transferred lending arrangements by way of relationship management and servicing the loans, as well as being subject to normal and customary requirements of the SBA loan program and standard representations and warranties related to sold amounts. In the event of a loss resulting from default and a determination by the SBA that there is a deficiency in the manner in which the loan was originated, funded or serviced by the Corporation, the SBA may require the Corporation to repurchase the loan, deny its liability under the guaranty, reduce the amount of the guaranty, or, if it has already paid under the guaranty, seek recovery of the principal loss related to the deficiency from the Corporation. The Corporation must comply with applicable SBA regulations in order to maintain the guaranty. In addition, the Corporation retains the option to repurchase the sold guaranteed portion of an SBA loan if the loan defaults.

Management has assessed estimated losses inherent in the outstanding guaranteed portions of SBA loans sold in accordance with ASC 450, Contingencies, and determined a recourse reserve based on the probability of future losses for these loans to be $2.8 million and $1.8 million at December 31, 2017 and 2016, respectively, which is reported in accrued interest payable and other liabilities on the Consolidated Balance Sheets. During the years ended December 31, 2017 and 2016, a $2.2 million and $2.1 million recourse reserve provision was recorded, respectively.

The summary of the activity in the SBA recourse reserve for the year ended December 31, 2017 and 2016 is as follows:

	At December 31,	
	2017	2016
	(In Thousands)	
Balance at the beginning of the period	$1,750	$—
SBA recourse provision	2,240	2,068
Charge-offs, net	(1,141)	(318)
Balance at the end of the period	$2,849	$1,750

In the normal course of business, various legal proceedings involving the Corporation are pending. Management, based upon advice from legal counsel, does not anticipate any significant losses as a result of these actions. Management believes that any liability arising from any such proceedings currently existing or threatened will not have a material adverse effect on the Corporation's financial position, results of operations and cash flows.

Note 19 – Fair Value Disclosures
The Corporation determines the fair values of its financial instruments based on the fair value hierarchy established in ASC Topic 820, which requires an entity to maximize the use of observable inputs and minimize the use of

unobservable inputs when measuring fair value. Fair value is defined as the price that would be received in an orderly transaction that is not a forced liquidation or distressed sale at the measurement date and is based on exit prices. Fair value includes assumptions about risk, such as nonperformance risk in liability fair values, and is a market-based measurement, not an entity-specific measurement. The standard describes three levels of inputs that may be used to measure fair value.

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Level 1 — Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date.

Level 2 — Level 2 inputs are inputs, other than quoted prices included with Level 1, that are observable for the asset or liability either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 — Level 3 inputs are supported by little or no market activity and are significant to the fair value of the assets or liabilities.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Corporation's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

Assets and liabilities measured at fair value on a recurring basis, segregated by fair value hierarchy level, are summarized below:

	December 31, 2017 Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total
	(In Thousands)			
Assets:				
Securities available-for-sale:				
U.S. government agency obligations - government-sponsored enterprises	$ —	$1,000	$ —	$1,000
Municipal obligations	—	9,414	—	9,414
Collateralized mortgage obligations - government issued	—	22,249	—	22,249
Collateralized mortgage obligations - government-sponsored enterprises	—	90,305	—	90,305
Other securities	—	3,037	—	3,037
Interest rate swaps	—	942	—	942
Liabilities:				
Interest rate swaps	—	1,064	—	1,064

	December 31, 2016 Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total
	(In Thousands)			
Assets:				
Securities available-for-sale:				
U.S. government agency obligations - government-sponsored enterprises	$ —	$6,295	$ —	$6,295
Municipal obligations	—	8,156	—	8,156
Asset backed securities	—	1,081	—	1,081
Collateralized mortgage obligations - government issued	—	31,213	—	31,213
Collateralized mortgage obligations - government-sponsored enterprises	—	99,148	—	99,148
Interest rate swaps	—	352	—	352
Liabilities:				

Interest rate swaps	—352	—	352

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For assets and liabilities measured at fair value on a recurring basis, there were no transfers between the levels during the year ended December 31, 2017 or 2016 related to the above measurements.

Assets and liabilities measured at fair value on a non-recurring basis, segregated by fair value hierarchy, are summarized below:

	December 31, 2017 Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total
	(In Thousands)			
Impaired loans	$—	$10,063	$5,084	$15,147
Foreclosed properties	—	1,069	—	1,069

	December 31, 2016 Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total
	(In Thousands)			
Impaired loans	$—	$12,268	$1,097	$13,365
Foreclosed properties	—	1,472	—	1,472

Impaired loans were written down to the fair value of their underlying collateral less costs to sell of $15.1 million and $13.4 million at December 31, 2017 and 2016, respectively, through the establishment of specific reserves or by recording charge-offs when the carrying value exceeded the fair value of the underlying collateral of impaired loans. Valuation techniques consistent with the market approach, income approach or cost approach were used to measure fair value and primarily included observable inputs for the individual impaired loans being evaluated such as current appraisals, recent sales of similar assets or other observable market data, and are reflected within Level 2 of the hierarchy. In cases where an input is unobservable, specifically when discounts are applied to appraisal values to adjust such values to current market conditions or to reflect net realizable value, the impaired loan balance is reflected within Level 3 of the hierarchy. The quantification of unobservable inputs for Level 3 impaired loan values range from 15% - 21% as of the measurement date of December 31, 2017. The weighted average of those unobservable inputs was 18%. The majority of the impaired loans in the Level 3 category are considered collateral dependent loans or are supported by a SBA guaranty.

Foreclosed properties, upon initial recognition, are remeasured and reported at fair value through a charge-off to the allowance for loan and lease losses, if deemed necessary, based upon the fair value of the foreclosed property. The fair value of a foreclosed property, upon initial recognition, is estimated using a market approach or Level 2 inputs based on observable market data, typically a current appraisal, or Level 3 inputs based upon assumptions specific to the individual property or equipment. Level 3 inputs typically include unobservable inputs such as management applied discounts used to further reduce values to a net realizable value and may be used in situations when observable inputs become stale. Foreclosed property fair value inputs may transition to Level 1 upon receipt of an accepted offer for the sale of the related foreclosed property.

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Fair Value of Financial Instruments

The Corporation is required to disclose estimated fair values for its financial instruments. Fair value estimates, methods and assumptions, consistent with exit price concepts for fair value measurements, are set forth below:

	December 31, 2017				
	Carrying Amount	Fair Value			
		Total	Level 1	Level 2	Level 3
	(In Thousands)				
Financial assets:					
Cash and cash equivalents	$52,539	$52,539	$ 35,114	$17,425	$ —
Securities available-for-sale	126,005	126,005	—	126,005	—
Securities held-to-maturity	37,778	37,696	—	37,696	—
Loans held for sale	2,194	2,413	—	2,413	—
Loans and lease receivables, net	1,482,832	1,482,664	—	10,063	1,472,601
Bank-owned life insurance	40,323	40,323	40,323	—	—
Federal Home Loan Bank and Federal Reserve Bank stock	5,670	5,670	—	—	5,670
Accrued interest receivable	5,019	5,019	5,019	—	—
Interest rate swaps	942	942	—	942	—
Financial liabilities:					
Deposits	1,394,331	1,391,801	1,010,147	381,654	—
Federal Home Loan Bank advances and other borrowings	207,898	191,441	—	191,441	—
Junior subordinated notes	10,019	8,836	—	—	8,836
Accrued interest payable	2,095	2,095	2,095	—	—
Interest rate swaps	1,064	1,064	—	1,064	—
Off-balance-sheet items:					
Standby letters of credit	75	75	—	—	75

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	December 31, 2016				
	Carrying Amount	Fair Value			
		Total	Level 1	Level 2	Level 3
	(In Thousands)				
Financial assets:					
Cash and cash equivalents	$77,517	$77,517	$ 55,622	$21,895	$ —
Securities available-for-sale	145,893	145,893	—	145,893	—
Securities held-to-maturity	38,612	38,520	—	38,520	—
Loans held for sale	1,111	1,222	—	1,222	—
Loans and lease receivables, net	1,429,763	1,447,044	—	12,268	1,434,776
Bank-owned life insurance	39,048	39,048	—	39,048	—
Federal Home Loan Bank and Federal Reserve Bank stock	2,131	2,131	—	2,131	—
Accrued interest receivable	4,677	4,677	4,677	—	—
Interest rate swaps	352	352	—	352	—
Financial liabilities:					
Deposits	1,538,855	1,539,413	1,063,720	$475,693	—
Federal Home Loan Bank advances and other borrowings	59,676	60,893	—	60,893	—
Junior subordinated notes	10,004	9,072	—	—	9,072
Accrued interest payable	1,765	1,765	1,765	—	—
Interest rate swaps	352	352	—	352	—
Off-balance-sheet items:					
Standby letters of credit	58	58	—	—	58

Disclosure of fair value information about financial instruments, for which it is practicable to estimate that value, is required whether or not recognized in the Consolidated Balance Sheets. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Certain financial instruments and all non-financial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented do not necessarily represent the underlying value of the Corporation.

Cash and Cash Equivalents: The carrying amount reported for cash and due from banks and interest bearing deposits held by the Corporation approximates fair value because of its immediate availability and because it does not present unanticipated credit concerns. As of December 31, 2017 and 2016, the Corporation held $17.4 million and $20.3 million, respectively, of commercial paper. The fair value of commercial paper is classified as a Level 2 input due to the lack of available independent pricing sources.

Securities: The fair value measurements of investment securities are determined by a third-party pricing service which considers observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, trade execution data, market consensus prepayment speeds, credit information and the securities' terms and conditions, among other things. The fair value measurements are subject to independent verification by another pricing source on a quarterly basis to review for reasonableness. Any significant differences in pricing are reviewed with appropriate members of management who have the relevant technical expertise to assess the results. The Corporation has determined that these valuations are classified in Level 2 of the fair value hierarchy. When the independent pricing service does not provide a fair value measurement for a particular security, the Corporation will estimate the fair value based on specific information about each security. Fair values derived in this manner are classified in Level 3 of the fair value hierarchy.

Loans Held for Sale: Loans held for sale, which consist of the guaranteed portions of SBA loans, are carried at the lower of cost or estimated fair value. The estimated fair value is based on what secondary markets are currently offering for portfolios with similar characteristics.

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Loans and Lease Receivables, net: The fair value estimation process for the loan portfolio uses an exit price concept and reflects discounts that the Corporation believes are consistent with liquidity discounts in the market place. Fair values are estimated for portfolios of loans with similar financial characteristics. The fair value of performing and nonperforming loans is calculated by discounting scheduled and expected cash flows through the estimated maturity using estimated market rates that reflect the credit and interest rate risk inherent in the portfolio of loans and then applying a discount factor based upon the embedded credit risk of the loan and the fair value of collateral securing nonperforming loans when the loan is collateral dependent. The estimate of maturity is based on the Bank’s historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic and lending conditions. Significant unobservable inputs include, but are not limited to, discounts (investor yield premiums) applied to fair value calculations to further determine the exit price value of a portfolio of loans.

Federal Home Loan Bank and Federal Reserve Bank Stock: The carrying amount of FHLB and FRB stock equals its fair value because the shares may be redeemed by the FHLB and the FRB at their carrying amount of $100 per share.

Bank-Owned Life Insurance: The carrying amount of the cash surrender value of life insurance approximates its fair value as the carrying value represents the current settlement amount.

Accrued Interest Receivable and Accrued Interest Payable: The carrying amounts reported for accrued interest receivable and accrued interest payable approximate fair value because of their immediate availability and because they do not present unanticipated credit concerns.

Deposits: The fair value of deposits with no stated maturity, such as demand deposits and money market accounts, is equal to the amount payable on demand. The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the intangible value that results from the funding provided by deposit liabilities compared to borrowing funds in the market.

Borrowed Funds: Market rates currently available to the Corporation and Bank for debt with similar terms and remaining maturities are used to estimate fair value of existing debt.

Interest Rate Swaps: The carrying amount and fair value of existing derivative financial instruments are based upon independent valuation models, which use widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative contract. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The Corporation incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty’s nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Corporation considers the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts and guarantees.

Financial Instruments with Off-Balance-Sheet Risks: The fair value of the Corporation’s off-balance-sheet instruments is based on quoted market prices and fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the credit standing of the related counterparty. Commitments to extend credit and standby letters of credit are generally not marketable. Furthermore, interest rates on any amounts drawn under such commitments would generally be established at market rates at the time of the draw. Fair value would principally derive from the present value of fees received for those products.

Limitations: Fair value estimates are made at a discrete point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Corporation’s entire holding of a particular financial instrument. Because no market exists for a significant portion of the Corporation’s financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and are not considered in the estimates.

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Note 20 – Condensed Parent Only Financial Information

The following represents the condensed financial information of FBFS only:

Condensed Balance Sheets

	As of December 31,	
	2017	2016
	(In Thousands)	
Assets		
Cash and due from banks	$1,472	$127
Investments in subsidiaries, at equity	196,810	196,221
Leasehold improvements and equipment, net	2,067	1,605
Other assets	5,993	4,738
Total assets	$206,342	$202,691
Liabilities and Stockholders' Equity		
Borrowed funds	$33,742	$33,512
Other liabilities	3,322	7,529
Total liabilities	37,064	41,041
Stockholders' equity	169,278	161,650
Total liabilities and stockholders' equity	$206,342	$202,691

Condensed Statements of Income

	For the Year Ended December 31,		
	2017	2016	2015
	(In Thousands)		
Net interest expense	$2,744	$2,799	$2,777
Non-interest income			
Consulting and rental income from consolidated subsidiaries	19,139	16,036	13,398
Other	34	33	35
Total non-interest income	19,173	16,069	13,433
Non-interest expense	21,575	19,250	16,854
Loss before income tax benefit and equity in undistributed net income of consolidated subsidiaries	5,146	5,980	6,198
Income tax benefit	1,965	2,170	2,527
Loss before equity in undistributed net income of consolidated subsidiaries	3,181	3,810	3,671
Equity in undistributed net income of consolidated subsidiaries	15,086	18,719	20,185
Net income	$11,905	$14,909	$16,514

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Condensed Statements of Cash Flows

	For the Year Ended December 31,		
	2017	2016	2015
	(In Thousands)		
Operating activities			
Net income	$11,905	$14,909	$16,514
Adjustments to reconcile net income to net cash used in operating activities:			
Equity in undistributed earnings of consolidated subsidiaries	(15,086)	(18,719)	(20,185)
Share-based compensation	1,078	994	448
Excess tax benefit from share-based compensation	(37)	(83)	—
Net (decrease) increase in other liabilities	(4,170)	1,198	2,390
Other, net	(2,233)	(3,162)	(481)
Net cash used in operating activities	(8,543)	(4,863)	(1,314)
Investing activities			
Dividends received from subsidiaries	14,534	13,534	7,034
Capital contributions to subsidiaries	—	(3,500)	(3,000)
Net cash provided by investing activities	14,534	10,034	4,034
Financing activities			
Net (decrease) increase in short-term borrowed funds	(1,000)	(1,500)	1,500
Proceeds from issuance of subordinated notes payable	9,090	—	—
Repayment of subordinated notes payable	(7,875)	—	—
Proceeds from exercise of stock options	—	—	300
Purchase of treasury stock	(323)	(467)	(946)
Excess tax benefit from share-based compensation	—	—	162
Cash dividends paid	(4,538)	(4,176)	(3,816)
Net cash used in financing activities	(4,646)	(6,143)	(2,800)
Increase (decrease) in cash and cash equivalents	1,345	(972)	(80)
Cash and due from banks at the beginning of the period	127	1,099	1,179
Cash and due from banks at the end of the period	$1,472	$127	$1,099

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Note 21 – Condensed Quarterly Earnings (unaudited)

	2017				2016			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	(Dollars in Thousands, Except Per Share Data)							
Interest income	$19,504	$18,634	$19,225	$18,447	$20,321	$18,898	$19,555	$19,343
Interest expense	4,146	3,751	3,746	3,559	3,568	3,603	3,814	3,804
Net interest income	15,358	14,883	15,479	14,888	16,753	15,295	15,741	15,539
Provision for loan and lease losses	473	1,471	3,656	572	994	3,537	2,762	525
Non-interest income	3,525	4,339	4,738	4,063	3,931	3,640	5,823	4,594
Non-interest expense	14,859	14,231	14,221	13,560	14,523	15,753	13,458	12,699
Income (loss) before income tax expense	3,551	3,520	2,340	4,819	5,167	(355)	5,344	6,909
Income tax (benefit) expense[(1)]	(486)	936	454	1,422	1,199	(3,020)	1,621	2,356
Net income[(1)]	$4,037	$2,584	$1,886	$3,397	$3,968	$2,665	$3,723	$4,553
Per common share:								
Basic earnings[(1)]	$0.46	$0.30	$0.22	$0.39	$0.46	$0.31	$0.43	$0.52
Diluted earnings[(1)]	0.46	0.30	0.22	0.39	0.46	0.31	0.43	0.52
Dividends declared	0.13	0.13	0.13	0.13	0.12	0.12	0.12	0.12

(1) Results for the third quarter, second quarter and first quarter 2016 have been adjusted to reflect early adoption of ASU 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.”

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Report of Independent Registered Public Accounting Firm
To the Stockholders and Board of Directors
First Business Financial Services, Inc.:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of First Business Financial Services, Inc. and subsidiaries (the Company) as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three year period ended December 31, 2017, and the related notes (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2017, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 9, 2018 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ KPMG LLP

We have served as the Company's auditor since 1999.
Chicago, Illinois
March 9, 2018

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

The Corporation's management, with the participation of the Corporation's Chief Executive Officer and Chief Financial Officer, has evaluated the Corporation's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based upon that evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer have concluded that the Corporation's disclosure controls and procedures were effective as of December 31, 2017.

Changes in Internal Control over Financial Reporting

There was no change in the Corporation's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities and Exchange Act of 1934, as amended) that occurred during the quarter ended December 31, 2017 that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

Management's Annual Report on Internal Control over Financial Reporting

The Corporation's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. The Corporation's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Corporation's financial statements for external purposes in accordance with generally accepted accounting principles.

Management, under the supervision of the Chief Executive Officer and the Chief Financial Officer, assessed the effectiveness of the Corporation's internal control over financial reporting based on criteria for effective internal control over financial reporting established in Internal Control – Integrated Framework (2013), issued by the Committee of Sponsoring Organization of the Treadway Commission (COSO). Based on this assessment, management has determined that the Corporation's internal control over financial reporting was effective as of December 31, 2017.

KPMG LLP, the independent registered public accounting firm that audited the Consolidated Financial Statements of the Corporation included in this Annual Report on Form 10-K, has issued an attestation report on the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2017. The report, which expresses an unqualified opinion on the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2017, is included under the heading "Report of Independent Registered Public Accounting Firm."

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Report of Independent Registered Public Accounting Firm
To the Stockholders and Board of Directors
First Business Financial Services, Inc.:

Opinion on Internal Control Over Financial Reporting

We have audited First Business Financial Services, Inc. and subsidiaries' (the Company) internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2017, and the related notes (collectively, the consolidated financial statements), and our report dated March 9, 2018 expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ KPMG LLP
Chicago, Illinois
March 9, 2018

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Item 9B. Other Information
None.

PART III.
Item 10. Directors, Executive Officers and Corporate Governance

(a) Directors of the Registrant. The information included in the definitive Proxy Statement for the Annual Meeting of the Shareholders to be held on May 22, 2018 under the captions “Item 1 - Election of Directors,” “Corporate Governance Principles and Practices” and “Section 16(a) Beneficial Ownership Reporting Compliance” is incorporated herein by reference.
(b) Executive Officers of the Registrant. The information presented in Item 1 of this document is incorporated herein by reference.
(c) Code of Ethics. The Corporation has adopted a code of ethics applicable to all employees, including the principal executive officer, principal financial officer and principal accounting officer of the Corporation. The FBFS Code of Ethics is posted on the Corporation’s website at www.firstbusiness.com. The Corporation intends to satisfy the disclosure requirements under Item 5.05(c) of Form 8-K regarding any amendment to or waiver of the code with respect to its Chief Executive Officer and Chief Financial Officer, principal accounting officer, and persons performing similar functions, by posting such information to the Corporation’s website.

Item 11. Executive Compensation
Information with respect to compensation for our directors and officers included in the definitive Proxy Statement for the Annual Meeting of the Shareholders to be held on May 22, 2018 under the captions “Executive Compensation,” “Summary Compensation Table,” “Long Term Incentive Plans,” “Outstanding Equity Awards at December 31, 2017,” “Disclosure Regarding Termination and Change in Control Provisions” and “Director Compensation” is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters
Information with respect to security ownership of certain beneficial owners and management included in the definitive Proxy Statement for the Annual Meeting of the Shareholders to be held on May 22, 2018 under the caption “Principal Shareholders” is incorporated herein by reference.

Equity Compensation Plan Information

The following table summarizes certain information with respect to compensation plans under which equity securities of the Corporation are authorized for issuance as of December 31, 2017.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	—	$ —	211,835
Equity compensation plans not approved by security holders	—	—	—

Item 13. Certain Relationships and Related Transactions, and Director Independence
Information with respect to certain relationships and related transactions included in the definitive Proxy Statement for the Annual Meeting of the Shareholders to be held on May 22, 2018 under the captions “Related Party Transactions” and “Corporate Governance Principles and Practices” is incorporated herein by reference.

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Item 14. Principal Accountant Fees and Services

Information with respect to principal accounting fees and services included in the definitive Proxy Statement for the Annual Meeting of the Shareholders to be held on May 22, 2018 under the caption "Miscellaneous" is incorporated herein by reference.

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PART IV.
Item 15. Exhibits and Financial Statement Schedules
The Consolidated Financial Statements listed on the Index included under “Item 8. Financial Statements and Supplementary Data” are filed as a part of this Form 10-K. All financial statement schedules have been included in the Consolidated Financial Statements or are either not applicable or not significant.
Exhibit Index

Exhibit No.	Exhibit Name
3.1	Amended and Restated Articles of Incorporation of First Business Financial Services, Inc. (Incorporated by reference to Exhibit 3.1 to the Annual Report on Form 10-K filed on March 10, 2017)
3.2	Amended and Restated Bylaws of First Business Financial Services, Inc. (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed on January 31, 2012)
	Pursuant to Item 601(b)(4)(iii) of Regulation S-K, the Registrant agrees to furnish to the Securities and Exchange Commission, upon request, any instrument defining the rights of holders of long-term debt not being registered that is not filed as an exhibit to this Annual Report on Form 10-K. No such instrument authorizes securities in excess of 10% of the total assets of the Registrant.
4.1	Rights Agreement, dated as of June 5, 2008, between the Registrant and Computershare Trust Company, N.A. (incorporated by reference to Exhibit 4.1 to the Annual Report on Form 10-K filed on March 10, 2017)
4.2	Form of Common Stock Certificate (incorporated by reference to Exhibit 4.3 to Amendment No. 1 to the Registration Statement on Form S-1 filed on November 26, 2012)
10.1*	2012 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q filed on July 27, 2012)
10.2*	Form of Restricted Stock Agreement (incorporated by reference to Exhibit 4.5 to the Registration Statement on Form S-8 filed on August 13, 2012)
10.3*	Form of Executive Change-in-Control and Severance Agreement (incorporated by reference to Exhibit 10.3 to the Annual Report on Form 10-K filed on March 10, 2017)
10.4*	Amended and Restated Agreement effective December 22, 2014 between First Business Bank and Corey A. Chambas (incorporated by reference to Exhibit 10.8 of the Registrant’s Annual Report on Form 10-K filed on March 16, 2015)
10.5*	First Amendment of Agreement by and between First Business Bank and Corey Chambas (Amended and Restated December 22, 2014)(incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on December 29, 2016)
10.6*	Annual Incentive Bonus Program, as amended, dated March 6, 2015 (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on March 6, 2015)
10.7*	Offer Letter between the Company and David R. Seiler. accepted March 25, 2016 (incorporated by reference to Exhibit 99.1 to the Current Report on Form 8-K filed on April 8, 2016)

21 Subsidiaries of the Registrant

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23	Consent of KPMG LLP
31.1	Certification of the Chief Executive Officer
31.2	Certification of the Chief Financial Officer
32	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350
101	The following financial information from First Business Financial Services, Inc.’s Annual Report on Form 10-K for the year ended December 31, 2017, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets as of December 31, 2017 and December 31, 2016, (ii) Consolidated Statements of Income for the years ended December 31, 2017, 2016 and 2015, (iii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2017, 2016 and 2015, (iv) Consolidated Statements of Changes in Stockholders’ Equity for the years ended December 31, 2017, 2016 and 2015, (v) Consolidated Statements of Cash Flows for the years ended December 31, 2017, 2016 and 2015, and (vi) the Notes to Consolidated Financial Statements

* Management contract or compensatory plan.

Item 16. Form 10-K Summary
None.

Signatures

Pursuant to the requirements of Section 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.

FIRST BUSINESS FINANCIAL SERVICES, INC.

March 9, 2018	/s/ Corey A. Chambas Corey A. Chambas Chief Executive Officer

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/ Corey A. Chambas Corey A. Chambas	Chief Executive Officer (principal executive officer)	March 9, 2018
/s/ Edward G. Sloane, Jr. Edward G. Sloane, Jr.	Chief Financial Officer (principal financial officer)	March 9, 2018
/s/ Michael J. Murphy Michael J. Murphy	Chief Accounting Officer (principal accounting officer)	March 9, 2018
/s/ Jerome J. Smith Jerome J. Smith	Chairman of the Board of Directors	March 9, 2018
/s/ Mark D. Bugher Mark D. Bugher	Director	March 9, 2018
/s/ Jan A. Eddy Jan A. Eddy	Director	March 9, 2018
/s/ John J. Harris John J. Harris	Director	March 9, 2018
/s/ Gerald L. Kilcoyne Gerald L. Kilcoyne	Director	March 9, 2018
/s/ John M. Silseth John M. Silseth	Director	March 9, 2018
/s/ Carla C. Sanders Carla C. Sanders	Director	March 9, 2018
/s/ Carol P. Sanders Carol P. Sanders	Director	March 9, 2018
/s/ Dean W. Voeks Dean W. Voeks	Director	March 9, 2018

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