CHOICEONE FINANCIAL SERVICES INC
Form 10-K
March 29, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2017

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from__________________ to __________________

Commission File Number: 000-19202

ChoiceOne Financial Services, Inc.

(Exact Name of Registrant as Specified in its Charter)

Michigan (State or Other Jurisdiction of Incorporation or Organization)	**38-2659066** (I.R.S. Employer Identification No.)
109 East Division Street, Sparta, Michigan (Address of Principal Executive Offices)	**49345** (Zip Code)

(616) 887-7366
(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(g) of the Securities Exchange Act of 1934:

Common Stock
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth. See definitions of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

As of June 30, 2017, the aggregate market value of common stock held by non-affiliates of the Registrant was $73.5 million. This amount is based on an average bid price of $23.44 per share for the Registrant's stock as of such date.

As of February 28, 2018, the Registrant had 3,374,279 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement of ChoiceOne Financial Services, Inc. for the Annual Meeting of Shareholders to be held on May 23, 2018 are incorporated by reference into Part III of this Form 10-K.

ChoiceOne Financial Services, Inc.

Form 10-K ANNUAL REPORT

Contents

FORWARD-LOOKING STATEMENTS

This report and the documents incorporated into this report contain forward-looking statements that are based on management's beliefs, assumptions, current expectations, estimates and projections about the financial services industry, the economy, and ChoiceOne Financial Services, Inc. Words such as "anticipates," "believes," "expects," "forecasts," "intends," "is likely," "plans," "predicts," "projects," "may," "could," "estimates," and variations of such words and similar ex are intended to identify such forward-looking statements. Management's determination of the provision and allowance for loan losses, the carrying value of goodwill, loan servicing rights and other real estate owned, and the fair value of investment securities (including whether any impairment on any investment security is temporary or other than temporary and the amount of any impairment) and management's assumptions concerning pension and other postretirement benefit plans involve judgments that are inherently forward-looking. All of the information concerning interest rate sensitivity is forward-looking. All statements with references to future time periods are forward-looking. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions ("risk factors") that are difficult to predict with regard to timing, extent, likelihood, and degree of occurrence. Therefore, actual results and outcomes may materially differ from what may be expressed, implied or forecasted in such forward-looking statements. Furthermore, ChoiceOne Financial Services, Inc. undertakes no obligation to update, amend, or clarify forward-looking statements, whether as a result of new information, future events, or otherwise.

Risk factors include, but are not limited to, the risk factors disclosed in Item 1A of this report. These are representative of the risk factors that could cause a difference between an ultimate actual outcome and a preceding forward-looking statement.

PART I

Item 1. Business

General

ChoiceOne Financial Services, Inc. ("ChoiceOne" or the "Company") is a financial holding company registered under the Bank Holding Company Act of 1956, as amended ("BHC Act"). The Company was incorporated on February 24, 1986, as a Michigan corporation. The Company was formed to create a bank holding company for the purpose of acquiring all of the capital stock of ChoiceOne Bank (formerly Sparta State Bank), which became a wholly owned subsidiary of the Company on April 6, 1987. The Company's only subsidiary and significant asset as of December 31, 2017, was ChoiceOne Bank (the "Bank"). Effective November 1, 2006, the Company merged with Valley Ridge Financial Corp. ("VRFC"), a one-bank holding company for Valley Ridge Bank ("VRB"). In the merger, the Company issued shares of its common stock in exchange for all outstanding shares of VRFC. In December 2006, VRB was consolidated into the Bank. The Bank owns all of the outstanding common stock of ChoiceOne Insurance Agencies, Inc., an independent insurance agency headquartered in Sparta, Michigan (the "Insurance Agency").

The Company’s business is primarily concentrated in a single industry segment - banking. The Bank is a full-service banking institution that offers a variety of deposit, payment, credit and other financial services to all types of customers. These services include time, savings, and demand deposits, safe deposit services, and automated transaction machine services. Loans, both commercial and consumer, are extended primarily on a secured basis to corporations, partnerships and individuals. Commercial lending covers such categories as business, industry, agricultural, construction, inventory and real estate. The Bank’s consumer loan department makes direct and indirect loans to consumers and purchasers of residential and real property. No material part of the business of the Company or the Bank is dependent upon a single customer or very few customers, the loss of which would have a materially adverse effect on the Company.

The Bank’s primary market area lies within Kent, Muskegon, Newaygo, and Ottawa counties in Michigan in the communities where the Bank’s offices are located. Currently the Bank serves these markets through twelve full-service offices and one loan production office. The Bank is in the process of establishing two additional full-service offices which are scheduled to open in 2018. The Company and the Bank have no foreign assets or income except for foreign debt securities.

At December 31, 2017, the Company had consolidated total assets of $646.5 million, net loans of $394.2 million, total deposits of $539.9 million and total shareholders’ equity of $76.6 million. For the year ended December 31, 2017, the Company recognized consolidated net income of $6.2 million. The principal source of revenue for the Company and the Bank is interest and fees on loans. On a consolidated basis, interest and fees on loans accounted for 60%, 59%, and 59% of total revenues in 2017, 2016, and 2015, respectively. Interest on securities accounted for 13%, 13%, and 12% of total revenues in 2017, 2016, and 2015, respectively. For more information about the Company’s financial condition and results of operations, see the consolidated financial statements and related notes included in Part II, Item 8 of this report.

Competition

The Bank's competition primarily comes from other financial institutions located within Kent, Muskegon, Newaygo, and Ottawa counties in western Michigan. There are a number of larger commercial banks within the Bank's primary market area. The Bank also competes with a large number of other financial institutions, such as savings and loan associations, insurance companies, consumer finance companies, credit unions and commercial finance and leasing companies for deposits, loans and service business. Money market mutual funds, brokerage houses and nonfinancial institutions provide many of the financial services offered by the Bank. Many of these competitors have substantially greater resources than the Bank. The principal methods of competition for financial services are price (the rates of interest charged for loans, the rates of interest paid for deposits and the fees charged for services) and the convenience and quality of services rendered to customers.

Supervision and Regulation

Banks and bank holding companies are extensively regulated. The Company is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"). The Company's activities are generally limited to owning or controlling banks and engaging in such other activities as the Federal Reserve Board may determine to be closely related to banking. Prior approval of the Federal Reserve Board, and in some cases various other government agencies, is required for the Company to acquire control of any additional bank holding companies, banks or other operating subsidiaries. Under Federal Reserve Board policy, the Company is expected to act as a source of financial strength to the Bank and to commit resources to support it.

The Bank is chartered under state law and is subject to regulation by the Michigan Department of Insurance and Financial Services ("DIFS"). State banking laws place restrictions on various aspects of banking, including permitted activities, loan interest rates, branching, payment of dividends and capital and surplus requirements. The Bank is a member of the Federal Reserve System and is also subject to regulation by the Federal Reserve Board. The Bank's deposits are insured by the Federal Deposit Insurance Corporation (the "FDIC") to the maximum extent provided by law. The Bank is a member of the Federal Home Loan Bank system, which provides certain advantages to the Bank, including favorable borrowing rates for certain funds.

The Company is a legal entity separate and distinct from the Bank. The Company's primary source of funds available to pay dividends to shareholders is dividends paid to it by the Bank. There are legal limitations on the extent to which the Bank can lend or otherwise supply funds to the Company. In addition, payment of dividends to the Company by the Bank is subject to various state and federal regulatory limitations.

The FDIC formed the Deposit Insurance Fund ("DIF") in accordance with the Federal Deposit Insurance Reform Act of 2005 ("Reform Act") to create a stronger and more stable insurance system. The FDIC maintains the insurance reserves of the DIF by assessing depository institutions an insurance premium. The DIF insures deposit accounts of the Bank up to a maximum amount of $250,000 per separately insured depositor. FDIC insured depository institutions are required to pay deposit insurance premiums based on the risk an institution poses to the DIF. In February 2011, the FDIC finalized rules, effective for assessments occurring after April 1, 2011, which redefined an institution's assessment base as average consolidated total assets minus average Tier 1 capital. The new rules also established the initial base assessment rate for Risk Category 1 institutions, such as the Bank, at 5 to 9 basis points (annualized). Effective July 1, 2016, the FDIC amended its rules to eliminate Risk Categories for small banks, replacing them with a method based on a bank's CAMELS composite rating and several financial ratios. On that date, the Bank's initial base assessment rate was reduced to 3 basis points, since the Federal Deposit Insurance Reserve Ratio reached 1.15% as of June 30, 2016.

The Deposit Insurance Funds Act of 1996 authorized the Financing Corporation ("FICO") to impose periodic assessments on all depository institutions. The purpose of these periodic assessments is to spread the cost of the interest payments on the outstanding FICO bonds issued to recapitalize the Savings Association Insurance Fund ("SAIF") over a larger number of institutions.

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

The Company and the Bank are subject to regulatory “risk-based” capital guidelines. Failure to meet these capital guidelines could subject the Company or the Bank to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting brokered deposits, and other restrictions on its business. In addition, the Bank would generally not receive regulatory approval of any application that requires the consideration of capital adequacy, such as a branch or merger application, unless it could demonstrate a reasonable plan to meet the capital requirement within a reasonable period of time.

Under Federal Reserve Board policy, the Company is expected to act as a source of financial strength to the Bank and to commit resources to support the Bank. In addition, if DIFS deems the Bank’s capital to be impaired, DIFS may require the Bank to restore its capital by a special assessment on the Company as the Bank’s sole shareholder. If the Company fails to pay any assessment, the Company’s directors will be required, under Michigan law, to sell the shares of the Bank’s stock owned by the Company to the highest bidder at either a public or private auction and use the proceeds of the sale to restore the Bank’s capital.

The Federal Deposit Insurance Corporation Improvement Act (“FDICIA”) requires, among other things, federal banking agencies to take “prompt corrective action” in respect of depository institutions that do not meet minimum capital requirements. FDICIA sets forth the following five capital categories: “well-capitalized,” “adequately-capitalized,” “undercapitalized,” “significantly-undercapitalized” and “critically-undercapitalized.” A depository institution’s capital category will depend upon how its capital levels compare with various relevant capital measures as established by regulation, which include Tier 1 and total risk-based capital ratio measures and a leverage capital ratio measure. Under certain circumstances, the appropriate banking agency may treat a well-capitalized, adequately-capitalized, or undercapitalized institution as if the institution were in the next lower capital category.

Federal banking regulators are required to take specified mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories. The severity of the action depends upon the capital category in which the institution is placed. Subject to a narrow exception, the banking regulator must generally appoint a receiver or conservator for an institution that is critically undercapitalized. An institution in any of the undercapitalized categories is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. An undercapitalized institution is also generally prohibited from paying any dividends, increasing its average total assets, making acquisitions, establishing any branches, accepting or renewing any brokered deposits or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval.

On July 3, 2013, the FDIC Board of Directors approved the Regulatory Capital Interim Final Rule, implementing Basel III. This rule redefines Tier 1 capital as two components (Common Equity Tier 1 and Additional Tier 1), creates a new capital ratio (Common Equity Tier 1 Risk-based Capital Ratio) and implements a capital conservation buffer. It also revises the prompt corrective action thresholds and makes changes to risk weights for certain assets and off-balance-sheet exposures. The Bank was required to transition into the new rule beginning on January 1, 2015.

Banks are subject to a number of federal and state laws and regulations, which have a material impact on their business. These include, among others, minimum capital requirements, state usury laws, state laws relating to fiduciaries, the Truth in Lending Act, the Truth in Savings Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Fair Credit Reporting Act, the Expedited Funds Availability Act, the Community Reinvestment Act, the Real Estate Settlement Procedures Act, the Service Members Civil Relief Act, the USA PATRIOT Act, the Bank Secrecy Act, regulations of the Office of Foreign Assets Controls, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, electronic funds transfer laws, redlining laws, predatory lending laws, antitrust laws, environmental laws, money laundering laws and privacy laws. The monetary policy of the Federal Reserve Board may influence the growth and distribution of bank loans, investments and deposits, and may also affect interest rates on loans and deposits. These policies may have a significant effect on the operating results of banks.

In general, the BHC Act limits the business of bank holding companies to banking, managing or controlling banks and other activities that the Federal Reserve Board has determined to be closely related to the business of banking. In addition, bank holding companies that qualify and elect to be financial holding companies may engage in any activities that are financial in nature or complementary to a financial activity and do not pose a substantial risk to the safety and soundness of depository institutions or the financial system without prior approval of the Federal Reserve Board. Activities that are financial in nature include securities underwriting and dealing, insurance underwriting and making merchant banking investments.

In order for the Comany to maintain financial holding company status, both the Company and the Bank must be categorized as “well-capitalized” and “well-managed” under applicable regulatory guidelines. If the Company or the Bank ceases to meet these requirements, the Federal Reserve Board may impose corrective capital and/or managerial requirements and place limitations on the Company’s ability to conduct the broader financial activities permissible for financial holding companies. In addition, if the deficiencies persist, the Federal Reserve Board may require the Company to divest of the Bank. The Company and the Bank were both categorized as “well-capitalized” and “well-managed” as of December 31, 2017.

Bank holding companies may acquire banks and other bank holding companies located in any state in the United States without regard to geographic restrictions or reciprocity requirements imposed by state banking law. Banks may also establish interstate branch networks through acquisitions of and mergers with other banks. The establishment of *de novo* interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) is allowed only if specifically authorized by state law.

Michigan banking laws do not significantly restrict interstate banking. The Michigan Banking Code permits, in appropriate circumstances and with the approval of the Department of Insurance and Financial Services, (1) acquisition of Michigan banks by FDIC-insured banks, savings banks or savings and loan associations located in other states, (2) sale by a Michigan bank of branches to an FDIC-insured bank, savings bank or savings and loan association located in a state in which a Michigan bank could purchase branches of the purchasing entity, (3) consolidation of Michigan banks and FDIC-insured banks, savings banks or savings and loan associations located in other states having laws permitting such consolidation, (4) establishment of branches in Michigan by FDIC-insured banks located in other states, the District of Columbia or U.S. territories or protectorates having laws permitting a Michigan bank to establish a branch in such jurisdiction, and (5) establishment by foreign banks of branches located in Michigan.

Banks are subject to the provisions of the Community Reinvestment Act (“CRA”). Under the terms of the CRA, the appropriate federal bank regulatory agency is required, in connection with its examination of a bank, to assess the bank’s record in meeting the credit needs of the community served by that bank, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the institution. Under the CRA, institutions are assigned a rating of “outstanding,” “satisfactory,” “needs to improve,” or “substantial non-compliance.” The regulatory agency’s assessment of the bank’s record is made available to the public. Further, a bank’s federal regulatory agency is required to assess the CRA compliance record of any bank that has applied to establish a new branch office that will accept deposits, relocate an office, or merge or consolidate with, or acquire the assets or assume the liabilities of, a federally regulated financial institution. In the case of a bank holding company applying for approval to acquire a bank or another bank holding company, the Federal Reserve Board will assess the CRA compliance record of each subsidiary bank of the applicant bank holding company, and such compliance records may be the basis for denying the application. Upon receiving notice that a subsidiary bank is rated less than “satisfactory,” a financial holding company will be prohibited from additional activities that are permitted to be conducted by a financial holding company and from acquiring any company engaged in such activities. The Bank’s CRA rating was “Satisfactory” as of its more recent examination.

Effects of Compliance With Environmental Regulations

The nature of the business of the Bank is such that it holds title, on a temporary or permanent basis, to a number of parcels of real property. These include properties owned for branch offices and other business purposes as well as properties taken in or in lieu of foreclosure to satisfy loans in default. Under current state and federal laws, present and past owners of real property may be exposed to liability for the cost of cleanup of environmental contamination on or originating from those properties, even if they are wholly innocent of the actions that caused the contamination. These liabilities can be material and can exceed the value of the contaminated property. Management is not presently aware of any instances where compliance with these provisions will have a material effect on the capital expenditures, earnings or competitive position of the Company or the Bank, or where compliance with these provisions will adversely affect a borrower's ability to comply with the terms of loan contracts.

Employees

As of February 28, 2018, the Company, the Bank and the Insurance Agency employed 173 employees, of which 135 were full-time employees. The Company, the Bank, and the Insurance Agency believe their overall relations with their employees are good.

Statistical Information

Additional statistical information describing the business of the Company appears on the following pages and in Management's Discussion and Analysis of Financial Condition and Results of Operations and in Item 7 of this report and in the Consolidated Financial Statements and the notes thereto in Item 8 of this report. The following statistical information should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and notes in this report.

Securities Portfolio

The carrying value of securities categorized by type at December 31 was as follows:

(Dollars in thousands)	2017	2016	2015
U.S. Government and federal agency	$35,126	$59,052	$57,207
U.S. Treasury notes and bonds	1,960	4,072	6,100
State and municipal	100,048	88,973	77,754
Mortgage-backed securities	9,820	7,789	6,970
Corporate	5,151	7,041	8,387
Foreign debt securities	—	4,400	995
Equity securities	3,392	2,883	2,453
Asset-backed securities	94	178	270
Total	$155,591	$174,388	$160,136

The Company did not hold investment securities from any one issuer at December 31, 2017, that were greater than 10% of the Company’s shareholders’ equity, exclusive of U.S. Government and U.S. Government agency securities.

Presented below is the fair value of securities as of December 31, 2017 and 2016, a schedule of maturities of securities as of December 31, 2017, and the weighted average yields of securities as of December 31, 2017:

		Securities maturing within:				
(Dollars in thousands)	Less than 1 Year	1 Year - 5 Years	5 Years - 10 Years	More than 10 Years	Fair Value at Dec. 31, 2017	Fair Value at Dec. 31, 2016
U.S. Government and federal agency	$19,175	$10,019	$5,932	$—	$35,126	$59,052
U.S. Treasury notes and bonds	—	1,960	—	—	1,960	4,072
State and municipal	8,221	51,656	37,722	2,449	100,048	88,973
Corporate	—	5,151	—	—	5,151	7,041
Foreign debt securities	—	—	—	—	—	4,400
Asset-backed securities	94	—	—	—	94	178
Total debt securities	27,490	68,786	43,654	2,449	142,379	163,716
Mortgage-backed securities	—	9,732	88	—	9,820	7,789
Equity securities (2)	—	—	1,000	2,392	3,392	2,883
Total	$27,490	$78,518	$44,742	$4,841	$155,591	$174,388

	Weighted average yields:				
	Less than 1 Year	1 Year - 5 Years	5 Years - 10 Years	More than 10 Years	Total
U.S. Government and federal agency	2.08 %	1.78 %	2.59 %	— %	2.08 %
U.S. Treasury notes and bonds	—	1.85	—	—	1.85
State and municipal (1)	3.73	3.06	3.44	4.46	3.29
Corporate	—	2.25	—	—	2.25
Foreign debt securities	—	—	—	—	—
Asset-backed securities	1.92	—	—	—	1.92
Mortgage-backed securities	5.50	2.60	3.06	—	2.60
Equity securities (2)	—	—	4.62	0.99	2.01

(1) The yield is computed for tax-exempt securities on a fully tax-equivalent basis at an incremental tax rate of 34%.
(2) Equity securities are preferred and common stock that may or may not have a stated maturity.

Loan Portfolio

The Bank's loan portfolio categorized by loan type (excluding loans held for sale) as of December 31, 2017 is presented below:

(Dollars in thousands)	2017	2016	2015	2014	2013
Agricultural	$48,464	$44,614	$40,232	$41,098	$37,048
Commercial and industrial	104,386	96,088	94,347	88,062	68,530
Consumer	24,513	21,596	20,090	20,752	19,931
Real estate - commercial	123,487	110,762	97,736	99,807	96,987
Real estate - construction	6,613	6,153	5,390	2,691	890
Real estate - residential	91,322	89,787	91,509	93,703	92,580
Total loans, gross	$398,785	$369,000	$349,304	$346,113	$315,966

Maturities and Sensitivities of Loans to Changes in Interest Rates

The following schedule presents the maturities of loans (excluding residential real estate and consumer loans) as of December 31, 2017. All loans over one year in maturity (excluding residential real estate and consumer loans) are also presented classified according to the sensitivity to changes in interest rates as of December 31, 2017.

(Dollars in thousands)	Less than 1 Year	1 Year - 5 Years	More than 5 Years	Total
Loan Type				
Agricultural	$11,729	$16,594	$20,141	$48,464
Commercial and industrial	31,676	61,042	11,668	104,386
Real estate - commercial	13,803	56,355	53,329	123,487
Real estate - construction	6,408	205	—	6,613
Totals	$63,616	$134,196	$85,138	$282,950

(Dollars in thousands)

Loan Sensitivity to Changes in Interest Rates	Less than 1 Year	1 Year - 5 Years	More than 5 Years	Total
Loans with fixed interest rates	$19,170	$116,042	$73,332	$208,544
Loans with floating or adjustable interest rates	44,446	18,154	11,806	74,406
Totals	$63,616	$134,196	$85,138	$282,950

Loan maturities are classified according to the contractual maturity date or the anticipated amortization period, whichever is appropriate. The anticipated amortization period is used in the case of loans where a balloon payment is due before the end of the loan's normal amortization period. At the time the balloon payment is due, the loan can either be rewritten or payment in full can be requested. The decision regarding whether the loan will be rewritten or a payment in full will be requested will be based upon the loan's payment history, the borrower's current financial condition, and other relevant factors.

Risk Elements

The following loans were classified as nonperforming as of December 31:

(Dollars in thousands)

	2017	2016	2015	2014	2013
Loans accounted for on a nonaccrual basis	$1,096	$1,983	$2,198	$3,361	$3,123
Accruing loans which are contractually past due 90 days or more as to principal or interest payments	258	229	29	58	11
Loans defined as "troubled debt restructurings"	2,896	2,853	3,271	3,175	4,523
Totals	$4,250	$5,065	$5,498	$6,594	$7,657

A loan is placed on nonaccrual status at the point in time at which the collectability of principal or interest is considered doubtful.

The table below illustrates interest forgone and interest recorded on nonperforming loans for the years presented:

(Dollars in thousands)

	2017	2016	2015	2014	2013
Interest on non-performing loans that would have been earned had the loans been in an accrual or performing status	$ 73	$ 107	$ 150	$ 204	$ 251
Interest on non-performing loans that was actually recorded when received	$ —	$—	$—	$—	$—

Potential Problem Loans

At December 31, 2017, there were $3.6 million of loans not disclosed above where some concern existed as to the borrowers' abilities to comply with original loan terms. Specific loss allocations totaling $302,000 from the allowance for loan losses had been allocated for all nonperforming and potential problem loans as of December 31, 2017. However, the entire allowance for loan losses is also available for these potential problem loans.

Loan Concentrations

As of December 31, 2017, there was no concentration of loans exceeding 10% of total loans that is not otherwise disclosed as a category of loans pursuant to Item III.A. of Industry Guide 3.

Other Interest-Bearing Assets

As of December 31, 2017, there were no other interest-bearing assets requiring disclosure under Item III.C.1. or 2. of Industry Guide 3 if such assets were loans.

Summary of Loan Loss Experience

The following schedule presents a summary of activity in the allowance for loan losses for the periods shown and the percentage of net charge-offs during each period to average gross loans outstanding during the period:

(Dollars in thousands)	2017	2016	2015	2014	2013
Allowance for loan losses at beginning of year	$4,277	$4,194	$4,173	$4,735	$5,852
Charge-offs:					
Agricultural	—	—	—	—	88
Commercial and industrial	439	37	30	1	122
Consumer	253	218	291	273	351
Real estate - commercial	—	—	—	665	858
Real estate - construction	—	—	—	—	—
Real estate - residential	43	102	140	133	732
Total charge-offs	735	357	461	1,072	2,151
Recoveries:					
Agricultural	—	—	1	20	6
Commercial and industrial	21	31	64	119	337
Consumer	169	149	121	179	175
Real estate - commercial	258	89	47	48	84
Real estate - construction	40	—	—	—	—
Real estate - residential	62	171	149	44	132
Total recoveries	550	440	382	410	734
Net charge-offs (recoveries)	185	(83)	79	662	1,417
Provision for loan losses (1)	485	—	100	100	300
Allowance for loan losses at end of year	$4,577	$4,277	$4,194	$4,173	$4,735
Allowance for loan losses as a percentage of:					
Total loans as of year end	1.15 %	1.16 %	1.20 %	1.21 %	1.50 %
Nonaccrual loans, accrual loans past due 90 days or more and troubled debt restructurings	108 %	84 %	76 %	63 %	62 %
	0.05 %	(0.02)%	0.02 %	0.20 %	0.45 %

Ratio of net charge-offs during the period to average loans outstanding during the period										
Loan recoveries as a percentage of prior year's charge-offs	154	%	95	%	36	%	19	%	29	%

(1) Additions to the allowance for loan losses charged to operations during the periods shown were based on management's judgment after considering factors such as loan loss experience, evaluation of the loan portfolio, and prevailing and anticipated economic conditions. The evaluation of the loan portfolio is based upon various risk factors such as the financial condition of the borrower, the value of collateral and other considerations, which, in the opinion of management, deserve current recognition in estimating loan losses.

The following schedule presents an allocation of the allowance for loan losses to the various loan categories as of the years ended December 31:

(Dollars in thousands)	2017	2016	2015	2014	2013
Agricultural	$506	$433	$420	$186	$178
Commercial and industrial	1,001	688	586	527	562
Consumer	262	305	297	184	192
Real estate - commercial	1,761	1,438	1,030	1,641	1,842
Real estate - construction	35	62	46	9	12
Real estate - residential	726	1,013	1,388	1,193	1,626
Unallocated	286	338	427	433	323
Total allowance	$4,577	$4,277	$4,194	$4,173	$4,735

The increase in the allowance allocation to commercial and industrial loans and commercial real estate loans was due to growth in these categories and an increase in the inherent risk. The decline in the allocation to residential real estate loans was caused by lower historical charge-off levels. Changes in historical charge-off levels and environmental factors affected all loan categories.

Management periodically reviews the assumptions, loss ratios and delinquency trends in estimating the appropriate level of its allowance for loan losses and believes the unallocated portion of the total allowance was sufficient at December 31, 2017.

The following schedule presents the stratification of the loan portfolio by category, based on the amount of loans outstanding as a percentage of total loans for the respective years ended December 31:

	2017	2016	2015	2014	2013
Agricultural	12 %	12 %	12 %	12 %	12 %
Commercial and industrial	26	26	26	25	22
Consumer	6	6	6	6	6
Real estate - commercial	31	30	28	29	31
Real estate - construction	2	2	2	1	—
Real estate - residential	23	24	26	27	29
Total allowance	100 %	100 %	100 %	100 %	100 %

Deposits

The following schedule presents the average deposit balances by category and the average rates paid thereon for the respective years:

(Dollars in thousands)

	2017		2016		2015	
Noninterest-bearing demand	$136,353	— %	$123,848	— %	$115,488	— %
Interest-bearing demand and money market deposits	208,049	0.18	196,662	0.13	165,767	0.14
Savings	76,107	0.02	73,118	0.03	67,826	0.04
Certificates of deposit	104,936	0.75	86,042	0.60	94,891	0.66
Total	$525,445	0.23%	$479,670	0.16%	$443,972	0.20%

The following table illustrates the maturities of certificates of deposits issued in denominations of $100,000 or more as of December 31, 2017:

(Dollars in thousands)

Maturing in less than 3 months	$22,918
Maturing in 3 to 6 months	14,309
Maturing in 6 to 12 months	13,066
Maturing in more than 12 months	9,313
Total	$59,606

At December 31, 2017, the Bank had no material foreign deposits.

Short-Term Borrowings

Federal funds purchased by the Company are unsecured overnight borrowings from correspondent banks. Federal funds purchased are due the next business day. The table below provides additional information regarding these short-term borrowings:

(Dollars in thousands)

	2017	2016	2015
Outstanding balance at December 31	$—	$—	$—
Average interest rate at December 31	— %	— %	— %
Average balance during the year	$703	$610	$—
Average interest rate during the year	1.47 %	0.70 %	— %
Maximum month end balance during the year	$5,470	$4,100	$1,857

Repurchase agreements include advances by Bank customers that are not covered by federal deposit insurance. These agreements are direct obligations of the Company and are secured by securities held in safekeeping at a correspondent bank. The table below provides additional information regarding these short-term borrowings:

(Dollars in thousands)

	2017	2016	2015
Outstanding balance at December 31	$7,148	$7,913	$9,460
Average interest rate at December 31	0.05 %	0.05 %	0.04 %
Average balance during the year	$4,958	$7,762	$17,825
Average interest rate during the year	0.05 %	0.05 %	0.17 %
Maximum month end balance during the year	$8,440	$10,539	$26,743

Advances from the Federal Home Loan Bank (“FHLB”) with original repayment terms less than one year are considered short-term borrowings for the Company. These advances are secured by residential real estate mortgage loans and U.S. government agency securities. The advances have maturities ranging from 1 month to 12 months from the date of issue.

The table below provides additional information regarding these short-term borrowings:

(Dollars in thousands)

	2017	2016	2015
Outstanding balance at December 31	$20,268	$12,000	$—
Average interest rate at December 31	1.36 %	0.86 %	0.57 %

Average balance during the year	$22,830	$25,732	$11,332
Average interest rate during the year	1.21 %	0.61 %	0.73 %
Maximum month end balance during the year	$40,273	$45,000	$31,873

There were no other categories of short-term borrowings whose average balance outstanding exceeded 30% of shareholders' equity in 2017, 2016 or 2015.

Return on Equity and Assets

The following schedule presents certain financial ratios of the Company for the years ended December 31:

	2017	2016	2015
Return on assets (net income divided by average total assets)	0.98 %	1.04 %	1.04 %
Return on equity (net income dividend by average equity)	8.22 %	8.44 %	8.39 %
Dividend payout ratio (dividends declared per share divided by net income per share)	37.57 %	36.63 %	37.79 %
Equity to assets ratio (average equity divided by average total assets)	11.91 %	12.30 %	12.40 %

Item 1A. Risk Factors

The Company is subject to many risks and uncertainties. Although the Company seeks ways to manage these risks and develop programs to control risks to the extent that management can control them, the Company cannot predict the future. Actual results may differ materially from management's expectations. Some of these significant risks and uncertainties are discussed below. The risks and uncertainties described below are not the only ones that the Company faces. Additional risks and uncertainties of which the Company is unaware, or that it currently does not consider to be material, also may become important factors that affect the Company and its business. If any of these risks were to occur, the Company's business, financial condition or results of operations could be materially and adversely affected.

Investments in the Company's common stock involve risk.

The market price of the Company's common stock may fluctuate significantly in response to a number of factors, including:

Variations in quarterly or annual operating results
Changes in dividends per share
Changes in interest rates
New developments, laws or regulations in the banking industry
Acquisitions or business combinations involving the Company or its competition
Regulatory actions, including changes to regulatory capital levels, the components of regulatory capital and how regulatory capital is calculated
Volatility of stock market prices and volumes
Changes in market valuations of similar companies
New litigation or contingencies or changes in existing litigation or contingencies
Changes in accounting policies or procedures as may be required by the Financial Accounting Standards Board or other regulatory agencies
Rumors or erroneous information
Credit and capital availability
Issuance of additional shares of common stock or other debt or equity securities of the Company

Asset quality could be less favorable than expected.

A significant source of risk for the Company arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loan agreements. Most loans originated by the Company are secured, but some loans are unsecured depending on the nature of the loan.

With respect to secured loans, the collateral securing the repayment of these loans includes a wide variety of real and personal property that may be insufficient to cover the obligations owed under such loans. Collateral values may be adversely affected by changes in prevailing economic, environmental and other conditions, including declines in the value of real estate, changes in interest rates, changes in monetary and fiscal policies of the federal government, terrorist activity, environmental contamination and other external events.

The Company's allowance for loan losses may not be adequate to cover actual loan losses.

The risk of nonpayment of loans is inherent in all lending activities and nonpayment of loans may have a material adverse effect on the Company's earnings and overall financial condition, and the value of its common stock. The Company makes various assumptions and judgments about the collectability of its loan portfolio and provides an allowance for potential losses based on a number of factors. If its assumptions are wrong, the allowance for loan losses may not be sufficient to cover losses, which could have an adverse effect on the Company's operating results, and may cause it to increase the allowance in the future. The actual amount of future provisions for loan losses cannot now be determined and may exceed the amounts of past provisions for loan losses. Federal and state banking regulators, as an integral part of their supervisory function, periodically review the allowance for loan losses. These regulatory agencies may require the Company to increase its provision for loan losses or to recognize further loan charge-offs based upon their judgments, which may be different from the Company's judgments. Any increase in the allowance for loan losses could have a negative effect on the Company's regulatory capital ratios, net income, financial condition and results of operations.

General economic conditions in the state of Michigan could be less favorable than expected.

The Company is affected by general economic conditions in the United States, although most directly within Michigan. An economic downturn within Michigan could negatively impact household and corporate incomes. This impact may lead to decreased demand for both loan and deposit products and increase the number of customers who fail to pay interest or principal on their loans.

The Company could be adversely affected by the soundness of other financial institutions, including defaults by larger financial institutions.

The Company's ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of credit, trading, clearing, counterparty or other relationships between financial institutions. The Company has exposure to multiple counterparties, and it routinely executes transactions with counterparties in the financial industry. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, could lead to market-wide liquidity problems and losses or defaults by the Company or by other institutions. This is sometimes referred to as "systemic risk" and may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges, with which the Company interacts on a daily basis, and therefore could adversely affect the Company.

If the Company does not adjust to changes in the financial services industry, its financial performance may suffer.

The Company's ability to maintain its financial performance and return on investment to shareholders will depend in part on its ability to maintain and grow its core deposit customer base and expand its financial services to its existing customers. In addition to other banks, competitors include credit unions, securities dealers, brokers, mortgage bankers, investment advisors and finance and insurance companies. The increasingly competitive environment is, in part, a result of changes in the economic environment within the state of Michigan, regulation, changes in technology and product delivery systems and the accelerating pace of consolidation among financial service providers. New competitors may emerge to increase the degree of competition for the Company's customers and services. Financial services and products are also constantly changing. The Company's financial performance will also depend in part upon customer demand for the Company's products and services and the Company's ability to develop and offer competitive financial products and services.

Changes in interest rates could reduce the Company's income and cash flow.

The Company's income and cash flow depends, to a great extent, on the difference between the interest earned on loans and securities, and the interest paid on deposits and other borrowings. Market interest rates are beyond the Company's control, and they fluctuate in response to general economic conditions and the policies of various governmental and regulatory agencies including, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates and interest rate relationships, will influence the origination of loans, the purchase of investments, the generation of deposits and the rate received on loans and securities and paid on deposits and other borrowings.

The Company is subject to liquidity risk in its operations, which could adversely affect its ability to fund various obligations.

Liquidity risk is the possibility of being unable to meet obligations as they come due or capitalize on growth opportunities as they arise because of an inability to liquidate assets or obtain adequate funding on a timely basis, at a reasonable cost and within acceptable risk tolerances. Liquidity is required to fund various obligations, including credit obligations to borrowers, loan originations, withdrawals by depositors, repayment of debt, dividends to shareholders, operating expenses and capital expenditures. Liquidity is derived primarily from retail deposit growth and earnings retention, principal and interest payments on loans and investment securities, net cash provided from operations and access to other funding. If the Company is unable to maintain adequate liquidity, then its business, financial condition and results of operations would be negatively affected.

Legislative or regulatory changes or actions could adversely impact the Company or the businesses in which it is engaged.

The financial services industry is extensively regulated. The Company and the Bank are subject to extensive state and federal regulation, supervision and legislation that govern almost all aspects of their operations. Laws and regulations may change from time to time and are primarily intended for the protection of consumers, depositors and the deposit insurance fund, and not to benefit the Company's shareholders. The impact of any changes to laws and regulations or other actions by regulatory agencies may negatively impact the Company or its ability to increase the value of its business. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of an institution, the classification of assets by the institution and the adequacy of an institution's allowance for loan losses. Future regulatory changes or accounting pronouncements may increase the Company's regulatory capital requirements or adversely affect its regulatory capital levels. Additionally, actions by regulatory agencies against the Company or the Bank could require the Company to devote significant time and resources to defending its business and may lead to penalties that materially affect the Company.

The Company relies heavily on its management and other key personnel, and the loss of any of them may adversely affect its operations.

The Company is and will continue to be dependent upon the services of its management team and other key personnel. Losing the services of one or more key members of the Company's management team could adversely affect its operations.

The Company may be a defendant in a variety of litigation and other actions, which may have a material adverse effect on the Company's financial condition and results of operations.

The Company and the Bank are regularly involved in a variety of litigation arising out of the normal course of business. The Company's insurance may not cover all claims that may be asserted against it, and any claims asserted against it, regardless of merit or eventual outcome, may harm its reputation or cause the Company to incur unexpected expenses, which could be material in amount. Should the ultimate expenses, judgments or settlements in any litigation exceed the Company's insurance coverage, they could have a material adverse effect on the Company's financial condition and results of operations. In addition, the Company may not be able to obtain appropriate types or levels of insurance in the future, nor may it be able to obtain adequate replacement policies with acceptable terms, if at all.

If the Company cannot raise additional capital when needed, its ability to further expand its operations through organic growth or acquisitions could be materially impaired.

The Company is required by federal and state regulatory authorities to maintain specified levels of capital to support its operations. The Company may need to raise additional capital to support its current level of assets or its growth. The Company's ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside its control, and on its financial performance. The Company cannot assure that it will be able to raise additional capital in the future on terms acceptable to it or at all. If the Company cannot raise additional capital when needed, its ability to maintain its current level of assets or to expand its operations through organic growth or acquisitions could be materially limited.

Unauthorized disclosure of sensitive or confidential client or customer information, whether through a breach of computer systems or otherwise, could severely harm the Company's business.

As part of its business, the Company collects, processes and retains sensitive and confidential client and customer information on behalf of itself and other third parties. Despite the security measures the Company has in place for its facilities and systems, and the security measures of its third party service providers, the Company may be vulnerable to security breaches, acts of vandalism, computer viruses, misplaced or lost data, programming and/or human errors or other similar events. Any security breach involving the misappropriation, loss or other unauthorized disclosure of confidential customer information, whether by the Company or by its vendors, could severely damage the Company's reputation, expose it to the risks of litigation and liability, disrupt the Company's operations and have a material adverse effect on the Company's business.

The Company's information systems may experience an interruption or breach in security.

The Company relies heavily on communications and information systems to conduct its business and deliver its products. Any failure, interruption or breach in security of these systems could result in failures or disruptions in the Company's customer relationship management, general ledger, deposit, loan and other systems. While the Company has policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of its information systems, there can be no assurance that any such failures, interruptions or security breaches of the Company's information systems or its customers' information or computer systems would not damage the Company's reputation, result in a loss of customer business, subject the Company to additional regulatory scrutiny, or expose the Company to civil litigation and financial liability, any of which could have a material adverse effect on the Company's financial condition and results of operations.

Environmental liability associated with commercial lending could result in losses.

In the course of its business, the Company may acquire, through foreclosure, properties securing loans it has originated or purchased that are in default. Particularly in commercial real estate lending, there is a risk that hazardous substances could be discovered on these properties. In this event, the Company might be required to remove these substances from the affected properties at the Company's sole cost and expense. The cost of this removal could substantially exceed the value of affected properties. The Company may not have adequate remedies against the prior owner or other responsible parties and could find it difficult or impossible to sell the affected properties. These events could have an adverse effect on the Company's business, results of operations and financial condition.

The Company depends upon the accuracy and completeness of information about customers.

In deciding whether to extend credit to customers, the Company relies on information provided to it by its customers, including financial statements and other financial information. The Company may also rely on representations of customers as to the accuracy and completeness of that information and on reports of independent auditors on financial statements. The Company's financial condition and results of operations could be negatively impacted to the extent that the Company extends credit in reliance on financial statements that do not comply with generally accepted accounting principles or that are misleading or other information provided by customers that is false or misleading.

The Company operates in a highly competitive industry and market area.

The Company faces substantial competition in all areas of its operations from a variety of different competitors, many of which are larger and may have more financial resources. Such competitors primarily include national and regional banks within the various markets where the Company operates, as well as internet banks and other Fintech companies. The Company also faces competition from many other types of financial institutions, including savings and loan associations, credit unions, finance companies, brokerage firms, insurance companies and other financial intermediaries. The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. The Company competes with these institutions both in attracting deposits and in making new loans. Technology has lowered barriers to entry into the market and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of the Company's competitors have fewer regulatory constraints and may have lower cost structures, such as credit unions that are not subject to federal income tax. Due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services than the Company can.

Severe weather, natural disasters, acts of war or terrorism and other external events could significantly impact the Company's business.

Severe weather, natural disasters, acts of war or terrorism and other adverse external events could have a significant impact on the Company's ability to conduct business. Such events could affect the stability of the Company's deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause the Company to incur additional expenses.

The Company relies on dividends from the Bank for most of its revenue.

The Company is a separate and distinct legal entity from the Bank. It receives substantially all of its revenue from dividends from the Bank. These dividends are the principal source of funds to pay cash dividends on the Company’s common stock. Various federal and/or state laws and regulations limit the amount of dividends that the Bank may pay to the Company. If the Bank is unable to pay dividends to the Company, the Company may not be able to pay cash dividends on its common stock. The earnings of the Bank have been the principal source of funds to pay cash dividends to shareholders. Over the long-term, cash dividends to shareholders are dependent upon earnings, as well as capital requirements, regulatory restraints and other factors affecting the Company and the Bank.

Additional risks and uncertainties could have a negative effect on financial performance.

Additional factors could have a negative effect on the financial performance of the Company and the Company’s common stock. Some of these factors are financial market conditions, changes in financial accounting and reporting standards, new litigation or changes in existing litigation, regulatory actions and losses.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The offices of the Company as of February 28, 2018, were as follows:

Company's main office:
109 East Division, Sparta, Michigan
Office is owned by the Bank and comprises 24,000 square feet.

Bank's branch office:
416 West Division, Sparta, Michigan
Office is leased by the Bank and comprises 3,000 square feet.

Bank's branch office:
4170 - 17 Mile Road, Cedar Springs, Michigan
Office is owned by the Bank and comprises 3,000 square feet.

Bank's branch office:
6795 Courtland Drive, Rockford, Michigan
Office is owned by the Bank and comprises 2,400 square feet.

Bank's branch office:
5050 Alpine Avenue NW, Comstock Park, Michigan
Office is owned by the Bank and comprises 2,400 square feet.

Bank's branch office:
450 West Muskegon, Kent City, Michigan
Office is owned by the Bank and comprises 27,300 square feet.

Bank's branch office:
3069 Slocum Road, Ravenna, Michigan
Office is owned by the Bank and comprises 4,800 square feet.

Bank’s branch office:
5475 East Apple Avenue, Muskegon, Michigan
Office is owned by the Bank and comprises 4,800 square feet.

Bank’s branch office:
661 West Randall, Coopersville, Michigan
Office is owned by the Bank and comprises 2,700 square feet.

Bank’s branch office:
10 West Main Street, Grant, Michigan
Office is owned by the Bank and comprises 4,800 square feet.

Bank’s branch office:
246 West River Valley Drive, Newaygo, Michigan
Office is owned by the Bank and comprises 2,600 square feet.

Bank’s branch office:
1423 West Main Street, Fremont, Michigan
Office is owned by the Bank and comprises 1,600 square feet.

Bank’s loan production office:
237 Fulton West, Grand Rapids, Michigan
Office is leased by the Bank and comprises 1,800 square feet.

The Company believes that the offices are suitable and adequate for future needs and are in good condition. The Company’s management believes all offices are adequately covered by property insurance.

Item 3. Legal Proceedings
As of December 31, 2017, there were no significant pending legal proceedings to which the Company or the Bank is a party or to which any of their properties were subject, except for legal proceedings arising in the ordinary course of business. In the opinion of management, pending legal proceedings will not have a material adverse effect on the consolidated financial condition of the Company.

Item 4. Mine Safety Disclosures
Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Stock Information

Several brokers trade ChoiceOne's common shares in the OTC Pink marketplace. There is no well-established public trading market for the shares and trading activity is infrequent. ChoiceOne's trading volume and recent share price information can be viewed under the symbol '**COFS**' on certain financial websites.

The range of high and low bid prices for shares of common stock for each quarterly period during the past two years is as follows:

	2017		2016	
	Low	High	Low	High
First Quarter	$21.43	$23.33	$21.27	$22.67
Second Quarter	21.67	23.99	21.05	22.71
Third Quarter	21.95	23.55	20.97	22.61
Fourth Quarter	22.03	24.10	20.57	22.86

The prices listed above are over-the-counter market quotations reported to ChoiceOne by its market makers. The over-the-counter market quotations reflect inter-dealer prices without retail markup, markdown or commission and may not necessarily represent actual transactions. As of February 28, 2018, the average bid price for shares of

ChoiceOne common stock was $24.65.

As of February 28, 2018, there were 678 shareholders of record of ChoiceOne common stock.

The following table summarizes the quarterly cash dividends declared per share of common stock during 2017 and 2016:

	2017	2016
First Quarter	$0.16	$0.16
Second Quarter	0.17	0.16
Third Quarter	0.17	0.16
Fourth Quarter	0.17	0.16
Total	$0.67	$0.64

ChoiceOne's principal source of funds to pay cash dividends is the earnings and dividends paid by the Bank. The Bank is restricted in its ability to pay cash dividends under current banking regulations. See Note 20 to the consolidated financial statements for a description of these restrictions. Based on information presently available, management expects ChoiceOne to declare and pay regular quarterly cash dividends in 2018, although the amount of the quarterly dividends will be dependent on market conditions and ChoiceOne's requirements for cash and capital, among other things.

On October 25, 2017, the Company issued 542 shares of common stock to its directors pursuant to the Directors' Stock Purchase Plan for an aggregate cash price of $13,000. The Company relied on the exemption contained in Section 4(6) of the Securities Act of 1933 in connection with these sales.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan	Maximum Number of Shares that May Yet be Purchased Under the Plan
October 1 - October 31, 2017				
Employee Transactions	—	$ —	—	
Repurchase Plan	—	$ —	—	20,424
November 1 - November 30, 2017				
Employee Transactions (1)	587	$ 23.00	—	
Repurchase Plan (2)	5,000	$ 23.00	5,000	15,424
December 1 - December 31, 2017				
Employee Transactions	—	$ —	—	
Repurchase Plan	—	$ —	—	15,424

(1) Shares submitted for cancellation to satisfy tax withholding obligations that occur upon the vesting of restricted units. The value of the shares delivered or withheld is determined by the applicable stock compensation plan.

(2) The Company purchased 5,000 shares of its own common stock during the quarter ended December 31, 2017. As of December 31, 2017, there were 15,424 shares remaining that may yet be purchased under approved plans or programs. The repurchase plan was adopted and announced on July 26, 2007. There is no stated expiration date. The plan authorized the repurchase of up to 100,000 shares.

The information under Item 12 of this report regarding equity compensation plans is incorporated herein by reference.

Item 6. Selected Financial Data

ChoiceOne Financial Services, Inc.
Selected Financial Data

(Dollars in thousands, except per share data)

	2017	2016	2015	2014	2013
For the year					
Net interest income	$20,563	$19,343	$18,362	$17,863	$17,596
Provision for loan losses	485	—	100	100	300
Noninterest income	7,811	7,881	7,702	6,802	6,245
Noninterest expense	19,334	18,972	18,276	16,794	16,664
Income before income taxes	8,555	8,252	7,688	7,771	6,877
Income tax expense	2,387	2,162	1,945	2,076	1,783
Net income	6,168	6,090	5,743	5,695	5,094
Cash dividends declared	2,317	2,231	2,170	1,945	1,780
Per share					
Basic earnings	$1.79	$1.76	$1.67	$1.65	$1.48
Diluted earnings	1.78	1.76	1.66	1.64	1.47
Cash dividends declared	0.67	0.64	0.63	0.56	0.51
Shareholders’ equity (at year end)	22.20	20.72	20.18	19.12	17.79
Average for the year					
Securities	$177,125	$173,119	$152,361	$142,361	$133,704
Gross loans	388,609	357,880	342,382	330,355	312,798
Deposits	525,445	479,670	443,972	422,737	410,462
Federal Home Loan Bank advances	22,830	26,049	19,989	14,555	7,415
Shareholders’ equity	75,026	72,134	68,439	64,143	61,317
Assets	629,748	586,299	551,762	526,669	502,333
At year end					
Securities	$159,158	$177,955	$163,323	$145,706	$139,832
Gross loans	398,785	369,000	349,304	346,113	315,966
Deposits	539,853	512,386	474,696	434,828	418,127
Federal Home Loan Bank advances	20,268	12,301	11,332	18,363	6,392
Shareholders’ equity	76,550	71,698	69,842	66,190	61,558
Assets	646,544	607,371	567,746	549,640	514,575
Selected financial ratios					
Return on average assets	0.98 %	1.04 %	1.04 %	1.08 %	1.01 %
Return on average shareholders’ equity	8.22	8.44	8.39	8.88	8.31
Cash dividend payout as a percentage of net income	37.57	36.63	37.79	34.15	34.93
Shareholders’ equity to assets (at year end)	11.84	11.80	12.30	12.04	11.96

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

The following discussion is designed to provide a review of the consolidated financial condition and results of operations of ChoiceOne, and its wholly-owned subsidiaries. This discussion should be read in conjunction with the consolidated financial statements and related footnotes.

RESULTS OF OPERATIONS

Summary

Net income for 2017 was $6,168,000, which represented a $78,000 or 1% increase from 2016. The growth in net income resulted primarily from an increase in net interest income in 2017 compared to 2016, which was partially offset by a higher provision for loan losses and higher noninterest expense. The effect of $39.8 million of growth in average earning assets in 2017 compared to 2016 was partially offset by a 5 basis point decrease in the rate earned on average earning assets. A combination of an increase in net charge-offs in 2017 compared to the prior year and loan growth in 2017 caused ChoiceOne to recognize $485,000 in provision expense for loan losses in 2017 compared to no provision in 2016. ChoiceOne had $185,000 in net loan charge-offs in 2017, compared to net loan recoveries of $83,000 in 2016. A decline in noninterest income of $70,000 in 2017 compared to 2016 was mainly caused by a decrease in gains on sales of loans and net losses on sales of securities in 2017 in contrast to net gains recognized in 2016. This was offset by a $908,000 gain on the sale of a portion of ChoiceOne's investment book of business discussed further in the noninterest income section below. The increase of $362,000 in noninterest expense in 2017 compared to the prior year was primarily due to higher salaries and benefits expense as well as increased occupancy expense and professional fees.

Net income for 2016 was $6,090,000, which represented a $347,000 or 6% increase from 2015. The growth in net income resulted primarily from an increase in interest income in 2016 compared to 2015, which was partially offset by higher noninterest expense. The effect of $34.6 million of growth in average earning assets in 2016 compared to 2015 was partially offset by an 8 basis point decrease in the rate earned on average assets. Net loan charge-offs continued to be low in 2016, which allowed for no provision expense for loan losses in 2016 compared to $100,000 in 2015. ChoiceOne had $83,000 in net loan recoveries in 2016, compared to net loan charge-offs of $79,000 in 2015. Growth in noninterest income of $179,000 in 2016 compared to 2015 was mainly caused by higher gains on sales of loans. The increase of $696,000 in noninterest expense in 2016 compared to the prior year was primarily due to higher salaries and benefits.

Dividends

Cash dividends of $2,317,000 or $0.67 per common share were declared in 2017, compared to $2,231,000 or $0.64 per common share in 2016 and $2,170,000 or $0.63 per common share in 2015. The dividend yield on ChoiceOne's common stock was 2.86% as of year-end 2017, compared to 2.86% in 2016 and 2.77% in 2015. The cash dividend payout as a percentage of net income was 38% in 2017, compared to 37% in 2016 and 38% in 2015. In addition, a 5%

stock dividend was paid on May 31, 2017, which caused $3,779,000 to be transferred from retained earnings to paid-in capital.

Table 1 – Average Balances and Tax-Equivalent Interest Rates

	Year ended December 31,								
	2017			2016			2015		
(Dollars in thousands)	Average Balance	Interest	Rate	Average Balance	Interest	Rate	Average Balance	Interest	Rate
Assets:									
Loans (1) (2)	$388,609	$17,974	4.63%	$357,880	$16,518	4.62%	$342,382	$15,982	4.67%
Taxable securities (3)	122,150	2,371	1.94	118,787	2,171	1.83	102,550	1,783	1.74
Nontaxable securities (1)	54,975	2,142	3.90	54,332	2,190	4.03	49,952	2,156	4.32
Other	9,465	102	1.08	4,231	21	0.49	5,753	14	0.25
Interest-earning assets	575,199	22,589	3.93	535,230	20,900	3.91	500,637	19,935	3.98
Noninterest-earning assets (4)	54,549			51,069			51,125		
Total assets	$629,748			$586,299			$551,762		
Liabilities and Shareholders' Equity:									
Interest-bearing demand deposits	$208,049	$385	0.18%	$196,662	$253	0.13%	$165,767	$226	0.14%
Savings deposits	76,107	14	0.02	73,118	20	0.03	67,826	26	0.04
Certificates of deposit	104,936	790	0.75	86,042	517	0.60	94,891	625	0.66
Advances from Federal Home Loan Bank	22,830	276	1.21	26,049	171	0.66	19,989	83	0.41
Other	5,661	13	0.23	8,372	8	0.10	18,156	30	0.17
Interest-bearing liabilities	417,583	1,478	0.36	390,243	969	0.25	366,629	990	0.27
Demand deposits	136,353			123,848			115,488		
Other noninterest-bearing liabilities	786			74			1,206		
Total liabilities	554,722			514,165			483,323		
Shareholders' equity	75,026			72,134			68,439		
Total liabilities and shareholders' equity	$629,748			$586,299			$551,762		
Net interest income (tax-equivalent basis)-interest spread		21,111	3.57%		19,931	3.66%		18,944	3.71%
Tax-equivalent adjustment (1)		(548)			(591)			(582)	
Net interest income		$20,563			$19,340			$18,362	
Net interest income as a percentage of earning assets (tax-equivalent			3.67%			3.72%			3.78%

basis)

(1) Interest on nontaxable securities and loans has been adjusted to a fully tax-equivalent basis to facilitate comparison to the taxable interest-earning assets. The adjustment uses an incremental tax rate of 34% for the years presented.

(2) Interest on loans included net origination fees charged on loans of approximately $1,003,000, $1,054,000, and $957,000 in 2017, 2016, and 2015, respectively.

(3) Interest on taxable securities includes dividends on Federal Home Loan Bank and Federal Reserve Bank stock.

(4) Noninterest-earning assets include loans on a nonaccrual status, which averaged approximately $1,486,000, $2,416,000, and $2,145,000 in 2017, 2016, and 2015, respectively.

Table 2 – Changes in Tax-Equivalent Net Interest Income

(Dollars in thousands)	Year ended December 31, 2017 Over 2016			2016 Over 2015		
	Total	Volume	Rate	Total	Volume	Rate
Increase (decrease) in interest income (1)						
Loans (2)	$1,456	$1,421	$35	$536	$717	$(181)
Taxable securities	200	63	137	388	293	95
Nontaxable securities (2)	(48)	26	(74)	34	182	(148)
Other	81	41	40	8	(4)	12
Net change in interest income	1,689	1,551	138	966	1,188	(222)
Increase (decrease) in interest expense (1)						
Interest-bearing demand deposits	132	16	116	27	40	(13)
Savings deposits	(6)	1	(7)	(6)	2	(8)
Certificates of deposit	273	127	146	(108)	(56)	(52)
Advances from Federal Home Loan Bank	105	(23)	128	88	30	58
Other	5	(4)	9	(22)	(12)	(10)
Net change in interest expense	509	117	392	(21)	4	(25)
Net change in tax-equivalent net interest income	$1,180	$1,434	$(254)	$987	$1,184	$(197)

(1) The volume variance is computed as the change in volume (average balance) multiplied by the previous year's interest rate. The rate variance is computed as the change in interest rate multiplied by the previous year's volume (average balance). The change in interest due to both volume and rate has been allocated to the volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

(2) Interest on tax-exempt securities and loans has been adjusted to a fully tax-equivalent basis using an incremental tax rate of 34% for the years presented.

Net Interest Income

Tax-equivalent net interest income increased $1,180,000 in 2017 compared to 2016. The increase was attributed to an increase of $40.0 million in interest-earning assets, which was partially offset by a 5 basis point decrease in the rate earned on these assets and a 9 basis point increase in interest bearing liabilities. ChoiceOne's net interest spread declined 9 basis points in 2017 compared to 2016.

The average balance of loans increased $30.7 million in 2017 compared to 2016. Most of the increase resulted from growth of $12.7 million in commercial real estate loans and $8.3 million of commercial and industrial loans. Partially offsetting the effect of the loan growth was a 4 basis point decrease in the average rate earned on loans. Tax-equivalent interest income on loans increased $1.5 million in 2017 compared to the prior year. The average balance of total securities increased by $4.0 million in 2017 compared to 2016 as securities were purchased to provide earning assets growth. Interest income from securities increased $152,000 in 2017 compared to the prior year.

The average balance of interest-bearing demand deposits increased $11.4 million in 2017 compared to 2016. The effect of this increase and a 4 basis point increase in the average rate paid caused interest expense to be $132,000 higher in 2017 than in the prior year. The effect of the $3.0 million increase in average savings deposits was partially offset by a 2 basis point decline in the average rate paid. The average balance of certificates of deposit was $18.9 million higher in 2017 than in the prior year. The average balance increase plus the impact of a 9 basis point increase in the average rate paid caused interest expense to grow $273,000. A $3.2 million decline in the average balance of Federal Home Loan Bank advances, partially offset by an 80 basis point increase in the average rate paid, caused interest expense to increase $105,000 in 2017 compared to the prior year.

ChoiceOne's tax-equivalent net interest income spread was 3.57% for 2017 and 3.66% for 2016. The decline in the net interest income spread resulted from the average rate paid on interest-bearing liabilities increased more in 2017 than the average rate earned on interest-earning assets.

Tax-equivalent net interest income increased $987,000 in 2016 compared to 2015. The increase was attributed to an increase of $34.6 million in interest-earning assets and a decrease of 2 basis points on interest-bearing liabilities, which were partially offset by an 8 basis point decline in the average rate on interest-earning assets. ChoiceOne's net interest spread declined 5 basis points in 2016 compared to 2015 as general market rates had more of a downward effect on assets than liabilities.

The average balance of loans increased $15.5 million in 2016 compared to 2015. Most of the increase resulted from growth of $13.6 million in commercial and industrial and commercial real estate loans. Partially offsetting the loan growth was a 5 basis point decrease in the average rate earned on loans, which caused tax-equivalent interest income on loans to increase $536,000 in 2016 compared to the prior year. The average balance of total securities increased by $20.6 million in 2016 compared to 2015 as securities were purchased to provide earning assets growth. This growth in the average balance was partially offset by a lower average rate earned on securities; however, interest income from securities still increased $422,000 in 2016 compared to the prior year.

The average balance of interest-bearing demand deposits increased $30.9 million in 2016 compared to 2015. The effect of this increase, partially offset by a 1 basis point decline in the average rate paid, caused interest expense to be $27,000 higher in 2016 than in the prior year. The effect of the $5.3 million increase in average savings deposits was more than offset by a 1 basis point decline in average rate paid which caused a $6,000 decrease in interest expense in 2016 compared to the prior year. The average balance of certificates of deposit was $8.8 million lower in 2016 than in the prior year. The average balance decrease plus the effect of a 6 basis point decline in the average rate paid caused interest expense on certificates of deposit to fall $108,000 in 2016 compared to 2015. A $6.1 million increase in the average balance of Federal Home Loan Bank advances and a 25 basis point increase in the average rate paid caused interest expense to increase $88,000 in 2016 compared to the prior year. The growth experienced in non-interest bearing demand deposits and savings deposits was primarily due to depositors choosing the liquidity afforded by this type of deposit as compared to certificates of deposit or nonbank investments.

ChoiceOne’s net interest income spread was 3.66% for 2016 and 3.71% for 2015. The continuation of low general market interest rates in both 2015 and 2016 caused the reduction in rates for both assets and liabilities.

Provision and Allowance For Loan Losses

Table 3 – Provision and Allowance For Loan Losses

(Dollars in thousands)	2017	2016	2015	2014	2013
Allowance for loan losses at beginning of year	$4,277	$4,194	$4,173	$4,735	$5,852
Charge-offs:					
Agricultural	—	—	—	—	88
Commercial and industrial	439	37	30	1	122
Real estate - commercial	—	—	—	665	858
Real estate - construction	—	—	—	—	—
Real estate - residential	43	102	140	133	732
Consumer	253	218	291	273	351
Total	735	357	461	1,072	2,151
Recoveries:					
Agricultural	—	—	1	20	6
Commercial and industrial	21	31	64	119	337
Real estate - commercial	258	89	47	48	84
Real estate - construction	40	—	—	—	—
Real estate - residential	62	171	149	44	132
Consumer	169	149	121	179	175
Total	550	440	382	410	734
Net charge-offs (recoveries)	185	(83)	79	662	1,417
Provision for loan losses (1)	485	—	100	100	300
Allowance for loan losses at end of year	$4,577	$4,277	$4,194	$4,173	$4,735
Allowance for loan losses as a percentage of:					
Total loans as of year end	1.15 %	1.16 %	1.20 %	1.21 %	1.50 %
Nonaccrual loans, accrual loans past due 90 days or more and troubled debt restructurings	108 %	84 %	76 %	63 %	62 %
Ratio of net charge-offs (recoveries) to average total loans outstanding during the year	0.05 %	(0.02)%	0.02 %	0.20 %	0.45 %
Loan recoveries as a percentage of prior year's charge-offs	154 %	95 %	36 %	19 %	29 %

The provision for loan losses was $485,000 in 2017 compared to $0 in 2016. The increase to provision during the year was partly due to net charge-offs occurring in 2017 in contrast to net recoveries experienced in 2016. The increase was also caused by loan growth during 2017. The allowance for loan losses as a percentage of total loans decreased slightly from 1.16% as of the end of 2016 to 1.15% as of the end of 2017. The coverage ratio of the allowance for loan losses to nonperforming loans increased from 84% as of December 31, 2016 to 108% as of December 31, 2017. ChoiceOne had $302,000 of specific allowance allocations for problem loans as of the end of 2017, compared to $403,000 as of the prior year end. Specific allowance amounts have been allocated where the fair values of loans were considered to be less than their carrying values. ChoiceOne obtains valuations on collateral dependent loans when the loan is considered by management to be impaired and uses the valuation amounts in the determination of fair value. Management believes the specific reserves allocated to certain problem loans at the end of 2017 and 2016 were reasonable based on the circumstances surrounding each particular borrower.

The following schedule presents an allocation of the allowance for loan losses to the various loan categories as of the years ended December 31:

(Dollars in thousands)

	2017	2016	2015	2014	2013
Agricultural	$506	$433	$420	$186	$178
Commercial and industrial	1,001	688	586	527	562
Real estate - commercial	1,761	1,438	1,030	1,641	1,842
Real estate - construction	35	62	46	9	12
Real estate - residential	726	1,013	1,388	1,193	1,626
Consumer	262	305	297	184	192
Unallocated	286	338	427	433	323
Total allowance for loan losses	$4,577	$4,277	$4,194	$4,173	$4,735

The increase in the allowance allocation to commercial and industrial loans and commercial real estate loans was due to growth in these categories and an increase in the inherent risk. The decline in the allocation to residential real estate loans was caused by lower historical charge-off levels. Changes in historical charge-off levels and environmental factors affected all loan categories.

Management maintains the allowance at a level that it believes adequately provides for losses inherent in the loan portfolio. Such losses are estimated by a variety of factors, including specific examination of certain borrowing relationships and consideration of historical losses incurred on certain types of credits. Current economic conditions and collateral values affect loss estimates. Management focuses on early identification of problem credits through ongoing reviews by management and the independent loan review function. Based on the current state of the economy and a recent review of the loan portfolio, management believes that the allowance for loan losses as of December 31, 2017 was adequate. As charge-offs, changes in the level of nonperforming loans, and changes within the composition of the loan portfolio occur, the provision and allowance for loan losses will be reviewed by the Bank's management and adjusted as necessary.

Noninterest Income

Total noninterest income decreased $70,000 in 2017 compared to 2016. Customer service charges increased $79,000 in 2017 due to higher overdraft and debit card fees. Gains on loan sales declined $483,000 in 2017 compared to 2016 as mortgage sales volume was lower in 2017 than in 2016. This was primarily due to higher interest rates and a relatively low inventory of homes available for sale in ChoiceOne's primary markets. The large decline in gain on sales of securities was caused by ChoiceOne's decision in the fourth quarter of 2017 to sell securities to support the funding of loan growth and decrease the bank's dependence on wholesale borrowings due to increases in interest rates. As a result, ChoiceOne sold approximately $35 million in securities and recorded a fourth quarter loss of $457,000 on the sale. Management believes this decision will be accretive to income in 2018 and recognizing the losses during 2017 resulted in beneficial tax treatment. A gain of $908,000 was recognized upon the sale of a portion of ChoiceOne's investment book of business during the fourth quarter of 2017. This sale was the primary reason for the decrease in insurance and investment commissions from 2016 to 2017. The increase in other noninterest income from 2016 to 2017 was primarily due to a $61,000 improvement in income from ChoiceOne's investment in a title insurance agency.

Total noninterest income increased $179,000 in 2016 compared to 2015. Customer service charges decreased $27,000 in 2016 compared to the prior year due to a slight decline in service charges on checking accounts. A decrease in insurance and investment commissions of $51,000 in 2016 compared to 2015 was caused by lower commission income from sales of REIT investments during 2016 compared to 2015. Gains on sales of loans increased $332,000 in 2016 compared to 2015 as longer-term mortgage rates declined causing a positive impact on mortgage volume. Net gains on sales of securities increased $51,000 as opportunities to harvest gains on the securities portfolio increased in the low interest rate environment that existed during most of 2016. Net losses on sales of other assets were $80,000 lower in 2016 than in the prior year as write-downs of values of other real estate properties and losses on sales of properties were lower in 2016 than in 2015. Earnings on life insurance policies were $295,000 lower in 2016 than 2015 as the result of a death benefit received on a former employee's life insurance policy in 2015.

Noninterest Expense

Total noninterest expense increased $362,000 in 2017 compared to 2016. Salaries and benefits increased $267,000 in 2017 compared to the prior year due to higher costs related to salaries, stock-based compensation, and health insurance. Occupancy and equipment expense grew $308,000 in 2017 compared to the prior year primarily as a result of costs related to remodeling expenses to ChoiceOne's headquarters in Sparta, Michigan which was completed in 2017. Expense was also affected by a full year's cost of two new ATM locations that were added during 2016. Professional fees increased $231,000 in 2017 compared to 2016 due in part to higher legal fees related to the sale of the investment book of business and costs associated with the search, purchase, and branch application process on two additional branches that are scheduled to be opened in 2018. Intangible amortization expense was $0 in 2017 as the related intangible assets were fully amortized by the end of 2016. The decrease in other noninterest expense in 2017 compared to the prior year was caused in part by lower recruiting expense and by lower FDIC insurance expense due to a reduced FDIC assessment rate after the Deposit Insurance Fund reached a 1.15% reserve threshold on June 30, 2016.

Total noninterest expense increased $696,000 in 2016 compared to 2015. Salaries and benefits increased $709,000 in 2016 compared to the prior year due to higher costs related to salaries, stock-based compensation, commissions, and health insurance. Occupancy and equipment expense grew $192,000 in 2016 compared to the prior year primarily as a result of costs related to the lease of the loan production office than began in early 2016 and the lease of two new ATM locations that were added during 2016. Data processing expense decreased $47,000 as expenses related to Internet banking were lower in 2016 than in the prior year. Intangible amortization expense decreased by $69,000 in 2016 compared to 2015 as intangible assets were fully amortized by the end of 2016. FDIC insurance expense decreased in the last two quarters of 2016 due to a reduced FDIC assessment rate after the Deposit Insurance Fund reached a 1.15% reserve threshold on June 30, 2016.

Income Taxes

In the fourth quarter of 2017, ChoiceOne adjusted its net deferred tax asset for the impact of the lower corporate income tax rate which will be effective beginning in 2018. This adjustment caused the recognition of $206,000 of income tax expense, increasing tax expense in the fourth quarter of 2017 compared to the same time period in 2016. The reduction of the corporate income tax rate will have a positive effect on net income in future periods. Overall, income taxes increased $225,000 in 2017 compared to 2016. The effective tax rate was 28% in 2017, compared to 26% in 2016 and 25% in 2015. Income taxes increased $217,000 in 2016 compared to 2015. The increase in income taxes during 2017 compared to 2016 was primarily due to the adjustment of the deferred tax asset. The increase in tax expense in 2016 was caused by higher income before taxes.

Financial Condition

Summary

Total assets were $646.5 million as of December 31, 2017, which represented an increase of $39.2 million or 6.5% from the end of 2016. Securities available for sale decreased $18.8 million during 2017 due to the sale of securities in the fourth quarter of 2017. Net loans increased $29.5 million in 2017, with most of the increase occurring in commercial real estate and commercial and industrial loans. The increase of $300,000 in the allowance for loan losses resulted from provision for loan losses in 2017 required as a result of loan growth and higher net charge-offs in the current year compared to 2016. Total deposits increased $27.5 million in 2017 due to growth in checking deposits, savings deposits, and certificates of deposit.

Securities

The Bank’s securities available for sale balances as of December 31 were as follows:

(Dollars in thousands)

	2017	2016
U.S. Government and federal agency	$35,126	$59,052
U.S. Treasury notes and bonds	1,960	4,072
State and municipal	100,048	88,973
Mortgage-backed	9,820	7,789
Corporate	5,151	7,041
Foreign debt	—	4,400
Equity securities	3,392	2,883
Asset-backed securities	94	178
Total	$155,591	$174,388

The securities available for sale portfolio decreased $18.8 million from December 31, 2016 to December 31, 2017. The decline in the securities balance was caused by the sale of $35 million of securities in the fourth quarter of 2017. Approximately $15.2 million in various securities were called or matured in 2017, which was partially offset by securities purchases. Principal payments for municipal and mortgage-backed securities totaling $2.4 million were received during 2017. The Bank's Investment Committee continues to monitor the portfolio and purchases securities as it considers prudent. Also, certain securities are sold under agreements to repurchase and management plans to continue this practice as a low-cost source of funding.

Equity securities included a money market preferred security (MMP) and a trust preferred security totaling $1.5 million, and common stock of $1.9 million as of December 31, 2017. As of December 31, 2016, equity securities included an MMP and trust preferred security totaling $1.5 million, and common stock of $1.4 million.

Loans

The Bank's loan portfolio as of December 31 was as follows:

(Dollars in thousands)

	2017	2016
Agricultural	$48,464	$44,614
Commercial and industrial	104,386	96,088
Consumer	24,513	21,596
Real estate - commercial	123,487	110,762
Real estate - construction	6,613	6,153
Real estate - residential	91,322	89,787
Total loans	$398,785	$369,000

The loan portfolio (excluding loans held for sale and loans to other financial institutions) increased $29.8 million from December 31, 2016 to December 31, 2017. Economic factors in ChoiceOne's market are continuing to improve in most industry sectors. Residential mortgage loans volume was lower in 2017 mainly due to higher interest rates and a relatively low inventory of homes available for sale in ChoiceOne's primary markets. Growth experienced in the commercial and industrial and commercial real estate loan categories was due in part to calling efforts by ChoiceOne's loan officers.

The Bank entered into an agreement at the beginning of 2017 to provide a line of credit to facilitate funding of residential mortgage loan originations at other financial institutions. The loans are short-term in nature and are designed to provide funding for the time period between the loan origination and its subsequent sale in the secondary market. As of December 31, 2017 the balance of the line of credit was $6.8 million.

Information regarding impaired loans can be found in Note 3 to the consolidated financial statements included in this report. In addition to its review of the loan portfolio for impaired loans, management also monitors various nonperforming loans. Nonperforming loans are comprised of (1) loans accounted for on a nonaccrual basis; (2) loans, not included in nonaccrual loans, which are contractually past due 90 days or more as to interest or principal payments; and (3) loans, not included in nonaccrual or past due 90 days or more, which are considered troubled debt restructurings. Troubled debt restructurings consist of loans where the terms have been modified to assist the borrowers in making their payments. The modifications can include capitalization of interest onto the principal balance, reduction in interest rate, and extension of the loan term.

The balances of these nonperforming loans as of December 31 were as follows:

(Dollars in thousands)

	2017		2016	
Loans accounted for on a nonaccrual basis	$	1,096	$	1,983
Loans contractually past due 90 days or more as to principal or interest payments		258		229
Loans considered troubled debt restructurings which are not included above		2,896		2,853
Total	$	4,250	$	5,065

Nonaccrual loans included $423,000 in agricultural loans, $222,000 in commercial and industrial loans, $15,000 in consumer loans, and $436,000 in residential real estate loans as of December 31, 2017. Nonaccrual loans included $482,000 in agricultural loans, $245,000 in commercial and industrial loans, $6,000 in consumer loans, $458,000 in commercial real estate loans, and $792,000 in residential real estate loans as of December 31, 2016. The primary reason for the decline in nonaccrual loans in 2017 was loan paydowns and two charge-offs related to commercial and industrial loans. Loans considered troubled debt restructurings which were not on a nonaccrual basis and were not 90 days or more past due as to principal or interest payments consisted of $24,000 in commercial and industrial loans, $556,000 in commercial real estate loans, $17,000 in consumer loans, and $2,299,000 in residential real estate loans at December 31, 2017, compared to $26,000 in commercial and industrial loans, $615,000 in commercial real estate loans, $20,000 in consumer loans, and $2,192,000 in residential real estate loans at December 31, 2016.

Management also maintains a list of loans that are not classified as nonperforming loans but where some concern exists as to the borrowers' abilities to comply with the original loan terms. These loans totaled $3.6 million as of December 31, 2017, compared to $5.3 million as of December 31, 2016.

Deposits and Other Funding Sources

The Bank’s deposit balances as of December 31 were as follows:

(Dollars in thousands)

	2017	2016
Noninterest-bearing demand deposits	$151,462	$127,611
Interest-bearing demand deposits	126,363	122,465
Money market deposits	94,178	99,454
Savings deposits	75,080	75,835
Local certificates of deposit	82,598	79,108
Brokered certificates of deposit	10,172	7,913
Total deposits	$539,853	$512,386

Total deposits increased $27.5 million from December 31, 2016 to December 31, 2017. The demand deposit categories as well as money market deposits and savings deposits grew $21.7 million as the Bank’s depositors valued liquid funds more than the interest rates paid on certificates of deposit. Local and brokered certificates of deposit also experienced some growth in 2017.

Securities sold under agreements to repurchase declined $765,000 during 2017 due to normal fluctuations in overnight balances in sweep repurchase accounts used by the Bank’s local clients. Federal Home Loan Bank advances increased $8.0 million from December 31, 2016 to December 31, 2017 in order to assist with the funding of loan growth. A blanket collateral agreement covering agricultural real estate loans and residential real estate loans was pledged against all outstanding advances at the end of 2017. Approximately $28.2 million of additional advances were available as of December 31, 2017 based on the collateral pledged.

In 2018, management will continue to focus its marketing efforts toward growth in local deposits. If local deposit growth is insufficient to support asset growth, management believes that advances from the FHLB and brokered certificates of deposit can address corresponding funding needs.

Shareholders’ Equity

Total shareholders’ equity increased $4.9 million from December 31, 2016 to December 31, 2017. The growth in equity resulted from the retention of earnings in 2017 as net income exceeded dividends paid by $3.9 million. Accumulated other comprehensive income increased by $835,000 in 2017 principally as a result of available for sale securities moving from a net unrealized loss at the end of 2016 to a net unrealized gain as of the end of 2017.

Note 20 to the consolidated financial statements presents regulatory capital information for the Bank at the end of 2017 and 2016. Management will monitor these capital ratios during 2018 as they relate to asset growth and earnings retention. ChoiceOne's Board of Directors and management do not plan to allow capital to decrease below those levels necessary to be considered "well capitalized" by regulatory guidelines. At December 31, 2017, the Bank was categorized as "well-capitalized." On July 3, 2013, the FDIC Board of Directors approved the Regulatory Capital Interim Final Rule, implementing Basel III. This rule redefines Tier 1 capital as two components (Common Equity Tier 1 and Additional Tier 1), creates a new capital ratio (Common Equity Tier 1 Risk-based Capital Ratio) and implements a capital conservation buffer. It also revises the prompt corrective action thresholds and makes changes to risk weights for certain assets and off-balance-sheet exposures. Banks were required to transition into the new rule beginning on January 1, 2015. A 2.5% capital conservation buffer will be phased in over a period of four years beginning in 2016. Based on ChoiceOne's capital levels and balance sheet composition at December 31, 2017, management believes implementation of the new rule will have no material impact on ChoiceOne's capital needs.

Table 4 – Contractual Obligations

The following table discloses information regarding the maturity of ChoiceOne's contractual obligations at December 31, 2017:

	Payment Due by Period				
(Dollars in thousands)	Total	Less than 1 year	1 - 3 Years	3 - 5 Years	More than 5 Years
Time deposits	$92,770	$67,698	$18,712	$6,360	$ —
Repurchase agreements	7,148	7,148	—	—	—
Advances from Federal Home Loan Bank	20,268	20,034	73	79	82
Operating leases	760	117	241	251	152
Other obligations	595	99	198	143	155
Total	$121,541	$95,096	$19,222	$6,833	$ 389

Liquidity and Interest Rate Risk

Net cash from operating activities was $8.1 million for 2017 compared to $10.9 million for 2016. Lower net proceeds from loan sales was the main reason for the decrease. Cash used in investing activities was $18.3 million in 2017 compared to $41.5 million in 2016. The large year over year change was caused by sales of securities in 2017, the effect of which was partially offset by higher loan growth in 2017 than in 2016. Cash flows from financing activities were $32.2 million in 2017 compared to $34.2 million in the prior year.

ChoiceOne's primary market risk exposure occurs in the form of interest rate risk. Liquidity risk also can have an impact but to a lesser extent. ChoiceOne's business is transacted in U.S. dollars with no foreign exchange risk exposure. Agricultural loans comprise a relatively small portion of ChoiceOne's total assets. Management believes that ChoiceOne's exposure to changes in commodity prices is insignificant.

Management believes that the current level of liquidity is sufficient to meet the Bank's normal operating needs. This belief is based upon the availability of deposits from both the local and national markets, maturities of securities, normal loan repayments, income retention, federal funds purchased lines of credit from correspondent banks, and advances available from the FHLB. Liquidity risk deals with ChoiceOne's ability to meet its cash flow requirements. These requirements include depositors desiring to withdraw funds and borrowers seeking credit. Relatively short-term liquid funds exist in the form of lines of credit to purchase federal funds at correspondent banks. As of December 31, 2017, the amount of federal funds available for purchase from the Bank's correspondent banks totaled approximately

$63.0 million. ChoiceOne had no federal funds purchased at the end of 2017 or 2016. The Bank also has a line of credit secured by ChoiceOne's commercial loans with the Federal Reserve Bank of Chicago for $82.5 million, which is designated for nonrecurring short-term liquidity needs. Longer-term liquidity needs may be met through local deposit growth, maturities of securities, normal loan repayments, advances from the FHLB, brokered certificates of deposit, and income retention. Approximately $28.2 million of borrowing capacity was available from the FHLB based on agricultural real estate loans and residential real estate loans pledged as collateral at year-end 2017. The acceptance of brokered certificates of deposit is not limited as long as the Bank is categorized as "well capitalized" under regulatory guidelines.

Critical Accounting Policies And Estimates

Management's discussion and analysis of financial condition and results of operations as well as disclosures found elsewhere in this report are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the market value of securities, the amount of the allowance for loan losses, loan servicing rights, carrying value of goodwill, and income taxes. Actual results could differ from those estimates.

Securities

Securities available for sale may be sold prior to maturity due to changes in interest rates, prepayment risks, yield, availability of alternative investments, liquidity needs, credit rating changes, or other factors. Securities classified as available for sale are reported at their fair value with changes flowing through other comprehensive income. Declines in the fair value of securities below their cost that are considered to be "other than temporary" are recorded as losses in the income statement. In estimating whether a fair value decline is considered to be "other than temporary," management considers the length of time and extent that the security's fair value has been less than its carrying value, the financial condition and near-term prospects of the issuer, and the Bank's ability and intent to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.

Market values for securities available for sale are obtained from outside sources and applied to individual securities within the portfolio. The difference between the amortized cost and the fair value of securities is recorded as a valuation adjustment and reported net of tax effect in other comprehensive income.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level believed adequate by management to absorb probable incurred losses inherent in the consolidated loan portfolio. Management's evaluation of the adequacy of the allowance for loan losses is an estimate based on reviews of individual loans, assessments of the impact of current economic conditions on the portfolio and historical loss experience of seasoned loan portfolios.

Management believes the accounting estimate related to the allowance for loan losses is a "critical accounting estimate" because (1) the estimate is highly susceptible to change from period to period because of assumptions concerning the changes in the types and volumes of the portfolios and current economic conditions and (2) the impact of recognizing an impairment or loan loss could have a material effect on the Company's assets reported on the balance sheet as well as its net income.

Loan Servicing Rights

Loan servicing rights represent the estimated value of servicing loans that are sold with servicing retained by ChoiceOne and are initially recorded at estimated fair value. Servicing rights are expensed in proportion to, and over the period of, estimated net servicing revenues. Management's accounting treatment of loan servicing rights is estimated based on current prepayment speeds that are typically market driven.

Management believes the accounting estimate related to loan servicing rights is a "critical accounting estimate" because (1) the estimate is highly susceptible to change from period to period because of significant changes within long-term interest rates affecting the prepayment speeds for current loans being serviced and (2) the impact of recognizing an impairment loss could have a material effect on ChoiceOne's net income. Management has obtained a third-party valuation of its loan servicing rights to corroborate its current carrying value at the end of each reporting period.

Goodwill

Generally accepted accounting principles require that the fair values of the assets and liabilities of an acquired entity be recorded at their fair value on the date of acquisition. The fair values are determined using both internal computations and information obtained from outside parties when deemed necessary. The net difference between the price paid for the acquired company and the net value of its balance sheet is recorded as goodwill. Accounting principles also require that goodwill be evaluated for impairment on an annual basis or more frequently whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Under recently issued accounting pronouncements, ChoiceOne is permitted to first perform a qualitative assessment to determine whether it is more likely than not (that is, a likelihood of more than 50 percent) that the fair value of equity is less than its carrying value. If the conclusion is that it is more likely than not that the fair value of equity is more than its carrying value, no further testing in the form of a quantitative assessment is necessary. If the conclusion is that it is more likely than not that the fair value of equity is less than its carrying value, then a two-step quantitative assessment test is performed to identify any potential goodwill impairment.

Management performed a qualitative assessment of goodwill as of September 30, 2017. The analysis was performed including evaluation of the share price, book value, and financial results of ChoiceOne as compared to the previous year. Additionally, industry and market conditions were evaluated and compared. Average deal prices in the Midwest of closed transactions have indicated increases in deal values to tangible common equity, deal values to earnings, and core deposit premiums when compared to the observed prices used in the last quantitative assessment of goodwill in 2016. Further, macro-economic trends have been on a positive trajectory recently and there have been no adverse legal, regulatory, contractual, political or other factors that have materially impacted ChoiceOne. Upon completion of the qualitative assessment, ChoiceOne believes that it is more likely than not that the fair value of ChoiceOne's equity exceeds the carrying value at the assessment date and there is no further quantitative assessment necessary.

Taxes

Income taxes include both a current and deferred portion. Deferred tax assets and liabilities are recorded to account for differences in the timing of the recognition of revenues and expenses for financial reporting and tax purposes. Generally accepted accounting principles require that deferred tax assets be reviewed to determine whether a valuation allowance should be established using a "more likely than not" standard. Based on its review of ChoiceOne's deferred tax assets as of December 31, 2017, management determined that no valuation allowance was necessary.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Interest rate risk is related to liquidity because each is affected by maturing assets and sources of funds. ChoiceOne's Asset/Liability Management Committee (the "ALCO") attempts to stabilize the interest rate spread and avoid possible adverse effects when unusual or rapid changes in interest rates occur. The ALCO uses a simulation model to measure the Bank's interest rate risk. The model incorporates changes in interest rates on rate-sensitive assets and liabilities. The degree of rate sensitivity is affected by prepayment assumptions that exist in the assets and liabilities. One method the ALCO uses of measuring interest rate sensitivity is the ratio of rate-sensitive assets to rate-sensitive liabilities. An asset or liability is considered to be rate-sensitive if it matures or otherwise reprices within a given time frame.

Table 5 documents the maturity or repricing schedule for ChoiceOne's rate-sensitive assets and liabilities for selected time periods:

Table 5 – Maturities and Repricing Schedule

	As of December 31, 2017				
(Dollars in thousands)	0 - 3 Months	3 - 12 Months	1 - 5 Years	Over 5 Years	Total
Assets					
Securities available for sale	$7,120	$17,332	$86,051	$45,089	$155,591
Federal Home Loan Bank stock	1,994	—	—	—	1,994
Federal Reserve Bank stock	—	—	—	1,573	1,573
Loans held for sale	1,721	—	—	—	1,721
Loans to other financial institutions	6,802	—	—	—	6,802
Loans	118,651	93,922	165,208	21,004	398,785
Cash surrender value of life insurance policies	—	—	—	14,514	14,514
Rate-sensitive assets	$136,288	$111,254	$251,258	$82,180	$580,980
Liabilities					
Interest-bearing demand deposits	$126,363	$—	$—	$—	$126,363
Money market deposits	94,178	—	—	—	94,178
Savings deposits	75,080	—	—	—	75,080
Certificates of deposits	28,305	39,511	24,659	295	92,770
Repurchase agreements	7,148	—	—	—	7,148
Advances from FHLB	10,009	10,025	152	82	20,268
Rate-sensitive liabilities	$341,083	$49,536	$24,811	$377	$415,807
Rate-sensitive assets less rate-sensitive liabilities:					
Asset (liability) gap for the period	$(204,795)	$61,718	$226,447	$81,803	$165,173

Under this method, the ALCO measures interest rate sensitivity by focusing on the one-year repricing gap. ChoiceOne's ratio of rate-sensitive assets to rate-sensitive liabilities that matured or repriced within a one-year time frame was 63% at December 31, 2017, compared to 68% at December 31, 2016. Table 5 above shows the entire balance of interest-bearing demand deposits, savings deposits, money market deposits, and overnight repurchase agreements in the shortest repricing term. Although these categories have the ability to reprice immediately, management has some control over the actual timing or extent of the changes in interest rates on these liabilities. The ALCO plans to continue to monitor the ratio of rate-sensitive assets to rate-sensitive liabilities on a quarterly basis in 2018. As interest rates change during 2018, the ALCO will attempt to match its maturing assets with corresponding liabilities to maximize ChoiceOne's net interest income.

Another method the ALCO uses to monitor its interest rate sensitivity is to subject rate-sensitive assets and liabilities to interest rate shocks. At December 31, 2017, management used a simulation model to subject its assets and liabilities up to an immediate 400 basis point increase. The maturities of loans and mortgage-backed securities were affected by certain prepayment assumptions. Maturities for interest-bearing core deposits were based on an estimate of the period over which they would be outstanding. The maturities of advances from the FHLB were based on their contractual maturity dates. In the case of variable rate assets and liabilities, repricing dates were used to determine their values. The simulation model measures the effect of immediate interest rate changes on both net interest income and shareholders' equity.

Table 6 provides an illustration of hypothetical interest rate changes as of December 31, 2017 and 2016:

Table 6 – Sensitivity to Changes in Interest Rates

(Dollars in thousands)	2017 Net Interest Income	Percent Change	Market Value of Equity	Percent Change
Change in Interest Rate				
400 basis point rise	$23,742	6 %	$176,632	9 %
300 basis point rise	23,409	5 %	174,281	8 %
200 basis point rise	23,064	3 %	171,240	6 %
100 basis point rise	22,704	2 %	167,423	4 %
Base rate scenario	22,336	— %	161,760	— %
100 basis point decline	20,987	-6 %	145,174	-10 %
200 basis point decline	19,769	-11 %	122,923	-24 %
300 basis point decline	19,206	-14 %	109,403	-32 %
400 basis point decline	18,805	-16 %	108,928	-33 %

(Dollars in thousands)	2016 Net Interest Income	Percent Change	Market Value of Equity	Percent Change
Change in Interest Rate				
400 basis point rise	$22,196	10 %	$154,009	9 %
300 basis point rise	21,684	7 %	151,373	8 %
200 basis point rise	21,177	5 %	148,553	6 %
100 basis point rise	20,638	2 %	145,321	3 %
Base rate scenario	20,203	— %	140,761	— %
100 basis point decline	19,097	-5 %	124,886	-11 %
200 basis point decline	18,072	-11 %	103,937	-26 %
300 basis point decline	17,476	-13 %	94,215	-33 %
400 basis point decline	17,122	-15 %	93,864	-33 %

As of December 31, 2017, the Bank was within its guidelines for immediate rate shocks up and down for all net interest income scenarios and for the up rate scenarios and the down 100 basis points scenario for the market value of shareholders' equity. The Bank's percent change in the 200, 300, and 400 basis points down scenarios for the market value of shareholders' equity was slightly higher than the policy guidelines. As of December 31, 2016, the Bank was within its guidelines for immediate rate shocks up and down for both net interest income and the market value of shareholders' equity. The ALCO plans to continue to monitor the effect of changes in interest rates on both net interest income and shareholders' equity and will make changes in the duration of its rate-sensitive assets and rate-sensitive liabilities where necessary.

Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors of ChoiceOne Financial Services, Inc.

Opinion on the Financial Statements

We have audited the accompanying balance sheets of ChoiceOne Financial Services, Inc. (the "Company") as of December 31, 2017, and 2016, the related statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2017, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements referred to above 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 accounting principles generally accepted in the United States of America.

Basis for Opinion

The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("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 financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the 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 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 financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Plante & Moran, PLLC
We have served as the Company's auditor since 2006.

Auburn Hills, Michigan
March 28, 2018

ChoiceOne Financial Services, Inc.
Consolidated Balance Sheets

(Dollars in thousands)	December 31, 2017	2016
Assets		
Cash and due from banks	$36,837	$14,809
Securities available for sale (Note 2)	155,591	174,388
Federal Home Loan Bank stock	1,994	1,994
Federal Reserve Bank stock	1,573	1,573
Loans held for sale	1,721	1,974
Loans to other financial institutions	6,802	—
Loans (Note 3)	398,785	369,000
Allowance for loan losses (Note 3)	(4,577)	(4,277)
Loans, net	394,208	364,723
Premises and equipment, net (Note 5)	12,855	12,588
Other real estate owned, net (Note 7)	106	437
Cash value of life insurance policies	14,514	14,117
Goodwill (Note 6)	13,728	13,728
Other assets	6,615	7,040
Total assets	$646,544	$607,371
Liabilities		
Deposits – noninterest-bearing (Note 8)	$151,462	$127,611
Deposits – interest-bearing (Note 8)	388,391	384,775
Total deposits	539,853	512,386
Repurchase agreements (Note 9)	7,148	7,913
Advances from Federal Home Loan Bank (Note 10)	20,268	12,301
Other liabilities (Notes 11 and 13)	2,725	3,073
Total liabilities	569,994	535,673
Shareholders' Equity (Note 20)		
Preferred stock; shares authorized: 100,000; shares outstanding: none	—	—
Common stock and paid-in capital, no par value; shares authorized: 7,000,000; shares outstanding: 3,448,569 in 2017 and 3,277,944 in 2016 (Note 14)	50,290	46,299
Retained earnings	26,023	25,997
Accumulated other comprehensive income (loss), net	237	(598)
Total shareholders' equity	76,550	71,698
Total liabilities and shareholders' equity	$646,544	$607,371

See accompanying notes to consolidated financial statements.

ChoiceOne Financial Services, Inc.
Consolidated Statements of Income

(Dollars in thousands, except per share data)	Years ended December 31,		
	2017	2016	2015
Interest income			
Loans, including fees	$17,964	$16,507	$15,971
Securities:			
Taxable	2,556	2,334	1,939
Tax exempt	1,419	1,450	1,428
Other	102	21	14
Total interest income	22,041	20,312	19,352
Interest expense			
Deposits	1,189	790	877
Advances from Federal Home Loan Bank	276	171	83
Other	13	8	30
Total interest expense	1,478	969	990
Net interest income	20,563	19,343	18,362
Provision for loan losses (Note 3)	485	—	100
Net interest income after provision for loan losses	20,078	19,343	18,262
Noninterest income			
Customer service charges	4,135	4,056	4,083
Insurance and investment commissions	826	1,009	1,060
Gains on sales of loans (Note 4)	1,265	1,748	1,416
Net gains/(losses) on sales of securities (Note 2)	(280)	312	261
Net gains/(losses) on sales and write-downs of other assets (Note 7)	26	(41)	(121)
Earnings on life insurance policies	398	356	651
Gain on sale of investment book of business	908	—	—
Other	533	441	352
Total noninterest income	7,811	7,881	7,702
Noninterest expense			
Salaries and benefits (Notes 13 and 14)	10,249	9,982	9,273
Occupancy and equipment (Note 5)	2,896	2,588	2,396
Data processing	2,279	2,273	2,320
Professional fees	1,166	935	971
Supplies and postage	399	385	413
Advertising and promotional	298	222	253
Intangible amortization (Note 6)	—	379	448
FDIC insurance	200	238	288
Other	1,847	1,970	1,914
Total noninterest expense	19,334	18,972	18,276

Income before income tax	8,555	8,252	7,688
Income tax expense (Note 11)	2,387	2,162	1,945
Net income	$6,168	$6,090	$5,743
Basic earnings per share (Note 15)	$1.79	$1.76	$1.67
Diluted earnings per share (Note 15)	$1.78	$1.76	$1.66
Dividends declared per share	$0.67	$0.64	$0.63

See accompanying notes to consolidated financial statements.

ChoiceOne Financial Services, Inc.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)	Years ended December 31,		
	2017	2016	2015
Net income	$6,168	$6,090	$5,743
Other comprehensive income:			
Changes in net unrealized gains (losses) on investment securities available for sale, net of tax expense (benefit) of $324, $(812), and $168 for the years ended December 31, 2017, 2016, and 2015, respectively	628	(1,573)	324
Reclassification adjustment for realized gain on sale of investment securities available for sale included in net income, net of tax expense (benefit) of $(95), $106, and $89 for the years ended December 31, 2017, 2016, and 2015, respectively	185	(206)	(172)
Change in adjustment for postretirement benefits, net of tax benefit (expense) of $9, $12, and $11 for the years ended December 31, 2017, 2016, and 2015, respectively	(17)	(22)	(22)
Other comprehensive income/(loss), net of tax	796	(1,801)	130
Comprehensive income	$6,964	$4,289	$5,873

See accompanying notes to consolidated financial statements.

ChoiceOne Financial Services, Inc.
Consolidated Statements of Changes in Shareholders' Equity

(Dollars in thousands, except per share data)	Number of Shares	Common Stock and Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss), Net	Total
Balance, January 1, 2015	3,295,834	$ 46,552	$ 18,565	$ 1,073	$ 66,190
Net income			5,743		5,743
Other comprehensive income				130	130
Shares issued	13,310	206			206
Shares repurchased	(16,200)	(371)			(371)
Change in ESOP repurchase obligation		(4)			(4)
Effect of employee stock purchases		15			15
Stock compensation shares issued	2,284				—
Stock compensation expense		103			103
Cash dividends declared ($0.63 per share)			(2,170)		(2,170)
Balance, December 31, 2015	3,295,228	$ 46,501	$ 22,138	$ 1,203	$ 69,842
Net income			6,090		6,090
Other comprehensive loss				(1,801)	(1,801)
Shares issued	8,460	173			173
Shares repurchased	(35,000)	(794)			(794)
Termination of ESOP repurchase obligation		127			127
Effect of employee stock purchases		13			13
Stock compensation shares issued	9,256				—
Stock compensation expense		279			279
Cash dividends declared ($0.64 per share)			(2,231)		(2,231)
Balance, December 31, 2016	3,277,944	$ 46,299	$ 25,997	$ (598)	$ 71,698
Net income			6,168		6,168
Other comprehensive income				796	796
Shares issued	8,776	149			149
Shares repurchased	(8,800)	(203)			(203)
Effect of employee stock purchases		13			13
Stock options exercised	1,463	13			13
Stock-based compensation expense		240			240
Restricted stock units issued	5,197				—
Stock dividend declared (5%)	163,989	3,779	(3,786)		(7)
			(39)	39	—

Effect of tax law change on other comprehensive income					
Cash dividends declared ($0.67 per share)			(2,317)		(2,317)
Balance, December 31, 2017	3,448,569	$ 50,290	$ 26,023	$ 237	$ 76,550

See accompanying notes to consolidated financial statements.

ChoiceOne Financial Services, Inc.
Consolidated Statements of Cash Flows

(Dollars in thousands)	Years ended December 31,		
	2017	2016	2015
Cash flows from operating activities:			
Net income	$6,168	$6,090	$5,743
Adjustments to reconcile net income to net cash from operating activities:			
Provision for loan losses	485	—	100
Depreciation	1,389	1,078	986
Amortization	1,061	1,531	1,497
Compensation expense on employee and director stock purchases, stock options, and restricted stock units	317	380	118
Net (gains)/losses on sales of securities	280	(312)	(261)
Gains on sales of loans	(1,265)	(1,748)	(1,416)
Loans originated for sale	(43,171)	(53,591)	(47,498)
Proceeds from loan sales	42,883	57,830	46,077
Earnings on bank-owned life insurance	(398)	(356)	(347)
Earnings from death benefit	—	—	(304)
Proceeds on bank-owned life insurance	—	—	461
(Gains)/losses on sales of other real estate owned	(18)	8	30
Write-downs of other real estate owned	—	—	91
Proceeds from sales of other real estate owned	663	247	406
Deferred federal income tax (benefit)/expense	62	(82)	(631)
Net change in:			
Other assets	417	(1,952)	(503)
Other liabilities	(783)	1,804	(571)
Net cash from operating activities	8,090	10,927	3,978
Cash flows from investing activities:			
Sales of securities available for sale	57,628	15,317	25,876
Maturities, prepayments and calls of securities available for sale	17,572	36,705	27,084
Purchases of securities available for sale	(56,123)	(69,526)	(70,902)
Purchase of Federal Reserve Bank stock	—	—	(301)
Purchases or calls of FHLB stock	—	(380)	299
Purchase of bank-owned life insurance policies	—	(1,500)	—
Loan originations and payments, net	(35,723)	(20,274)	(3,678)
Additions to premises and equipment	(1,656)	(1,819)	(1,038)
Net cash from investing activities	(18,302)	(41,477)	(22,660)
Cash flows from financing activities:			
Net change in deposits	27,467	37,690	39,868
Net change in repurchase agreements	(765)	(1,547)	(17,283)
Proceeds from Federal Home Loan Bank advances	212,500	311,017	194,575
Payments on Federal Home Loan Bank advances	(204,533)	(310,048)	(201,606)

Issuance of common stock	98	85	206
Repurchase of common stock	(203)	(794)	(371)
Cash dividends and fractional shares from stock dividend	(2,324)	(2,231)	(2,170)
Net cash from financing activities	32,240	34,172	13,219
Net change in cash and cash equivalents	22,028	3,622	(5,463)
Beginning cash and cash equivalents	14,809	11,187	16,650
Ending cash and cash equivalents	$36,837	$14,809	$11,187
Supplemental disclosures of cash flow information:			
Cash paid for interest	$1,465	$984	$1,005
Cash paid for income taxes	2,120	1,760	2,395
Loans transferred to other real estate owned	314	661	408

See accompanying notes to consolidated financial statements.

Note 1 – Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include ChoiceOne Financial Services, Inc., its wholly-owned subsidiary, ChoiceOne Bank ("the Bank"), and ChoiceOne Bank's wholly-owned subsidiary, ChoiceOne Insurance Agencies, Inc. (together referred to as "ChoiceOne"). Intercompany transactions and balances have been eliminated in consolidation.

Nature of Operations

The Bank is a full-service community bank that offers commercial, consumer, and real estate loans as well as traditional demand, savings and time deposits to both commercial and consumer clients in Kent, Muskegon, Newaygo, and Ottawa counties in Michigan. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and real estate. Commercial loans are expected to be repaid from the cash flows from operations of businesses. Real estate loans are collateralized by either residential or commercial real estate.

The Insurance Agency is a wholly-owned subsidiary of the Bank. The Insurance Agency sells insurance policies such as life and health for both commercial and consumer clients. The Insurance Agency also offers alternative investment products such as annuities and mutual funds through a registered broker.

Together, the Bank and the Insurance Agency account for substantially all of ChoiceOne's assets, revenues and operating income.

Use of Estimates

To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, ChoiceOne's management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided. Actual results may differ from these estimates. Estimates associated with securities available for sale, the allowance for loan losses, other real estate owned, loan servicing rights, goodwill, and fair values of certain financial instruments are particularly susceptible to change.

Cash and Cash Equivalents

Cash and cash equivalents are defined to include cash on hand, demand deposits with other banks, and federal funds sold. Cash flows are reported on a net basis for customer loan and deposit transactions, deposits with other financial institutions, and short-term borrowings with original terms of 90 days or less.

Securities

Securities are classified as available for sale because they might be sold before maturity. Securities classified as available for sale are carried at fair value, with unrealized holding gains and losses reported separately in the accumulated other comprehensive income or loss section of shareholders' equity, net of tax effect. Restricted investments in Federal Reserve Bank stock and Federal Home Loan Bank stock are carried at cost. Equity securities consist of investments in preferred stock, trust-preferred securities, and investments in common stock of other financial institutions. All equities are held at the holding company and are considered available for sale.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized using the level-yield method without anticipating prepayments. Gains or losses on sales are recorded on the trade date based on the amortized cost of the security sold.

Management evaluates securities for other-than-temporary impairment ("OTTI") on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. The evaluation of securities includes consideration given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, whether the market decline was affected by macroeconomic conditions and whether ChoiceOne has the intent to sell the security or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis. In analyzing an issuer's financial condition, management may consider whether the securities are issued by the federal government or its agencies, or U.S. Government sponsored enterprises, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs, the amount of the OTTI recognized in earnings depends on whether ChoiceOne intends to sell the security or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis. If ChoiceOne intends to sell or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment. If a security is determined to be other-than-temporarily impaired, but ChoiceOne does not intend to sell the security, only the credit portion of the estimated loss is recognized in earnings, with the other portion of the loss recognized in other comprehensive income.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of unearned interest, deferred loan fees and costs, and an allowance for loan losses. Loans held for sale are reported at the lower of cost or market, on an aggregate basis.

Interest income on loans is reported on the interest method and includes amortization of net deferred loan fees and costs over the estimated loan term. Interest on loans is accrued based upon the principal balance outstanding. The accrual of interest is discontinued at the time at which commercial loans are 90 days past due unless the loan is secured by sufficient collateral and is in the process of collection. Interest on consumer or real estate secured loans is discontinued at the time at which the loan is 120 days past due unless the credit is secured by sufficient collateral and is in the process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed into nonaccrual status or charged off at an earlier date if collection of principal or interest is considered doubtful. Interest accrued but not received is reversed against interest income when the loans are placed into nonaccrual status. Interest received on such loans is applied to principal until qualifying for return to accrual. Loans are returned to accrual basis when all the principal and interest amounts contractually due are brought current and future payment is reasonably assured.

Loans to Other Financial Institutions

Loans to other financial institutions are made for the purpose of providing a warehouse line of credit to facilitate funding of residential mortgage loan originations at other financial institutions. The loans are short-term in nature and are designed to provide funding for the time period between the loan origination and its subsequent sale in the secondary market. Revenue on loans to other financial institutions earn a share of interest income, determined by the contract, from when the loan is funded to when the loan is sold on the secondary market. Similar to loans held for sale these loans are excluded from the allowance for loan losses as the risk of default is minimal during the short time period held.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. The allowance for loan losses is increased by the provision for loan losses and decreased by loans charged off less any recoveries of charged off loans. Management estimates the allowance for loan losses balance required based on past loan loss experience, the nature and volume of the loan portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance for loan losses may be made for specific loans, but the entire allowance for loan losses is available for any loan that, in management’s judgment, should be charged off. Loan losses are charged against the allowance for loan losses when management believes that collection of a loan balance is not possible.

The allowance for loan losses consists of general and specific components. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful.

A loan is impaired when full payment under the loan terms is not expected. Troubled debt restructuring of loans is undertaken to improve the likelihood that the loan will be repaid in full under the modified terms in accordance with a reasonable repayment schedule. All modified loans are evaluated to determine whether the loans should be reported as Troubled Debt Restructurings (TDR). A loan is a TDR when the Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower by modifying a loan. To make this determination, the Bank must determine whether (a) the borrower is experiencing financial difficulties and (b) the Bank granted the borrower a concession. This determination requires consideration of all facts and circumstances surrounding the modification. An overall general decline in the economy or some deterioration in a borrower's financial condition does not automatically mean the borrower is experiencing financial difficulties. Commercial loans are evaluated for impairment on an individual loan basis. If a loan is considered impaired or if a loan has been classified as a troubled debt restructured loan, a portion of the allowance for loan losses is allocated to the loan so that it is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller-balance homogeneous loans such as consumer and residential real estate mortgage loans are collectively evaluated for impairment and, accordingly, they are not separately identified for impairment disclosures.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Land is carried at cost. Land improvements are depreciated using the straight-line method with useful lives ranging from 7 to 15 years. Building and related components are depreciated using the straight-line method with useful lives ranging from 5 to 39 years. Leasehold improvements are depreciated over the shorter of the estimated life or the lease term. Furniture and equipment are depreciated using the straight-line method with useful lives ranging from 3 to 7 years. Fixed assets are periodically reviewed for impairment. If impaired, the assets are recorded at fair value.

Other Real Estate Owned

Real estate properties acquired in the collection of a loan are initially recorded at the lower of the Bank's basis in the loans or fair value at acquisition establishing a new cost basis. Any reduction to fair value from the carrying value of the related loan is accounted for as a loan loss. After acquisition, a valuation allowance reduces the reported amount to the lower of the initial amount or fair value less costs to sell. Expenses to repair or maintain properties are included within other noninterest expenses. Gains and losses upon disposition and changes in the valuation allowance are reported net within noninterest income.

Bank Owned Life Insurance

Bank owned life insurance policies are stated at the current cash surrender value of the policy, or the policy death proceeds less any obligation to provide a death benefit to an insured's beneficiaries if that value is less than the cash surrender value. Increases in the asset value are recorded as earnings in other income.

Loan Servicing Rights

Loan servicing rights represent the allocated value of servicing rights on loans sold with servicing retained. Servicing rights are expensed in proportion to, and over the period of, estimated net servicing revenues. Impairment is evaluated based on the fair value of the rights, using groupings of the underlying loans as to interest rates and then, secondarily, as to geographic and prepayment characteristics. Servicing rights are initially recorded at estimated fair value and fair value is determined using prices for similar assets with similar characteristics when available or based upon discounted cash flows using market-based assumptions. Any impairment of a grouping is reported as a valuation allowance.

Goodwill

Goodwill results from business acquisitions and represents the excess of the purchase price over the fair value of the acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment and any such impairment will be recognized in the period identified.

Loan Commitments and Related Financial Instruments

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

Employee Benefit Plans

ChoiceOne’s 401(k) plan allows participants to make contributions to their individual accounts under the plan in amounts up to the IRS maximum. Employer matching contributions from ChoiceOne to its 401(k) plan are discretionary. ChoiceOne also allows retired employees to participate in its health insurance plan. Employees who have attained age 55 and completed at least ten years of service to ChoiceOne are eligible to participate as a retiree until they are eligible for Medicare. These post-retirement benefits are accrued during the years in which the employee provides service.

Employee Stock Ownership Plan

Dividends on Employee Stock Ownership Plan (the “ESOP”) shares are recorded as a reduction of retained earnings. Upon distribution of shares to a participant, the participant has the right to require the Company to purchase his or her shares at fair value in accordance with the terms and conditions of the ESOP. As such, these shares are not classified in shareholders’ equity as permanent equity. Effective January 1, 2016, ChoiceOne terminated the ESOP and transferred shares held by the ESOP to the 401(k) plan.

Income Taxes

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

Earnings Per Share

Basic earnings per common share ("EPS") is based on weighted-average common shares outstanding. The weighted-average number of shares used in the computation of basic and diluted EPS includes shares allocated to the ESOP. Diluted EPS further assumes issue of any dilutive potential common shares issuable under stock options or restricted stock units granted.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income or loss. Other comprehensive income or loss includes unrealized gains and losses on securities available for sale and changes in the funded status of post-retirement plans, net of tax, which are also recognized as a separate component of shareholders' equity.

Accumulated other comprehensive income was as follows:

(Dollars in thousands)	Years ended December 31, 2017	2016
Unrealized gain (loss) on available for sale securities	$169	$(1,063)
Unrecognized gains on post-retirement benefits	132	157
Tax effect	(64)	308
Accumulated other comprehensive income (loss)	$237	$(598)

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe that there are any such matters that may have a material effect on the financial statements as of December 31, 2017.

Cash Restrictions

Cash on hand or on deposit with the Federal Reserve Bank of $810,000 and $621,000 was required to meet regulatory reserve and clearing requirements at December 31, 2017 and 2016, respectively. The balance in excess of the amount required was interest-bearing as of December 31, 2017 and December 31, 2016.

Stock-Based Compensation

The Company values share-based stock option awards granted using the Black-Scholes option-pricing model. The Company recognizes compensation expense for its awards on a straight-line basis over the requisite service period for the entire award (straight-line attribution method), ensuring that the amount of compensation cost recognized at any date at least equals the portion of the grant-date fair value of the award that is vested at that time. Compensation costs related to stock options granted are disclosed in Note 14.

ChoiceOne has granted restricted stock units to a select group of employees under the Stock Incentive Plan of 2012. Restricted stock units vest in three annual installments on each of the next three anniversaries of the grant date. Certain additional vesting provisions apply. Each unit, once vested, is settled by delivery of one share of ChoiceOne common stock.

Dividend Restrictions

Banking regulations require the maintenance of certain capital levels and may limit the amount of dividends that may be paid by the Bank to ChoiceOne (see Note 20).

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, which are more fully documented in Note 18 to the consolidated financial statements. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Operating Segments

While ChoiceOne's management monitors the revenue streams of various products and services for the Bank and Insurance Agency, operations and financial performance are evaluated on a company-wide basis. Accordingly, all of the financial service operations are considered by management to be aggregated into one reportable operating segment.

Recent Accounting Pronouncements

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU establishes a comprehensive revenue recognition standard for virtually all industries under U.S. GAAP, including those that previously followed industry-specific guidance such as the real estate, construction and software industries. The revenue standard's core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The ASU does not apply to financial instruments. The ASU is effective for public entities for reporting periods beginning after December 15, 2017 (therefore, for the year ending December 31, 2018 for ChoiceOne). Early implementation is not allowed for public companies. Management is currently assessing the impact to the ChoiceOne's consolidated financial statements but does not expect these changes to have a significant effect on the financial statements.

The FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. The ASU covers various changes to the accounting, measurement, and disclosure related to certain financial instruments. The most significant change included in the update is the requirement for certain equity investments (excluding investments that are consolidated or accounted for under the equity method of accounting) to be measured at fair value with changes in fair value recognized in net income. An entity may choose to measure equity investments that do not have readily determinable fair values at cost, minus impairment. When a qualitative assessment of equity investments without readily determinable fair values indicates that impairment exists, an entity is required to measure the investment at fair value. The update also eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The new standard is effective for ChoiceOne for the fiscal year beginning after December 15, 2017, including interim periods within this fiscal year. Management has assessed the expected impact and does not believe it will have a significant impact on ChoiceOne's consolidated financial statements.

The FASB issued ASU 2016-02, *Leases*. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. As ChoiceOne owns most of its branch locations, the impact of this ASU is not expected to be material.

The FASB issued ASU No. 2016-13*, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This ASU provides financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date by replacing the incurred loss impairment methodology in current generally accepted accounting principles (GAAP) with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The new guidance attempts to reflect an entity's current estimate of all expected credit losses and broadens the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually to include forecasted information, as well as past events and current conditions. There is no specified method for measuring expected credit losses, and an entity may apply methods that reasonably reflect its expectations of the credit loss estimate. Although an entity may still use its current systems and methods for recording the allowance for credit losses, under the new rules, the inputs used to record the allowance for credit losses generally will need to change to appropriately reflect an estimate of all expected credit losses and the use of reasonable and supportable forecasts. Additionally, credit losses on available-for-sale debt securities will have to be presented as an allowance rather than as a write-down. This ASU is effective for fiscal years beginning after December 15, 2019, and for interim periods within those years. Management is currently evaluating the impact of this new ASU on its consolidated financial statements which may be significant.

FASB issued ASU No. 2017-08, *Premium Amortization on Purchased Callable Debt Securities*. This ASU changes generally accepted accounting principles ("GAAP") to require premiums on purchased callable debt securities to be amortized to the earliest call date. Previous GAAP allowed entities to amortize to contractual maturity or to call date. The amendments in this ASU are effective for annual periods beginning after December 15, 2018, with early adoption permitted. As the Company has consistently amortized premiums on its purchased callable debt securities to the earliest call date, the Company has elected to early adopt this ASU effective January 1, 2017. There was no impact of adoption of this ASU by the Company.

Reclassifications

Certain amounts presented in prior year consolidated financial statements have been reclassified to conform to the current year's presentation.

Note 2 – Securities

The fair value of securities available for sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) at December 31 were as follows:

	2017			
(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government and federal agency	$35,518	$ —	$ (392)	$35,126
U.S. Treasury notes and bonds	1,991	—	(31)	1,960
State and municipal	99,609	910	(471)	100,048
Mortgage-backed	9,943	8	(131)	9,820
Corporate	5,184	2	(35)	5,151
Equity securities	3,083	309	—	3,392
Asset-backed securities	95	—	(1)	94
Total	$155,423	$ 1,229	$ (1,061)	$155,591

	2016			
(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government and federal agency	$59,864	$34	$(846)	$59,052
U.S. Treasury notes and bonds	4,111	—	(39)	4,072
State and municipal	89,169	748	(944)	88,973
Mortgage-backed	7,925	19	(155)	7,789
Corporate	7,069	12	(40)	7,041
Foreign debt	4,514	—	(114)	4,400
Equity securities	2,617	266	—	2,883
Asset-backed securities	182	—	(4)	178
Total	$175,451	$1,079	$(2,142)	$174,388

Information regarding sales of securities available for sale for the year ended December 31 follows:

(Dollars in thousands)	2017	2016	2015
Proceeds from sales of securities	$57,628	$15,317	$25,876
Gross realized gains	184	312	261
Gross realized losses	464	0	0

Contractual maturities of securities available for sale at December 31, 2017 were as follows:

(Dollars in thousands)	Amortized Cost	Fair Value
Due within one year	$ 27,715	$ 27,490
Due after one year through five years	68,760	68,786
Due after five years through ten years	43,556	43,654
Due after ten years	2,366	2,449
Total debt securities	142,397	142,379
Mortgage-backed securities	9,943	9,820
Equity securities	3,083	3,392
Total	$ 155,423	$ 155,591

Various securities were pledged as collateral for securities sold under agreements to repurchase and participation in a program that provided Community Reinvestment Act credits. The carrying amount of securities pledged as collateral at December 31 was as follows:

(Dollars in thousands)	2017	2016
Securities pledged for securities sold under agreements to repurchase	$ 9,902	$ 13,186
Security pledged for Community Reinvestment Act credits	262	250
Total	$ 10,164	$ 13,436

The fair value of securities pledged to secure repurchase agreements may decline, and the Company may be required to provide additional collateral. The Company manages this risk by pledging securities with fair values in excess of the repurchase liability.

Securities with unrealized losses at year-end 2017 and 2016, aggregated by investment category and length of time the individual securities have been in an unrealized loss position, were as follows:

	2017					
	Less than 12 months		More than 12 months		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government and federal agency	$ 20,297	$ (190)	$ 9,798	$ (202)	$ 30,095	$ (392)
U.S. Treasury notes and bonds	1,960	(31)	—	—	1,960	(31)
State and municipal	38,887	(319)	6,889	(152)	45,776	(471)
Mortgage-backed	8,481	(104)	838	(27)	9,319	(131)

Corporate	2,471	(17)	687	(18)	3,158	(35)
Asset-backed securities	—	—	94	(1)	94	(1)
Total temporarily impaired	$72,096	$ (661)	$18,306	$ (400)	$90,402	$ (1,061)

	2016					
	Less than 12 months		More than 12 months		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government and federal agency	$46,283	$(846)	$—	$—	$46,283	$(846)
U.S. Treasury notes and bonds	4,072	(39)	—	—	4,072	(39)
State and municipal	47,832	(944)	—	—	47,832	(944)
Mortgage-backed	5,980	(150)	251	(5)	6,231	(155)
Corporate	2,838	(40)	—	—	2,838	(40)
Foreign debt	4,400	(114)	—	—	4,400	(114)
Asset-backed securities	—	—	178	(4)	178	(4)
Total temporarily impaired	$111,405	$(2,133)	$429	$(9)	$111,834	$(2,142)

ChoiceOne evaluates all securities on a quarterly basis to determine whether unrealized losses are temporary or other than temporary. Consideration is given to the length of time and the 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 ChoiceOne to retain its investment in the issue for a period of time sufficient to allow for any anticipated recovery in fair value of amortized cost basis. Management believed that unrealized losses as of December 31, 2017 were temporary in nature and were caused primarily by changes in interest rates, increased credit spreads, and reduced market liquidity and were not caused by the credit status of the issuer. No other than temporary impairments were recorded in 2017 or 2016.

At December 31, 2017, there were 154 securities with an unrealized loss, compared to 196 securities with an unrealized loss as of December 31, 2016. The decrease in the number of securities in an unrealized loss position was due to the sale of $35.0 million in securities during the fourth quarter of 2017.

Note 3 – Loans and Allowance for Loan Losses

The Bank's loan portfolio as of December 31 was as follows:

(Dollars in thousands)

	2017	2016
Agricultural	$48,464	$44,614
Commercial and industrial	104,386	96,088
Consumer	24,513	21,596
Real estate - commercial	123,487	110,762
Real estate - construction	6,613	6,153
Real estate - residential	91,322	89,787
Loans, gross	398,785	369,000
Allowance for loan losses	(4,577)	(4,277)
Loans, net	$394,208	$364,723

ChoiceOne manages its credit risk through the use of its loan policy and its loan approval process and by monitoring of loan credit performance. The loan approval process for commercial loans involves individual and group approval authorities. Individual authority levels are based on the experience of the lender. Group authority approval levels can consist of an internal loan committee that includes the Bank's President or Senior Lender and other loan officers for loans that exceed individual approval levels, or a loan committee of the Board of Directors for larger commercial loans. Most consumer loans are approved by individual loan officers based on standardized underwriting criteria, with larger consumer loans subject to approval by the internal loan committee.

Ongoing credit review of commercial loans is the responsibility of the loan officers. ChoiceOne's internal credit committee meets at least monthly and reviews loans with payment issues and loans with a risk rating of 5, 6, or 7. Risk ratings of commercial loans are reviewed periodically and adjusted if needed. ChoiceOne's consumer loan portfolio is primarily monitored on an exception basis. Loans where payments are past due are turned over to the Bank's collection department, which works with the borrower to bring payments current or take other actions when necessary. In addition to internal reviews of credit performance, ChoiceOne contracts with a third party for independent loan review that monitors the loan approval process and the credit quality of the loan portfolio.

Activity in the allowance for loan losses and balances in the loan portfolio were as follows:

(Dollars in thousands)

	Agricultural	Commercial and Industrial	Consumer	Commercial Real Estate	Construction Real Estate	Residential Real Estate	Unallocated	Total
2017								
Allowance for Loan Losses								
Beginning balance	$ 433	$ 688	$ 305	$ 1,438	$ 62	$ 1,013	$ 338	$ 4,277
Charge-offs	—	(439)	(253)	—	—	(43)	—	(735)
Recoveries	—	21	169	258	40	62	—	550
Provision	73	731	41	65	(67)	(306)	(52)	485
Ending balance	$ 506	$ 1,001	$ 262	$ 1,761	$ 35	$ 726	$ 286	$ 4,577
Individually evaluated for impairment	$ —	$ 26	$ 3	$ 49	$ —	$ 224	$ —	$ 302
Collectively evaluated for impairment	$ 506	$ 975	$ 259	$ 1,712	$ 35	$ 502	$ 286	$ 4,275
Loans								
Individually evaluated for impairment	$ 423	$ 124	$ 36	$ 778	$ —	$ 2,779		$ 4,140
Collectively evaluated for impairment	48,041	104,262	24,477	122,709	6,613	88,543		394,645
Ending balance	$ 48,464	$ 104,386	$ 24,513	$ 123,487	$ 6,613	$ 91,322		$ 398,785

(Dollars in thousands)

	Agricultural	Commercial and Industrial	Consumer	Commercial Real Estate	Construction Real Estate	Residential Real Estate	Unallocated	Total
2016								
Allowance for Loan Losses								
Beginning balance	$ 420	$ 586	$ 297	$ 1,030	$ 46	$ 1,388	$ 427	$ 4,194
Charge-offs	—	(37)	(218)	—	—	(102)	—	(357)
Recoveries	—	31	149	89	—	171	—	440
Provision	13	108	77	319	16	(444)	(89)	—
Ending balance	$ 433	$ 688	$ 305	$ 1,438	$ 62	$ 1,013	$ 338	$ 4,277
Individually evaluated for impairment	$ 3	$ 11	$ 2	$ 91	$ —	$ 296	$ —	$ 403
Collectively evaluated for impairment	$ 430	$ 677	$ 303	$ 1,347	$ 62	$ 717	$ 338	$ 3,874
Loans								
Individually evaluated for impairment	$ 526	$ 301	$ 28	$ 1,073	$ —	$ 2,983		$ 4,911
Collectively evaluated for impairment	44,088	95,787	21,568	109,689	6,153	86,804		364,089
Ending balance	$ 44,614	$ 96,088	$ 21,596	$ 110,762	$ 6,153	$ 89,787		$ 369,000

(Dollars in thousands)

	Agricultural	Commercial and Industrial	Consumer	Commercial Real Estate	Construction Real Estate	Residential Real Estate	Unallocated	Total
2015								
Allowance for Loan Losses								
Beginning balance	$ 186	$ 527	$ 184	$ 1,641	$ 9	$ 1,193	$ 433	$ 4,173
Charge-offs	—	(30)	(291)	—	—	(140)	—	(461)
Recoveries	1	64	121	47	—	149	—	382
Provision	233	25	283	(658)	37	186	(6)	100
Ending balance	$ 420	$ 586	$ 297	$ 1,030	$ 46	$ 1,388	$ 427	$ 4,194
Individually evaluated for impairment	$ 3	$ 15	$ 1	$ 191	$ —	$ 296	$ —	$ 506
Collectively evaluated for impairment	$ 417	$ 571	$ 296	$ 839	$ 46	$ 1,092	$ 427	$ 3,688

Loans							
Individually evaluated for impairment	$ 50	$ 192	$ 24	$ 2,790	$ —	$ 2,529	$ 5,585
Collectively evaluated for impairment	40,182	94,155	20,066	94,946	5,390	88,980	343,719
Ending balance	$ 40,232	$ 94,347	$ 20,090	$ 97,736	$ 5,390	$ 91,509	$ 349,304

The process to monitor the credit quality of ChoiceOne's loan portfolio includes tracking (1) the risk ratings of business loans, (2) the level of classified business loans, and (3) delinquent and nonperforming consumer loans. Business loans are risk rated on a scale of 1 to 8. A description of the characteristics of the ratings follows:

Risk ratings 1 and 2: These loans are considered pass credits. They exhibit good to exceptional credit risk and demonstrate the ability to repay the loan from normal business operations.

Risk rating 3: These loans are considered pass credits. They exhibit acceptable credit risk and demonstrate the ability to repay the loan from normal business operations.

Risk rating 4: These loans are considered watch credits. They have potential developing weaknesses that, if not corrected, may cause deterioration in the ability of the borrower to repay the loan. While a loss is possible for a loan with this rating, it is not anticipated.

Risk rating 5: These loans are considered special mention credits. Loans in this risk rating are considered to be inadequately protected by the net worth and debt service coverage of the borrower or of any pledged collateral. These loans have well defined weaknesses that may jeopardize the borrower's ability to repay the loan. If the weaknesses are not corrected, loss of principal and interest could be probable.

Risk rating 6: These loans are considered substandard credits. These loans have well defined weaknesses, the severity of which makes collection of principal and interest in full questionable. Loans in this category may be placed on nonaccrual status.

Risk rating 7: These loans are considered doubtful credits. Some loss of principal and interest has been determined to be probable. The estimate of the amount of loss could be affected by factors such as the borrower's ability to provide additional capital or collateral. Loans in this category are on nonaccrual status. No loans are classified as risk rating 7 and the category has been removed from the table below.

Risk rating 8: These loans are considered loss credits. They are considered uncollectible and will be charged off against the allowance for loan losses. No loans are classified as risk rating 8 and the category has been removed from the table below.

Information regarding the Bank's credit exposure as of December 31 was as follows:

Corporate Credit Exposure - Credit Risk Profile By Creditworthiness Category

(Dollars in thousands)	Agricultural		Commercial and Industrial		Commercial Real Estate	
	2017	2016	2017	2016	2017	2016
Risk ratings 1 and 2	$14,813	$12,005	$13,491	$12,135	$8,227	$8,013
Risk rating 3	22,721	23,852	63,366	56,714	78,868	59,343
Risk rating 4	10,199	7,505	26,943	25,895	33,429	39,641
Risk rating 5	308	726	491	1,267	1,533	1,867
Risk rating 6	423	526	95	77	1,430	1,898
	$48,464	$44,614	$104,386	$96,088	$123,487	$110,762

Consumer Credit Exposure - Credit Risk Profile Based On Payment Activity

(Dollars in thousands)	Consumer		Construction Real Estate		Residential Real Estate	
	2017	2016	2017	2016	2017	2016
Performing	$24,497	$21,590	$6,613	$6,153	$90,629	$88,767
Nonperforming	1	—	—	—	257	229
Nonaccrual	15	6	—	—	436	791
	$24,513	$21,596	$6,613	$6,153	$91,322	$89,787

Included within the loan categories above were loans in the process of foreclosure. As of December 31, 2017 and 2016, loans in the process of foreclosure totaled $131,000 and $282,000, respectively.

Loans are classified as performing when they are current as to principal and interest payments or are past due on payments less than 90 days. Loans are classified as nonperforming when they are past due 90 days or more as to principal and interest payments or are considered a troubled debt restructuring.

The following schedule provides information on loans that were considered troubled debt restructurings ("TDRs") that were modified during the twelve months ended December 31, 2017 and December 31, 2016. The Bank may agree to modify the terms of a loan in order to improve the Bank's ability to collect amounts due. These modifications may include reduction of the interest rate, extension of the loan term, or in some cases, reduction of the principal balance.

(Dollars in thousands)	December 31, 2017			December 31, 2016		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Agricultural	—	$ —	$ —	1	$ 105	$ 105
Residential real estate	3	296	296	2	155	155
	3	$ 296	$ 296	3	$ 260	$ 260

The pre-modification and post-modification outstanding recorded investment represents amounts as of the date of loan modification. If a difference exists between the pre-modification and post-modification outstanding recorded investment, it represents impairment recognized through the provision for loan losses computed based on a loan's post-modification present value of expected future cash flows discounted at the loan's original effective interest rate. If no difference exists, a loss is not expected to be incurred based on an assessment of the borrower's expected cash flows.

The following schedule provides information on TDRs as of December 31, 2017 and December 31, 2016 where the borrower was past due with respect to principal and/or interest for 30 days or more during the twelve months ended December 31, 2017 and December 31, 2016 that had been modified during the 12-month period prior to the default. Loans modified in a TDR may already be on nonaccrual status and partial charge-offs have in some cases already been taken against the outstanding loan balance. As a result, loans modified in a TDR for the Bank may have the financial effect of increasing the specific allowance associated with the loan. The allowance for impaired loans that have been modified in a TDR is measured based on the estimated fair value of the collateral, less any selling costs, if the loan is collateral dependent or on the present value of expected future cash flows discounted at the loan's effective interest rate. Management exercises significant judgement in developing these estimates.

At December 31, 2017 the Corporation had no commitments to lend additional funds to the related debtors whose terms have been modified in a TDR.:

	With Payment Defaults During the Following Periods			
	December 31, 2017		December 31, 2016	
(Dollars in thousands)	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Commercial real estate	—	$ —	1	$ 105

Impaired loans by loan category as of December 31 were as follows:

(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<u>2017</u>					
With no related allowance recorded					
Agricultural	$ 423	$ 455	$ —	$ 322	$ —
Commercial and industrial	—	—	—	103	—
Consumer	—	—	—	—	—

Commercial real estate	127	258	—	110	—
Residential real estate	115	126	—	106	4
Subtotal	665	839	—	641	4
With an allowance recorded					
Agricultural	—	—	—	121	—
Commercial and industrial	124	124	26	177	1
Consumer	36	36	3	33	1
Commercial real estate	651	734	49	826	34
Residential real estate	2,664	2,690	224	2,522	110
Subtotal	3,475	3,584	302	3,679	146
Total					
Agricultural	423	455	—	443	—
Commercial and industrial	124	124	26	280	1
Consumer	36	36	3	33	1
Commercial real estate	778	992	49	936	34
Residential real estate	2,779	2,816	224	2,628	114
Total	$ 4,140	$ 4,423	$ 302	$ 4,320	$ 150

(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
2016					
With no related allowance recorded					
Agricultural	$ 482	$ 485	$ —	$ 220	$ 13
Commercial and industrial	206	207	—	91	3
Consumer	—	—	—	1	—
Commercial real estate	342	939	—	925	2
Residential real estate	301	292	—	167	5
Subtotal	1,331	1,923	—	1,404	23
With an allowance recorded					
Agricultural	44	44	3	72	3
Commercial and industrial	95	95	11	218	—
Consumer	28	28	2	24	2
Commercial real estate	731	804	91	1,281	33
Residential real estate	2,682	2,711	296	2,672	108
Subtotal	3,580	3,682	403	4,267	146
Total					
Agricultural	526	529	3	292	16
Commercial and industrial	301	302	11	309	3
Consumer	28	28	2	25	2
Commercial real estate	1,073	1,743	91	2,206	35
Residential real estate	2,983	3,003	296	2,839	113
Total	$ 4,911	$ 5,605	$ 403	$ 5,671	$ 169

(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
2015					
With no related allowance recorded					
Agricultural	$ —	$ —	$ —	$ —	$ —
Commercial and industrial	74	103	—	25	—
Consumer	—	—	—	2	—
Commercial real estate	1,540	1,540	—	1,061	11
Residential real estate	13	13	—	191	—
Subtotal	1,627	1,656	—	1,279	11
With an allowance recorded					
Agricultural	50	50	3	62	(6)
Commercial and industrial	118	118	15	44	1
Consumer	24	24	1	34	3
Commercial real estate	1,250	1,755	191	2,002	64
Residential real estate	2,516	2,516	296	2,425	86
Subtotal	3,958	4,463	506	4,567	148

Total					
Agricultural	50	50	3	62	(6)
Commercial and industrial	192	221	15	69	1
Consumer	24	24	1	36	3
Commercial real estate	2,790	3,295	191	3,063	75
Residential real estate	2,529	2,529	296	2,616	86
Total	$ 5,585	$ 6,119	$ 506	$ 5,846	$ 159

An aging analysis of loans by loan category as of December 31 follows:

(Dollars in thousands)	Loans Past Due 30 to 59 Days (1)	Loans Past Due 60 to 89 Days (1)	Loans Past Due Greater Than 90 Days (1)	Total (1)	Loans Not Past Due	Total Loans	Loans 90 Days Past Due and Accruing
2017							
Agricultural	$—	$—	$83	$83	$48,381	$48,464	$ —
Commercial and industrial	20	—	—	20	104,366	104,386	—
Consumer	142	38	1	181	24,332	24,513	—
Commercial real estate	95	58	69	222	123,265	123,487	—
Construction real estate	—	—	—	—	6,613	6,613	—
Residential real estate	585	272	296	1,153	90,169	91,322	258
	$842	$368	$449	$1,659	$397,126	$398,785	$ 258
2016							
Agricultural	$—	$—	$—	$—	$44,614	$44,614	$ —
Commercial and industrial	—	30	245	275	95,813	96,088	—
Consumer	99	2	6	107	21,489	21,596	—
Commercial real estate	—	—	260	260	110,502	110,762	—
Construction real estate	—	—	—	—	6,153	6,153	—
Residential real estate	1,027	109	646	1,782	88,005	89,787	229
	$1,126	$141	$1,157	$2,424	$366,576	$369,000	$ 229

(1) Includes nonaccrual loans

Nonaccrual loans by loan category as of December 31 as follows:

(Dollars in thousands)	2017	2016
Agricultural	$423	$482
Commercial and industrial	—	245
Consumer	15	6
Commercial real estate	222	458
Construction real estate	—	—

Residential real estate	436	792
	$1,096	$1,983

Note 4 – Mortgage Banking

Activity in secondary market loans during the year was as follows:

(Dollars in thousands)	2017	2016	2015
Loans originated for resale, net of principal payments	$43,171	$53,591	$47,498
Proceeds from loan sales	42,883	57,830	46,077
Net gains on sales of loans held for sale	1,265	1,748	1,416
Loan servicing fees, net of amortization	155	159	113

Net gains on sales of loans held for sale include capitalization of loan servicing rights. Loans serviced for others are not reported as assets in the accompanying consolidated balance sheets. The unpaid principal balances of these loans were $122.5 million and $103.6 million at December 31, 2017 and 2016, respectively. The Bank maintains custodial escrow balances in connection with these serviced loans; however, such escrows were immaterial at December 31, 2017 and 2016.

Activity for loan servicing rights (included in other assets) was as follows:

(Dollars in thousands)

	2017	2016	2015
Balance, beginning of year	$697	$378	$489
Capitalized	443	491	49
Amortization	(232)	(172)	(160)
Balance, end of year	$908	$697	$378

The fair value of loan servicing rights was $1,402,000 and $1,029,000 as of December 31, 2017 and 2016, respectively. Consequently, a valuation allowance was not necessary at year-end 2017 or 2016. The fair value of servicing rights at December 31, 2017 was determined using a discount rate of 6.29% and prepayment speeds ranging from 7% to 14%. The fair value of servicing rights at December 31, 2016 was determined using a discount rate of 5.82% and prepayment speeds ranging from 10% to 19%.

Note 5 – Premises and Equipment

As of December 31, premises and equipment consisted of the following:

(Dollars in thousands)

	2017	2016
Land and land improvements	$5,560	$5,869
Leasehold improvements	38	38
Buildings	13,290	12,052
Furniture and equipment	5,932	5,394
Total cost	24,820	23,353
Accumulated depreciation	(11,965)	(10,765)
Premises and equipment, net	$12,855	$12,588

Depreciation expense was $1,389,000, $1,078,000, and $986,000 for 2017, 2016 and 2015, respectively.

The Bank leases certain branch properties, a loan production office, and automated-teller machine locations in its normal course of business. Rent expense totaled $99,000, $99,000, and $53,000 for 2017, 2016 and 2015, respectively. Rent commitments under non-cancelable operating leases were as follows, before considering renewal options that generally are present (dollars in thousands):

2018	$117
2019	119
2020	122
2021	124
2022	127
Thereafter	152
Total	$760

Note 6 - Goodwill and Intangible Assets

Goodwill

There were no changes in the goodwill balance in 2017 or 2016. ChoiceOne evaluates goodwill annually for impairment. Accounting pronouncements allow a company to first perform a qualitative assessment for goodwill prior to a quantitative assessment (Step 1 assessment). If the results of the qualitative assessment indicate that it is more likely than not that goodwill is impaired, then a quantitative assessment must be performed. If not, there is no further assessment required.

ChoiceOne engaged an outside consulting firm to assist management in performing its annual evaluation of goodwill for impairment as of June 30, 2016. The following steps were used in the valuation: determination of the reporting unit, determination of the appropriate standard of value, determination of the appropriate level of value, calculation of fair value, and comparison of the fair value computed to the equity carrying value. It was determined that the relevant reporting unit to be valued was ChoiceOne Bank. The standard of value used in the valuation was fair value as determined by generally accepted accounting principles. The appropriate level of value was determined to be the controlling interest level. The appraisal methodology used to calculate the fair value included the income approach, which was a discounted cash flow value based on projected earnings capacity. The income approach used a discount rate of 11.50%, a growth assumption of 5.0% for assets, and an assumption of cost savings of 20% of noninterest expense as a result of synergies and cost reductions from a change in control. The appraisal methodology also included the market approach, which was based on price-to-earnings multiples, price-to-tangible book value ratios, and core deposit premiums for selected bank sale transactions. The asset approach was also an approach that was reviewed, but it was not used in determining the fair value since it did not render a control level indication of value. The results from the valuation approaches were used to calculate an estimate of the fair value of ChoiceOne’s equity, which was compared to the carrying value of equity to determine whether the Step 1 test under generally accepted accounting principles that govern the valuation of goodwill was passed. The goodwill analysis determined that the fair value of ChoiceOne’s equity exceeded the carrying value by 31%. Based on this assessment, management believed that there was no indication of goodwill impairment at June 30, 2016. Based on the testing performed and a review of factors that might impact ChoiceOne’s stock value on September 30, 2017, no impairment of goodwill was deemed to exist as of December 31, 2017.

Acquired Intangible Assets

Information for acquired intangible assets at December 31 follows:

(Dollars in thousands)	2017 Gross Carrying Amount	2017 Accumulated Amortization	2016 Gross Carrying Amount	2016 Accumulated Amortization
Core deposit intangible	$ —	$ —	$4,134	$ 4,134
Other intangible assets	—	—	348	348
Totals	$ —	$ —	$4,482	$ 4,482

The core deposit intangible and other intangible assets were being amortized on a straight-line basis over ten years. Intangible assets were reviewed for impairment on a quarterly basis. These intangible assets were fully amortized as of the end of 2016 and will have no carrying value on the balance sheet going forward. Aggregate amortization expense was $0 in 2017, $379,000 in 2016, and $448,000 in 2015.

Note 7 – Other Real Estate Owned

Other real estate owned represents residential and commercial properties primarily owned as a result of loan collection activities and is reported net of a valuation allowance. Activity within other real estate owned was as follows: