REALNETWORKS INC
Form 8-K/A
April 03, 2019

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

FORM 8-K/A
(Amendment No. 1)
CURRENT REPORT
PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
DATE OF REPORT (DATE OF EARLIEST EVENT REPORTED) January 18, 2019

RealNetworks, Inc.
(Exact name of registrant as specified in its charter)

Washington	001-37745	91-1628146
(State or other jurisdiction of incorporation)	(Commission File Number)	(I.R.S. Employer Identification No.)

1501 First Avenue South, Suite 600
Seattle, Washington 98134
(Address of principal executive offices) (Zip code)
(206) 674-2700
Registrant's telephone number, including area code
Not Applicable
(Former name or former address if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:
Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter).
Emerging growth company o

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. o

Explanatory note: The purpose of this amendment is to provide the audited financial statements of Rhapsody International, Inc., a Delaware corporation doing business as Napster ("Napster"), as required by Item 9.01(a) of Form 8-K and the pro forma financial information required by Item 9.01(b) of Form 8-K in connection with the acquisition of Napster by RealNetworks, Inc ("RealNetworks"). This information was excluded from RealNetworks initial filing on Form 8-K, filed with the Securities and Exchange Commission on January 22, 2019, in reliance upon Item 9.01(a)(4) and Item 9.01(b)(2) of Form 8-K.

Item 9.01. Financial Statements and Exhibits.

(a) Financial Statements of Businesses Acquired.

1. The following listed Audited Financial Statements of Rhapsody International, Inc. for the years ended September 30, 2018 and 2017 are filed with this current report as Exhibit 99.2 attached hereto and incorporated herein by this reference.

a. Report of Ernst & Young LLP, Independent Auditors.
b. Consolidated Balance Sheets as of September 30, 2018 and 2017.
c. Consolidated Statements of Operations and Comprehensive Income (Loss) for the years ended September 30, 2018 and 2017.
d. Consolidated Statements of Changes in Stockholders' Deficit for the years ended September 30, 2018 and 2017.
e. Consolidated Statements of Cash Flows for the years ended September 30, 2018 and 2017.
f. Notes to Consolidated Financial Statements for the year ended September 30, 2018.

The Consent of Ernst & Young LLP with respect to their report on the Audited Financial Statements of Rhapsody International, Inc. for the years ended September 30, 2018 and 2017, is filed with this current report as Exhibit 23.1 attached hereto and incorporated herein by this reference.

(b) Pro Forma Financial Information.

The following listed Pro Forma Financial Information for RealNetworks is filed with this current report as Exhibit 99.3 attached hereto and incorporated herein by this reference.

a. Pro Forma Condensed Consolidated Balance Sheet as of December 31, 2018 (unaudited).
b. Pro Forma Condensed Consolidated Statement of Operation for the year ended December 31, 2018 (unaudited).
c. Notes to Pro Forma Condensed Consolidated Financial Information (unaudited).

(c) Exhibits.

Exhibit	Description
23.1	Consent of Ernst & Young LLP, Independent Auditors
99.1*	RealNetworks, Inc. press release dated January 22, 2019
99.2	Consolidated financial statements of Rhapsody International, Inc. for the years ended September 30, 2018 and 2017 with Report of Ernst & Young LLP, Independent Auditors
99.3	RealNetworks, Inc. Pro Forma Condensed Consolidated Balance Sheet as of December 31, 2018 (unaudited), Pro Forma Condensed Consolidated Statement of Operations for the year ended December 31, 2018 (unaudited), and Notes to Pro Forma Condensed Consolidated Financial Information (unaudited)

*Previously filed with the Securities and Exchange Commission as an exhibit to RealNetworks, Inc.'s current report on Form 8-K filed on January 22, 2019.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

REALNETWORKS, INC.

By: / S / Cary Baker
Cary Baker
Senior Vice President, Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)

Dated: April 3, 2019

EXHIBIT INDEX

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:1px solid #000000;padding-left:2px;padding-top:2px;padding-bottom:2px;">
December 31, 2017

Less than 12 Months

12 Months or Longer

Total

Fair Value

Unrealized
Losses

Fair Value

Unrealized
Losses

Fair Value

Unrealized
Losses

(In Thousands)
Held-to-maturity:

U.S. government agency securities - government-sponsored enterprises

$
—

$
—

$
1,499

$
9

$
1,499

$
9

Municipal securities

3,723

27

259

7

3,982

34

Mortgage backed securities - government issued

3,868

51

4,677

79

8,545

130

Mortgage backed securities - government-sponsored enterprises

—

—

5,527

86

5,527

86

$
7,591

$
78

$
11,962

$
181

$
19,553

$
259

86

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

Loan and lease receivables consist of the following:

	December 31, 2018	December 31, 2017
	(In Thousands)	
Commercial real estate:		
Commercial real estate — owner occupied	$203,476	$ 200,387
Commercial real estate — non-owner occupied	484,427	470,236
Land development	42,666	40,154
Construction	161,562	125,157
Multi-family	167,868	136,978
1-4 family	34,340	44,976
Total commercial real estate	1,094,339	1,017,888
Commercial and industrial	462,321	429,002
Direct financing leases, net	33,170	30,787
Consumer and other:		
Home equity and second mortgages	8,438	7,262
Other	20,789	18,099
Total consumer and other	29,227	25,361
Total gross loans and leases receivable	1,619,057	1,503,038
Less:		
Allowance for loan and lease losses	20,425	18,763
Deferred loan fees	1,402	1,443
Loans and leases receivable, net	$1,597,230	$ 1,482,832

The total amount of the Corporation’s ownership of SBA loans comprised of the following:

	December 31, 2018	December 31, 2017
	(In Thousands)	
Retained, unguaranteed portions of sold SBA loans	$23,898	$ 30,071
Other SBA loans(1)	22,024	22,254
Total SBA loans	$45,922	$ 52,325

(1) Primarily consisted of SBA CAPLine, Express and impaired loans that were repurchased from the secondary market, all of which were not saleable as of December 31, 2018 and 2017.

As of December 31, 2018 and 2017, $13.2 million and $11.1 million of SBA loans were considered impaired, respectively.

Loans transferred to third parties consist of the guaranteed portions of SBA loans which the Corporation sold in the secondary market, participation interests in other originated loans and residential real estate loans. The total principal amount of the guaranteed portions of SBA loans sold during the year ended December 31, 2018 and 2017 was $14.1 million and $16.5 million, respectively. Each of the transfers of these financial assets met the qualifications for sale accounting, and therefore, all of the loans transferred during the year ended December 31, 2018 and 2017 have been derecognized in the Consolidated Financial Statements. The guaranteed portions of SBA loans were transferred at their fair value and the related gain was recognized upon the transfer as non-interest income in the Consolidated Financial Statements. The total outstanding balance of sold SBA loans at December 31, 2018 and 2017 was $83.3 million and $100.3 million, respectively.

The total principal amount of transferred participation interests in other originated commercial loans during the year ended December 31, 2018 and 2017 was $73.9 million and $63.6 million, respectively, all of which were treated as sales and derecognized under the applicable accounting guidance at the time of transfer. No gain or loss was recognized on participation

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interests in other originated loans as they were transferred at or near the date of loan origination and the payments received for servicing the portion of the loans participated represents adequate compensation. The total outstanding balance of these transferred loans at December 31, 2018 and 2017 was $129.7 million and $106.4 million, respectively. As of December 31, 2018 and 2017, the total amount of the Corporation’s partial ownership of these transferred loans on the Consolidated Balance Sheets was $208.9 million and $181.7 million, respectively. No loans in this participation portfolio were considered impaired as of December 31, 2018 and 2017. The Corporation does not share in the participant’s portion of any potential charge-offs. The total amount of loan participations purchased on the Consolidated Balance Sheets as of December 31, 2018 and 2017 was $569,000 and $650,000, respectively.

The Corporation also previously sold residential real estate loans, servicing released, in the secondary market. The Corporation did not sell any residential real estate loans during the year ended December 31, 2018. The total principal amount of residential real estate loans sold during the year ended December 31, 2017 was $1.6 million. Each of the transfers of these financial assets met the qualifications for sale accounting, and therefore all of the loans transferred have been derecognized in the Consolidated Financial Statements. The loans were transferred at their fair value and the related gain was recognized as non-interest income upon the transfer in the Consolidated Financial Statements.

Certain of the Corporation’s executive officers, directors and their related interests are loan clients of the Bank. These loans to related parties are summarized below:

	December 31, 2018	December 31, 2017
	(In Thousands)	
Balance at beginning of year	$10,513	$6,332
New loans	5,014	8,269
Repayments	(6,304)	(4,088)
Change due to status of executive officers and directors	(7,368)	—
Balance at end of year	$1,855	$10,513

The following tables illustrate ending balances of the Corporation’s loan and lease portfolio, including impaired loans by class of receivable, and considering certain credit quality indicators:

	December 31, 2018				
	Category				
	I	II	III	IV	Total
	(Dollars in Thousands)				
Commercial real estate:					
Commercial real estate — owner occupied	$177,222	$15,085	$5,506	$5,663	$203,476
Commercial real estate — non-owner occupied	458,185	24,873	1,338	31	484,427
Land development	39,472	981	—	2,213	42,666
Construction	161,360	—	202	—	161,562
Multi-family	167,868	—	—	—	167,868
1-4 family	32,004	1,451	707	178	34,340
Total commercial real estate	1,036,111	42,390	7,753	8,085	1,094,339
Commercial and industrial	374,371	19,370	51,474	17,106	462,321
Direct financing leases, net	26,013	6,090	1,067	—	33,170
Consumer and other:					
Home equity and second mortgages	8,385	3	50	—	8,438
Other	20,499	—	—	290	20,789
Total consumer and other	28,884	3	50	290	29,227
Total gross loans and leases receivable	$1,465,379	$67,853	$60,344	$25,481	$1,619,057
Category as a % of total portfolio	90.51%	4.19%	3.73%	1.57%	100.00%

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

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

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

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

Category III — Loans and leases in this category are identified by management as warranting special attention. However, the balance in this category is not intended to represent the amount of adversely classified assets held by the Bank. Category III loans and leases generally exhibit undesirable characteristics, such as evidence of adverse financial trends and conditions, managerial problems, deteriorating economic conditions within the related industry or evidence of adverse public filings and may exhibit collateral shortfall positions. Management continues to believe that it will collect all contractual principal and interest in accordance with the original terms of the contracts relating to the loans and leases in this category, and therefore Category III loans are considered performing with no specific reserves established for this category. Category III loans are monitored by management and subcommittees of the Bank’s Loan Committee on a monthly basis.

Category IV — Loans and leases in this category are considered to be impaired. Impaired loans and leases, with the exception of performing troubled debt restructurings, have been placed on non-accrual as management has determined that it is unlikely

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that the Bank will receive the contractual principal and interest in accordance with the original terms of the agreement. Impaired loans are individually evaluated to assess the need for the establishment of specific reserves or charge-offs. When analyzing the adequacy of collateral, the Corporation obtains external appraisals at least annually for impaired loans and leases. External appraisals are obtained from the Corporation’s approved appraiser listing and are independently reviewed to monitor the quality of such appraisals. To the extent a collateral shortfall position is present, a specific reserve or charge-off will be recorded to reflect the magnitude of the impairment. Loans and leases in this category are monitored by management and subcommittees of the Bank’s Loan Committee on a monthly basis.

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The delinquency aging of the loan and lease portfolio by class of receivable was as follows:

	December 31, 2018					
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans and Leases
	(Dollars in Thousands)					
Accruing loans and leases						
Commercial real estate:						
Owner occupied	$157	$—	$—	$157	$197,656	$197,813
Non-owner occupied	—	2,272	—	2,272	482,124	484,396
Land development	—	—	—	—	40,453	40,453
Construction	14,824	—	—	14,824	146,738	161,562
Multi-family	—	—	—	—	167,868	167,868
1-4 family	363	60	—	423	33,917	34,340
Commercial and industrial	826	247	—	1,073	444,144	445,217
Direct financing leases, net	—	—	—	—	33,170	33,170
Consumer and other:						
Home equity and second mortgages	—	—	—	—	8,438	8,438
Other	—	—	—	—	20,499	20,499
Total	16,170	2,579	—	18,749	1,575,007	1,593,756
Non-accruing loans and leases						
Commercial real estate:						
Owner occupied	483	—	5,180	5,663	—	5,663
Non-owner occupied	—	—	31	31	—	31
Land development	—	—	119	119	2,094	2,213
Construction	—	—	—	—	—	—
Multi-family	—	—	—	—	—	—
1-4 family	—	—	—	—	—	—
Commercial and industrial	2,322	—	12,108	14,430	2,674	17,104
Direct financing leases, net	—	—	—	—	—	—
Consumer and other:						
Home equity and second mortgages	—	—	—	—	—	—
Other	—	—	279	279	11	290
Total	2,805	—	17,717	20,522	4,779	25,301
Total loans and leases						
Commercial real estate:						
Owner occupied	640	—	5,180	5,820	197,656	203,476
Non-owner occupied	—	2,272	31	2,303	482,124	484,427
Land development	—	—	119	119	42,547	42,666
Construction	14,824	—	—	14,824	146,738	161,562
Multi-family	—	—	—	—	167,868	167,868
1-4 family	363	60	—	423	33,917	34,340
Commercial and industrial	3,148	247	12,108	15,503	446,818	462,321
Direct financing leases, net	—	—	—	—	33,170	33,170
Consumer and other:						
Home equity and second mortgages	—	—	—	—	8,438	8,438
Other	—	—	279	279	20,510	20,789
Total	$18,975	$2,579	$17,717	$39,271	$1,579,786	$1,619,057

Percent of portfolio	1.17 %	0.16 %	1.09 %	2.42 %	97.58 %	100.00 %

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	December 31, 2017					
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans and Leases
	(Dollars in Thousands)					
Accruing loans and leases						
Commercial real estate:						
Owner occupied	$—	$—	$—	$—	$193,366	$193,366
Non-owner occupied	—	—	—	—	470,202	470,202
Land development	—	—	—	—	37,528	37,528
Construction	—	196	—	196	122,089	122,285
Multi-family	—	—	—	—	136,978	136,978
1-4 family	496	—	—	496	43,319	43,815
Commercial and industrial	1,169	197	—	1,366	415,315	416,681
Direct financing leases, net	—	—	—	—	30,787	30,787
Consumer and other:						
Home equity and second mortgages	106	—	—	106	7,156	7,262
Other	—	—	—	—	17,745	17,745
Total	1,771	393	—	2,164	1,474,485	1,476,649
Non-accruing loans and leases						
Commercial real estate:						
Owner occupied	405	—	4,836	5,241	1,780	7,021
Non-owner occupied	—	—	—	—	34	34
Land development	—	—	—	—	2,626	2,626
Construction	—	—	2,872	2,872	—	2,872
Multi-family	—	—	—	—	—	—
1-4 family	—	—	948	948	213	1,161
Commercial and industrial	782	—	7,349	8,131	4,190	12,321
Direct financing leases, net	—	—	—	—	—	—
Consumer and other:						
Home equity and second mortgages	—	—	—	—	—	—
Other	—	—	345	345	9	354
Total	1,187	—	16,350	17,537	8,852	26,389
Total loans and leases						
Commercial real estate:						
Owner occupied	405	—	4,836	5,241	195,146	200,387
Non-owner occupied	—	—	—	—	470,236	470,236
Land development	—	—	—	—	40,154	40,154
Construction	—	196	2,872	3,068	122,089	125,157
Multi-family	—	—	—	—	136,978	136,978
1-4 family	496	—	948	1,444	43,532	44,976
Commercial and industrial	1,951	197	7,349	9,497	419,505	429,002
Direct financing leases, net	—	—	—	—	30,787	30,787
Consumer and other:						
Home equity and second mortgages	106	—	—	106	7,156	7,262
Other	—	—	345	345	17,754	18,099
Total	$2,958	$393	$16,350	$19,701	$1,483,337	$1,503,038
Percent of portfolio	0.20 %	0.03 %	1.09 %	1.32 %	98.68 %	100.00 %

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The Corporation’s total impaired assets consisted of the following:

	December 31, 2018	December 31, 2017
	(In Thousands)	
Non-accrual loans and leases		
Commercial real estate:		
Commercial real estate — owner occupied	$5,663	$ 7,021
Commercial real estate — non-owner occupied	31	34
Land development	2,213	2,626
Construction	—	2,872
Multi-family	—	—
1-4 family	—	1,161
Total non-accrual commercial real estate	7,907	13,714
Commercial and industrial	17,104	12,321
Direct financing leases, net	—	—
Consumer and other:		
Home equity and second mortgages	—	—
Other	290	354
Total non-accrual consumer and other loans	290	354
Total non-accrual loans and leases	25,301	26,389
Foreclosed properties, net	2,547	1,069
Total non-performing assets	27,848	27,458
Performing troubled debt restructurings	180	332
Total impaired assets	$28,028	$ 27,790

	December 31, 2018	December 31, 2017
Total non-accrual loans and leases to gross loans and leases	1.56 %	1.76 %
Total non-performing assets to total gross loans and leases plus foreclosed properties, net	1.72	1.83
Total non-performing assets to total assets	1.42	1.53
Allowance for loan and lease losses to gross loans and leases	1.26	1.25
Allowance for loan and lease losses to non-accrual loans and leases	80.73	71.10

As of December 31, 2018 and 2017, $7.6 million and $8.8 million of the non-accrual loans and leases were considered troubled debt restructurings, respectively. There were no unfunded commitments associated with troubled debt restructured loans and leases as of December 31, 2018.

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

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During the year ended December 31, 2018, no loans were modified to a troubled debt restructuring. The following table provides the number of loans modified in a troubled debt restructuring and the pre- and post-modification recorded investment by class of receivable:

	For the Year Ended December 31, 2017		
	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
	(Dollars in Thousands)		
Commercial and industrial	4	$ 4,374	$ 4,344
Consumer and other	1	17	17
Total	5	$ 4,391	$ 4,361

There were no loans and leases modified in a troubled debt restructuring during the previous 12 months which subsequently defaulted during the year ended December 31, 2018.

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

	As of and for the Year Ended December 31, 2018						
	Recorded Investment[1]	Unpaid Principal Balance	Impairment Reserve	Average Recorded Investment[2]	Foregone Interest Income	Interest Income Recognized	Net Foregone Interest Income
	(In Thousands)						
With no impairment reserve recorded:							
Commercial real estate:							
Owner occupied	$ 1,273	$ 1,273	$ —	$ 6,638	$ 756	$ 197	$ 559
Non-owner occupied	31	72	—	33	2	—	2
Land development	2,213	6,510	—	2,366	68	—	68
Construction	—	—	—	2,148	219	—	219
Multi-family	—	—	—	—	—	—	—
1-4 family	178	183	—	808	42	81	(39)
Commercial and industrial	6,828	7,527	—	8,809	1,058	980	78
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	—	—	—	1	—	46	(46)
Other	279	945	—	305	55	—	55
Total	10,802	16,510	—	21,108	2,200	1,304	896
With impairment reserve recorded:							
Commercial real estate:							
Owner occupied	4,390	5,749	675	635	182	—	182
Non-owner occupied	—	—	—	—	—	—	—
Land development	—	—	—	—	—	—	—
Construction	—	—	—	—	—	—	—
Multi-family	—	—	—	—	—	—	—
1-4 family	—	—	—	—	—	—	—
Commercial and industrial	10,278	10,278	3,710	4,687	1,096	—	1,096
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	—	—	—	—	—	—	—
Other	11	11	11	1	—	—	—
Total	14,679	16,038	4,396	5,323	1,278	—	1,278
Total:							
Commercial real estate:							
Owner occupied	5,663	7,022	675	7,273	938	197	741
Non-owner occupied	31	72	—	33	2	—	2
Land development	2,213	6,510	—	2,366	68	—	68
Construction	—	—	—	2,148	219	—	219
Multi-family	—	—	—	—	—	—	—
1-4 family	178	183	—	808	42	81	(39)
Commercial and industrial	17,106	17,805	3,710	13,496	2,154	980	1,174
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	—	—	—	1	—	46	(46)
Other	290	956	11	306	55	—	55

Grand total	$25,481	$32,548	$ 4,396	$ 26,431	$ 3,478	$ 1,304	$ 2,174

(1) The recorded investment represents the unpaid principal balance net of any partial charge-offs.
(2) Average recorded investment is calculated primarily using daily average balances.

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	As of and for the Year Ended December 31, 2017						
	Recorded Investment(1)	Unpaid Principal Balance	Impairment Reserve	Average Recorded Investment(2)	Foregone Interest Income	Interest Income Recognized	Net Foregone Interest Income
	(In Thousands)						
With no impairment reserve recorded:							
Commercial real estate:							
Owner occupied	$7,077	$7,077	$ —	$ 5,549	$ 613	$ —	$ 613
Non-owner occupied	34	75	—	1,830	97	226	(129)
Land development	2,627	5,297	—	3,092	84	—	84
Construction	—	—	—	2,000	134	214	(80)
Multi-family	—	—	—	1	—	—	—
1-4 family	1,423	1,706	—	2,146	53	7	46
Commercial and industrial	5,465	6,502	—	3,634	858	7	851
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	4	3	—	7	—	—	—
Other	345	1,011	—	365	59	—	59
Total	16,975	21,671	—	18,624	1,898	454	1,444
With impairment reserve recorded:							
Commercial real estate:							
Owner occupied	—	—	—	—	—	—	—
Non-owner occupied	—	—	—	—	—	—	—
Land development	—	—	—	—	—	—	—
Construction	2,872	2,872	415	2,252	158	—	158
Multi-family	—	—	—	—	—	—	—
1-4 family	—	—	—	—	—	—	—
Commercial and industrial	6,865	8,813	4,067	12,288	639	—	639
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	—	—	—	—	—	—	—
Other	9	9	9	—	—	—	—
Total	9,746	11,694	4,491	14,540	797	—	797
Total:							
Commercial real estate:							
Owner occupied	7,077	7,077	—	5,549	613	—	613
Non-owner occupied	34	75	—	1,830	97	226	(129)
Land development	2,627	5,297	—	3,092	84	—	84
Construction	2,872	2,872	415	4,252	292	214	78
Multi-family	—	—	—	1	—	—	—
1-4 family	1,423	1,706	—	2,146	53	7	46
Commercial and industrial	12,330	15,315	4,067	15,922	1,497	7	1,490
Direct financing leases, net	—	—	—	—	—	—	—
Consumer and other:							
Home equity and second mortgages	4	3	—	7	—	—	—
Other	354	1,020	9	365	59	—	59
Grand total	$26,721	$33,365	$ 4,491	$ 33,164	$ 2,695	$ 454	$ 2,241

(1) The recorded investment represents the unpaid principal balance net of any partial charge-offs.

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

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

(1) The recorded investment represents the unpaid principal balance net of any partial charge-offs.

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

The difference between the recorded investment of loans and leases and the unpaid principal balance of $7.1 million, $6.6 million, and $3.4 million as of December 31, 2018, 2017, and 2016, respectively, represents partial charge-offs of loans and leases resulting from losses due to the appraised value of the collateral securing the loans and leases being below the carrying values of the loans and leases. Impaired loans and leases also included $180,000, $332,000, and $717,000 of loans as of

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December 31, 2018, 2017, and 2016, respectively, that were performing troubled debt restructurings, and although not on non-accrual, were reported as impaired due to the concession in terms. When a loan is placed on non-accrual, interest accrual is discontinued and previously accrued but uncollected interest is deducted from interest income. Cash payments collected on non-accrual loans are first applied to such loan's principal. Foregone interest represents the interest that was contractually due on the loan but not received or recorded. To the extent the amount of principal on a non-accrual loan is fully collected and additional cash is received, the Corporation will recognize interest income.

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

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

	As of and for the Year Ended December 31, 2018			
	Commercial Real Estate	Commercial and Industrial	Consumer and Other	Total
	(In Thousands)			
Beginning balance	$10,131	$ 8,225	$ 407	$18,763
Charge-offs	(4,501)	(1,545)	(55)	(6,101)
Recoveries	174	2,023	74	2,271
Net (charge-offs) recoveries	(4,327)	478	19	(3,830)
Provision for loan and lease losses	5,858	(624)	258	5,492
Ending balance	$11,662	$ 8,079	$ 684	$20,425

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

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

Ending balance	$12,384	$ 7,970	$ 558	$20,912

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

	December 31, 2018			
	Commercial Real Estate	Commercial and Industrial	Consumer and Other	Total
	(In Thousands)			
Allowance for loan and lease losses:				
Collectively evaluated for impairment	$10,987	$ 4,369	$ 673	$16,029
Individually evaluated for impairment	675	3,710	11	4,396
Loans acquired with deteriorated credit quality	—	—	—	—
Total	$11,662	$ 8,079	$ 684	$20,425
Loans and lease receivables:				
Collectively evaluated for impairment	$1,086,254	$ 478,385	$ 28,937	1,593,576
Individually evaluated for impairment	7,914	17,104	290	25,308
Loans acquired with deteriorated credit quality	171	2	—	173
Total	$1,094,339	$ 495,491	$ 29,227	$1,619,057

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

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

	December 31, 2018	December 31, 2017
	(In Thousands)	
Minimum lease payments receivable	$26,700	$ 24,898
Estimated unguaranteed residual values in leased property	9,330	8,312
Initial direct costs	73	76
Unearned lease and residual income	(2,933)	(2,499)
Investment in commercial direct financing leases	$33,170	$ 30,787

There were no impairments of residual value of leased property during the years ended December 31, 2018, 2017, and 2016.

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

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

(In Thousands)	
Maturities during year ended December 31,	
2019	$8,995
2020	6,676
2021	4,271
2022	3,285
2023	1,970
Thereafter	1,503
	$26,700

Note 5 – Premises and Equipment

A summary of premises and equipment was as follows:

	As of December 31,	
	2018	2017
	(In Thousands)	
Leasehold improvements	$2,622	$2,550
Furniture and equipment	7,021	6,442
	9,643	8,992
Less: accumulated depreciation	(6,359)	(5,836)
Total premises and equipment, net	$3,284	$3,156

Depreciation expense was $835,000, $744,000, and $767,000 for the years ended December 31, 2018, 2017, and 2016, respectively.

Note 6 – Goodwill and Other Intangible Assets

Goodwill

Goodwill is not amortized, but is subject to impairment tests on an annual basis and more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount (including goodwill). At December 31, 2018 and 2017, the Corporation had goodwill of $10.7 million, which was related to the acquisition of Alterra in 2014.

The Corporation conducted its annual impairment test on July 1, 2018, utilizing a qualitative assessment, and concluded that it was more likely than not the estimated fair value of the reporting unit exceeded its carrying value, resulting in no impairment. Management determined no changes to factors occurred through December 31, 2018 that would negatively impact the goodwill test.

Other Intangible Assets

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

Loan servicing rights are recognized upon sale of the guaranteed portions of SBA loans with servicing rights retained. When SBA loans are sold, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Loan servicing assets are subsequently measured using the amortization method, which requires servicing rights to be amortized into interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. For the years ended December 31, 2018, 2017, and 2016, loan servicing asset amortization totaled $786,000, $388,000, and $639,000, respectively.

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The estimated fair value of the Corporation's loan servicing asset was $1.3 million and $1.8 million as of December 31, 2018 and 2017, respectively. The Corporation periodically reviews this portfolio for impairment and engages a third-party valuation firm to assess the fair value of the overall servicing rights portfolio. During the year ended December 31, 2018, a $69,000 valuation allowance was established.
The core deposit intangible has a finite life and is amortized over a period of seven years. The net book value of the core deposit intangible was $100,000 and $147,000 as of December 31, 2018 and 2017, respectively. For the years ended December 31, 2018, 2017, and 2016, amortization totaled $47,000, $55,000, and $62,000, respectively.

Note 7 – Other Assets

The Corporation is a limited partner in several limited partnership investments. The Corporation is not the general partner, does not have controlling ownership and is not the primary beneficiary in any of these limited partnerships and the limited partnerships have not been consolidated. These investments are accounted for using the equity method of accounting and are evaluated for impairment at the end of each reporting period.
Historic Rehabilitation Tax Credits
In 2015, the Corporation invested in a development entity through BOC, a wholly-owned subsidiary of FBB, to acquire, rehabilitate and operate a historic building in Madison, Wisconsin. At December 31, 2018 and 2017, the net carrying value of the investment was $104,000 and $174,000, respectively. During 2016, the Corporation contributed an additional $2.8 million to the project, recognized $3.8 million in historic tax credits related to this investment and $3.3 million in impairment to the underlying investment.
In 2016, the Corporation also invested in a development entity through Mitchell Street, a wholly-owned subsidiary of FBB, to rehabilitate a historic building in Milwaukee, Wisconsin. At December 31, 2018 and 2017, the net carrying value of the investment was $570,000. The Corporation contributed an additional $217,000 and $4.9 million to the project in 2018 and 2017, respectively. During 2017, the Corporation recognized $3.0 million in federal historic tax credits related to this investment and sold the state historic tax credits associated with the investment to a third party for a pre-tax gain of $210,000. During 2018 and 2017 the Corporation recognized $217,000 and $2.3 million, respectively, in impairment to the underlying investment.
In 2017, the Corporation also invested in a development entity through FBB Tax Credit, a wholly-owned subsidiary of FBB, to rehabilitate a historic building in Kenosha, Wisconsin. At December 31, 2018 and 2017, the net carrying value of the investment was $417,000. The aggregate capital contributions to the project will depend upon the final amount of the certified project costs, but are expected to approximate $2.1 million. The credits will be taken when the project is placed in service and are subject to a five-year recapture period.
In 2018, the Corporation also invested in a development entity through FBB Tax Credit, to rehabilitate a county courthouse in Waukesha, Wisconsin. At December 31, 2018, the net carrying value of the investment was $238,000. The aggregate capital contributions to the project will depend upon the final amount of the certified project costs, but are expected to approximate $2.2 million. During 2018, the project was partially in service, and therefore, the Corporation recognized $868,000 in federal historic tax credits related to this investment and $544,000 in impairment to the underlying investment.
In 2018, the Corporation also invested in a development entity through FBB Tax Credit, to rehabilitate two buildings in Milwaukee, Wisconsin. At December 31, 2018, the net carrying value of the investment was $324,000. The aggregate capital contributions to the project will depend upon the final amount of the certified project costs, but are expected to approximate $4.6 million. During 2018, the project was partially in service, and therefore, the Corporation recognized $1.3 million in federal historic tax credits related to this investment and $873,000 in impairment to the underlying investment.
New Market Tax Credits
The Corporation invested in a community development entity ("CDE") through Rimrock Road, a wholly-owned subsidiary of FBB, to develop and operate a real estate project located in a low-income community. At December 31, 2018 and 2017, Rimrock Road had one CDE investment with a net carrying value of $6.1 million and $6.6 million respectively. The investment provides federal new market tax credits over the seven year compliance period through

2020. The remaining federal new market tax credit to be utilized was $900,000 as of December 31, 2018. The Corporation's use of the federal new market tax credit during the years ended December 31, 2018 and 2017 was $450,000.

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Other Investments

The Corporation has an equity investment in Aldine Capital Fund, LP, a mezzanine fund, of $600,000 and $904,000 recorded as of December 31, 2018 and 2017, respectively. The Corporation's equity investment in Aldine Capital Fund II, LP, also a mezzanine fund, totaled $3.4 million as of December 31, 2018 and 2017. The Corporation's equity investment in Aldine Capital Fund III, LP, also a mezzanine fund, totaled $188,000 as of December 31, 2018. The Corporation's share of these partnerships' income included in the Consolidated Statements of Income for the years ended December 31, 2018 and 2017 was $459,000 and $354,000, respectively.

The Corporation is the sole owner of $315,000 of common securities issued by Trust II. The purpose of Trust II was to complete the sale of $10.0 million of 10.50% fixed rate preferred securities. Trust II, a wholly owned subsidiary of the Corporation, is not consolidated into the financial statements of the Corporation. The investment in Trust II of $315,000 as of December 31, 2018 and 2017 is included in accrued interest receivable and other assets.

A summary of accrued interest receivable and other assets was as follows:

	December 31, 2018	December 31, 2017
	(In Thousands)	
Accrued interest receivable	$5,684	$ 5,019
Net deferred tax asset	3,172	2,584
Investment in historic development entities	1,653	1,161
Investment in a community development entity	6,081	6,591
Investment in limited partnerships	4,176	4,261
Investment in Trust II	315	315
Fair value of interest rate swaps	4,637	942
Prepaid expenses	2,894	3,091
Other assets	6,039	5,884
Total accrued interest receivable and other assets	$34,651	$ 29,848

Note 8 – Deposits

The composition of deposits was as follows:

	December 31, 2018			December 31, 2017		
	Balance	Average Balance	Average Rate	Balance	Average Balance	Average Rate
	(Dollars in Thousands)					
Non-interest-bearing transaction accounts	$280,769	$241,529	— %	$277,445	$230,907	— %
Interest-bearing transaction accounts	229,612	269,943	0.99	217,625	226,540	0.59
Money market accounts	516,045	491,756	1.09	515,077	583,241	0.47
Certificates of deposit	153,022	94,172	1.70	76,199	56,667	1.00
Wholesale deposits	275,851	302,440	1.95	307,985	361,712	1.70
Total deposits	$1,455,299	$1,399,840	1.11	$1,394,331	$1,459,067	0.74

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A summary of annual maturities of certificates of deposit outstanding and wholesale deposits at December 31, 2018 is as follows:

(In Thousands)	
Maturities during the year ended December 31,	
2019	$224,939
2020	119,881
2021	34,313
2022	24,145
2023	5,809
Thereafter	19,786
	$428,873

Deposits include approximately $61.9 million and $13.4 million of certificates of deposit and wholesale deposits which are denominated in amounts of $250,000 or more at December 31, 2018 and 2017, respectively.

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

The composition of borrowed funds was as follows:

	December 31, 2018			December 31, 2017		
	Balance	Weighted Average Balance	Weighted Average Rate	Balance	Weighted Average Balance	Weighted Average Rate
	(Dollars in Thousands)					
Federal funds purchased	$—	$119	2.43 %	$—	$66	1.22 %
FHLB advances	274,500	274,382	2.06	183,500	105,276	1.40
Line of credit	—	3	4.47	10	328	3.64
Other borrowings(1)	675	675	7.94	675	1,241	14.50
Subordinated notes payable	23,769	23,739	6.64	23,713	23,161	6.93
Junior subordinated notes	10,033	10,025	11.10	10,019	10,011	11.11
	$308,977	$308,943	2.72	$217,917	$140,083	3.14
Short-term borrowings	$136,500			$37,010		
Long-term borrowings	172,477			180,907		
	$308,977			$217,917		

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

The Corporation has a $435.2 million FHLB line of credit available for advances and open line borrowings which is collateralized as noted below. At December 31, 2018, $160.7 million of this line remained unused. There were no advances outstanding on the Corporation’s open line at December 31, 2018 and 2017. There were $274.5 million of term FHLB advances outstanding at December 31, 2018 with stated fixed interest rates ranging from 1.29% to 2.75% compared to $183.5 million of term FHLB advances outstanding at December 31, 2017 with stated fixed interest rates ranging from 1.20% to 2.42%. The term FHLB advances outstanding at December 31, 2018 are due at various dates through August 2024.

The Corporation is required to maintain as collateral mortgage-related securities, unencumbered first mortgage loans and secured small business loans in its portfolio aggregating at least the amount of outstanding advances from the FHLB. Loans totaling approximately $435.2 million and $388.2 million were pledged as collateral at December 31, 2018 and 2017, respectively.

The Corporation has a senior line of credit with a third-party financial institution of $10.5 million. As of December 31, 2018, the line of credit carried an interest rate of LIBOR + 2.75% with an interest rate floor of 3.125% that matured on February 20, 2019 and had certain performance debt covenants of which the Corporation was in compliance. The Corporation pays a commitment fee on this senior line of credit. For the years ended December 31, 2018 and 2017 the Corporation incurred $13,000 additional interest expense due to this fee. On February 19, 2019, the credit line was renewed for one additional year

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with pricing terms of LIBOR + 2.75% and a maturity date of February 20, 2020. There was no outstanding balance on the line of credit as of December 31, 2018.

The Corporation has subordinated notes payable. At December 31, 2018, the amount of subordinated notes payable outstanding was $23.8 million, which qualified for Tier 2 capital. At December 31, 2018, $15.0 million bore a fixed interest rate of 6.50% with a maturity date of September 1, 2024 and $9.1 million bore a fixed interest rate of 6.00% with a maturity date of April 15, 2027. There are no debt covenants on the subordinated notes payable. The Corporation may, at its option, redeem the notes, in whole or part, at any time after the fifth anniversary of issuance. As of December 31, 2018, $321,000 of debt issuance costs remain in the subordinated notes payable balance.

In September 2008, Trust II completed the sale of $10.0 million of 10.50% fixed rate trust preferred securities ("Preferred Securities"). Trust II also issued common securities of $315,000. Trust II used the proceeds from the offering to purchase $10.3 million of 10.50% junior subordinated notes ("Notes") of the Corporation. The Preferred Securities are mandatorily redeemable upon the maturity of the Notes on September 26, 2038. The Preferred Securities qualify under the risk-based capital guidelines as Tier 1 capital for regulatory purposes. Per the provisions of the Dodd-Frank Act, bank holding companies with total assets of less than $15 billion are not required to phase out trust preferred securities as an element of Tier 1 capital as other, larger institutions must. The Corporation used the proceeds from the sale of the Notes for general corporate purposes including providing additional capital to its subsidiaries. As of December 31, 2018, $282,000 of debt issuance costs remain reflected in junior subordinated notes on the Consolidated Balance Sheets.

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

Note 10 – Regulatory Capital

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

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

(i) render the Corporation unable to pay its debts as they become due in the usual course of business, or (ii) result in the Corporation's assets being less than the sum of its total liabilities plus the amount needed to satisfy the preferential rights upon dissolution of any stockholders with preferential rights superior to those stockholders receiving the dividend.

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

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

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

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

In August 2018, the Federal Reserve published a final rule revising the Small Bank Holding Company Policy Statement ("Policy Statement") that raised the total consolidated asset limit from $1 billion to $3 billion. Based on the criteria in the Policy Statement, effective immediately, the Corporation is no longer subject to the capital requirements of the Basel III Rule and is deemed to be "well-capitalized". Therefore, the consolidated capital ratios have been excluded from the below table as of December 31, 2018. Additionally, the Corporation is no longer required to file quarterly consolidated holding company reports with the Federal Reserve. Beginning December 31, 2018, the Corporation is required to submit holding company only reports on a bi-annual basis.

As of December 31, 2018, the Bank's capital levels remained characterized as well capitalized under the regulatory framework. The following tables summarizes the Bank's capital ratios and the ratios required by their federal regulator at December 31, 2018:

	Actual		Minimum Required for Capital Adequacy Purposes		For Capital Adequacy Purposes Plus Capital Conservation Buffer		Minimum Required to Be Well Capitalized Under Prompt Corrective Action Requirements	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in Thousands)							
As of December 31, 2018								
First Business Bank								
Total capital (to risk-weighted assets)	$220,474	11.49%	$ 153,456	8.00 %	$189,422	9.875%	$ 191,820	10.00 %
Tier 1 capital (to risk-weighted assets)	197,093	10.27	115,092	6.00	151,058	7.88	153,456	8.00
Common equity tier 1 capital (to risk-weighted assets)	197,093	10.27	86,319	4.50	122,285	6.375	124,683	6.50

Tier 1 leverage capital (to adjusted assets)	197,093	10.20	77,301	4.00	77,301	4.00	96,626	5.00

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The following table summarizes both the Corporation's and Bank's capital ratios and the ratios required by their federal regulators at December 31, 2017:

	Actual		Minimum Required for Capital Adequacy Purposes		For Capital Adequacy Purposes Plus Capital Conservation Buffer		Minimum Required to Be Well Capitalized Under Prompt Corrective Action Requirements	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in Thousands)							
As of December 31, 2017								
Total capital (to risk-weighted assets)								
Consolidated	$214,501	11.98 %	$ 143,219	8.00 %	$165,597	9.250 %	N/A	N/A
First Business Bank	207,986	11.66	142,736	8.00	165,038	9.250	$ 178,420	10.00 %
Tier 1 capital (to risk-weighted assets)								
Consolidated	$169,176	9.45 %	$ 107,414	6.00 %	$129,792	7.250 %	N/A	N/A
First Business Bank	186,374	10.45	107,052	6.00	129,354	7.250	$ 142,736	8.00 %
Common equity tier 1 capital (to risk-weighted assets)								
Consolidated	$159,157	8.89 %	$ 80,561	4.50 %	$102,939	5.750 %	N/A	N/A
First Business Bank	186,374	10.45	80,289	4.50	102,591	5.750	$ 115,973	6.50 %
Tier 1 leverage capital (to adjusted assets)								
Consolidated	$169,176	9.54 %	$ 70,920	4.00 %	$70,920	4.00 %	N/A	N/A
First Business Bank	186,374	10.56	70,617	4.00	70,617	4.00	$ 88,272	5.00 %

The following table reconciles stockholders' equity to federal regulatory capital at December 31, 2018 and 2017, respectively:

	As of December 31,	
	2018	2017
	(In Thousands)	
Stockholders' equity of the Corporation	$180,707	$169,278
Net unrealized and accumulated losses on specific items	1,684	1,238
Disallowed servicing assets	(751)	(848)
Disallowed goodwill and other intangibles	(10,498)	(10,511)
Junior subordinated notes	10,033	10,019
Tier 1 capital	181,175	169,176
Allowable general valuation allowances and subordinated debt	47,150	45,325
Total capital	$228,325	$214,501

Note 11 – Earnings per Common Share

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

There were no anti-dilutive employee share-based awards for the years ended December 31, 2018, 2017, and 2016.

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	For the Year Ended December 31,		
	2018	2017	2016
	(Dollars in Thousands, Except Share Data)		
Basic earnings per common share			
Net income	$16,303	$ 11,905	$ 14,909
Less: earnings allocated to participating securities	240	162	219
Basic earnings allocated to common shareholders	$16,063	$ 11,743	$ 14,690
Weighted-average common shares outstanding, excluding participating securities	8,640,198	8,612,770	8,573,722
Basic earnings per common share	$1.86	$ 1.36	$ 1.71
Diluted earnings per common share			
Earnings allocated to common shareholders, diluted	$16,063	$ 11,743	$ 14,690
Weighted-average diluted common shares outstanding, excluding participating securities	8,640,198	8,612,770	8,573,722
Diluted earnings per common share	$1.86	$ 1.36	$ 1.71

Note 12 – Share-Based Compensation

The Corporation adopted the 2012 Equity Incentive Plan (the “Plan”) during the quarter ended June 30, 2012. The Plan is administered by the Compensation Committee of the Board of Directors of the Corporation and provides for the grant of equity ownership opportunities through incentive stock options and nonqualified stock options, restricted stock, restricted stock units, dividend equivalent units, and any other type of award permitted by the Plan. As of December 31, 2018, 164,621 shares were available for future grants under the Plan. Shares covered by awards that expire, terminate or lapse will again be available for the grant of awards under the Plan. The Corporation may issue new shares and shares from its treasury stock for shares delivered under the Plan.

Restricted Stock

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

Restricted stock activity was as follows:

	For the Year Ended December 31,					
	2018		2017		2016	
	Number of Restricted Shares	Weighted Average Grant-Date Fair Value	Number of Restricted Shares	Weighted Average Grant-Date Fair Value	Number of Restricted Shares	Weighted Average Grant-Date Fair Value
Nonvested balance at beginning of year	130,441	$ 21.43	116,245	$ 21.13	135,471	$ 20.13
Granted	66,498	20.57	71,130	21.67	60,415	22.74
Vested	(46,034)	21.01	(48,550)	21.51	(56,090)	18.71
Forfeited	(19,284)	22.25	(8,384)	21.65	(23,551)	20.90
Nonvested balance as of end of year	131,621	21.02	130,441	21.43	116,245	21.13

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As of December 31, 2018, the Corporation had $2.5 million of deferred unvested compensation expense, which the Corporation expects to recognize over a weighted-average period of approximately 2.9 years.
Share-based compensation expense related to restricted stock included in the Consolidated Statements of Income was as follows:

	For the Year Ended December 31,		
	2018	2017	2016
	(In Thousands)		
Share-based compensation expense	$1,004	$1,078	$994

Note 13 – Employee Benefit Plans

The Corporation maintains a contributory 401(k) defined contribution plan covering substantially all employees. The Corporation matches 100% of amounts contributed by each participating employee, up to 3.0% of the employee's compensation. The Corporation may also make discretionary contributions up to an additional 6.0% of salary. Contributions are expensed in the period incurred and recorded in compensation expense in the Consolidated Statements of Income. The Corporation made a matching contribution of 3.0% to all eligible employees which totaled $700,000, $626,000, and $621,000 for the years ended December 31, 2018, 2017, and 2016, respectively. Discretionary contributions of 1.0%, or $180,000, 1.0%, or $183,000, and 1.2%, or $207,000, were made in 2018, 2017, and 2016, respectively.

As of December 31, 2018, 2017, and 2016, the Corporation had a deferred compensation plan under which it provided contributions to supplement the retirement income of one executive. Under the terms of the plan, benefits to be received are generally payable within six months of the date of the termination of employment with the Corporation. The expense associated with the deferred compensation plan for the years ended December 31, 2018, 2017, and 2016 was $150,000, $132,000, and $124,000, respectively. The present value of future payments under the remaining plan of $1.3 million and $1.1 million at December 31, 2018 and 2017, respectively, is included in accrued interest payable and other liabilities on the Consolidated Balance Sheets.

The Corporation owned life insurance policies on the life of the executive covered by the deferred compensation plan, which had cash surrender values and death benefits of approximately $2.5 million and $5.9 million, respectively, at December 31, 2018 and cash surrender values and death benefits of approximately $2.4 million and $5.9 million, respectively, at December 31, 2017. The remaining balance of the cash surrender value of bank-owned life insurance of $39.0 million and $37.9 million as of December 31, 2018 and 2017, respectively, is related to policies on a number of then-qualified individuals affiliated with the Bank.

Note 14 – Leases

The Corporation leases various office spaces, loan production offices and specialty financing production offices under noncancelable operating leases which expire on various dates through 2028. The Corporation's total rent expense was $2.1 million, $1.9 million, and $1.8 million for the years ended December 31, 2018, 2017, and 2016, respectively. Rent expense is recognized on a straight-line basis. The Corporation also leases other office equipment. Rental expense for these operating leases was $159,000, $129,000, and $136,000 for the years ended December 31, 2018, 2017, and 2016, respectively.

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

(In Thousands)	
2019	$1,690
2020	1,613
2021	1,434
2022	1,410

2023	1,014
Thereafter	3,063
	$10,224

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Note 15 - Other Non-Interest Expense

A summary of other non-interest expenses is as follows:

	Year Ended December 31,		
	2018	2017	2016
	(In Thousands)		
General and administrative expenses	$1,877	$1,905	$1,545
Travel and other employee expenses	1,530	1,298	1,354
Partnership income[1]	—	—	(790)
Other expenses	23	12	129
Total other non-interest expense	$3,430	$3,215	$2,238

(1) Partnership income was recorded in other non-interest income for the years ended December 31, 2018 and 2017.

Note 16 – Income Taxes

Income tax expense consists of the following:

	Year Ended December 31,		
	2018	2017	2016
	(In Thousands)		
Current:			
Federal	$729	$131	$2,839
State	1,054	448	425
Current tax expense	1,783	579	3,264
Deferred:			
Federal	(367)	1,657	(1,000)
State	(65)	90	(108)
Deferred tax (benefit) expense	(432)	1,747	(1,108)
Total income tax expense	$1,351	$2,326	$2,156

Deferred income tax assets and liabilities reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax basis. Deferred tax assets and liabilities are measured using enacted tax rates to apply to taxable income in the period in which the temporary differences are expected to be recovered or settled. Effective January 1, 2018, the enactment of the Tax Cuts and Jobs Act (the "Act") reduced the corporate federal income tax rate to 21% from 35%, which required the Corporation to revalue its deferred taxes as of December 31, 2017. The revaluation resulted in a $629,000 reduction to the Corporation's net deferred tax assets with a corresponding increase to income tax expense during the year ended December 31, 2017. Net deferred tax assets are included in accrued interest receivable and other assets in the Consolidated Balance Sheets. On December 22, 2017, the SEC issued Staff Accounting Bulletin 118 ("SAB 118"), which provides guidance on accounting for the Act's impact. SAB 118 provides a measurement period, which in no case should extend beyond one year from the Act's enactment, during which a company acting in good faith may complete the accounting for the impacts of the Act. In accordance with SAB 118, a company will reflect the income tax effects of the Act in the reporting period in which the accounting is complete.

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

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	December 31, 2018	December 31, 2017
	(In Thousands)	
Deferred tax assets:		
Allowance for loan and lease losses	$5,424	$ 4,795
SBA recourse reserve	785	729
Deferred compensation	1,045	482
State net operating loss carryforwards	571	615
Tax credit carryforwards	1,373	—
Non-accrual loan interest	1,472	942
Capital loss carryforwards	22	21
Unrealized losses on securities	579	423
Other	68	450
Total deferred tax assets before valuation allowance	11,339	8,457
Valuation allowance	—	—
Total deferred tax assets	11,339	8,457
Deferred tax liabilities:		
Leasing and fixed asset activities	6,965	5,338
Loan servicing asset	358	471
Other	844	64
Total deferred tax liabilities	8,167	5,873
Net deferred tax asset	$3,172	$ 2,584

The tax effects of unrealized gains and losses on securities are components of other comprehensive income. A reconciliation of the change in net deferred tax assets to deferred tax expense is as follows:

	December 31, 2018	December 31, 2017	December 31, 2016
	(In Thousands)		
Change in net deferred tax assets	$588	$ (1,468)	$ 1,419
Deferred taxes allocated to other comprehensive income	(156)	(279)	(311)
Deferred income tax benefit (expense)	$432	$ (1,747)	$ 1,108

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

The Corporation had state net operating loss carryforwards of approximately $9.1 million and $9.9 million at December 31, 2018 and 2017, respectively, which can be used to offset future state taxable income. The Corporation believes it will be able to fully utilize its Wisconsin state net operating losses under this law and therefore no valuation allowance has been established as of December 31, 2018.

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

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	Year Ended December 31,		
	2018	2017	2016
	(Dollars in Thousands)		
Income before income tax expense	$17,654	$14,231	$17,065
Tax expense at statutory federal rate of 21%, 35% and 35% applied to income before income tax expense, respectively	$3,707	$4,981	$5,973
State income tax, net of federal effect	803	511	206
Tax-exempt security and loan income, net of TEFRA adjustments	(847)	(1,045)	(1,114)
Bank-owned life insurance	(250)	(438)	(341)
Tax credits, net	(2,157)	(2,390)	(2,696)
Deferred tax revaluation adjustment	—	629	—
Other	95	78	128
Total income tax expense	$1,351	$2,326	$2,156
Effective tax rate	7.65 %	16.34 %	12.63 %

There were no uncertain tax positions outstanding as of December 31, 2018 and 2017. As of December 31, 2018, tax years remaining open for the State of Wisconsin tax were 2014 through 2017. Federal tax years that remained open were 2015 through 2017. As of December 31, 2018, there were also no unrecognized tax benefits that are expected to significantly increase or decrease within the next twelve months.

Note 17 – Derivative Financial Instruments

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

At December 31, 2018, the aggregate amortizing notional value of interest rate swaps with various commercial borrowers was $144.4 million. The Corporation receives fixed rates and pays floating rates based upon LIBOR on the swaps with commercial borrowers. These interest rate swaps mature between April 2019 and July 2034. Commercial borrower swaps are completed independently with each borrower and are not subject to master netting arrangements. These commercial borrower swaps were reported on the Consolidated Balance Sheet as a derivative asset of $4.6 million, included in accrued interest receivable and other assets, and as a derivative liability of $70,000, included in accrued interest payable and other liabilities. As of December 31, 2018, no interest rate swaps were in default.

At December 31, 2018, the aggregate amortizing notional value of interest rate swaps with dealer counterparties was also $144.4 million. The Corporation pays fixed rates and receives floating rates based upon LIBOR on the swaps with dealer counterparties. These interest rate swaps mature in April 2019 through July 2034. Dealer counterparty swaps are subject to master netting agreements among the contracts within our Bank and are reported on the Consolidated Balance Sheet as a net derivative liability of $4.5 million, included in accrued interest payable and other liabilities. The gross amount of dealer counterparty swaps, without regard to the enforceable master netting agreement, was a gross derivative liability of $4.6 million and a gross derivative asset of $70,000. No right of offset existed with the dealer counterparty swaps as of December 31, 2018.

All changes in the fair value of these instruments are recorded in other non-interest income. Given the mirror-image terms of the outstanding derivative portfolio, the change in fair value for the years ended December 31, 2018 and 2017 had an insignificant impact on the unaudited Consolidated Statements of Income.

The Corporation also enters into interest rate swaps to manage interest rate risk and reduce the cost of match-funding certain long-term fixed rate loans. These derivative contracts involve the receipt of floating rate interest from a counterparty in

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exchange for the Corporation making fixed-rate payments over the life of the agreement, without the exchange of the underlying notional value. The instruments are designated as cash flow hedges as the receipt of floating rate interest from the counterparty is used to manage interest rate risk associated with forecasted issuances of short-term FHLB advances. The change in the fair value of these hedging instruments is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the period that the hedged transactions affects earnings.

As of December 31, 2018, the aggregate notional value of interest rate swaps designated as cash flow hedges was $54.0 million. These interest rate swaps mature between December 2021 and December 2027. A pre-tax unrealized loss of $20,000 was recognized in other comprehensive income for the year ended December 31, 2018 and there was no ineffective portion of these hedges information about the balance sheet location and fair value of the Corporation's derivative instruments to qualified commercial borrowers as of December 31, 2018 and 2017.

	Interest Rate Swap Contracts			
	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
	(In Thousands)			
Derivatives not designated as hedging instruments				
December 31, 2018	Accrued interest receivable and other assets	$4,637	Accrued interest payable and other liabilities	$4,637
December 31, 2017	Accrued interest receivable and other assets	$942	Accrued interest payable and other liabilities	$942
Derivatives designated as hedging instruments				
December 31, 2018	Accumulated other comprehensive income (1)	$142	Accrued interest payable and other liabilities	$142
December 31, 2017	Accumulated other comprehensive income (1)	$122	Accrued interest payable and other liabilities	$122

(1) The fair value of derivatives designated as hedging instruments included in accumulated other comprehensive income represent pre-tax amounts, which are reported net of tax on the unaudited Consolidated Balance Sheets.

Note 18 – Commitments and Contingencies

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of clients. These financial instruments include commitments to extend credit and standby letters of credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the Consolidated Financial Statements. The contract amounts reflect the extent of involvement the Bank has in these particular classes of financial instruments.

In the event of non-performance, the Bank's exposure to credit loss for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Bank uses the same credit policies in making commitments and conditional obligations as they do for instruments reflected in the Consolidated Financial Statements. An accrual for credit losses on financial instruments with off-balance-sheet risk would be recorded separate from any valuation account related to any such recognized financial instrument. As of December 31, 2018 and 2017, there were no accrued credit losses for financial instruments with off-balance-sheet risk.

Financial instruments whose contract amounts represent potential credit risk were as follows:

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	At December 31,	
	2018	2017
	(In Thousands)	
Commitments to extend credit, primarily commercial loans	$553,801	$497,993
Standby letters of credit	12,436	13,845

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

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

Management has assessed estimated losses inherent in the outstanding guaranteed portions of SBA loans sold in accordance with ASC 450, Contingencies, and determined a recourse reserve based on the probability of future losses for these loans to be $3.0 million and $2.8 million at December 31, 2018 and 2017, respectively, which is reported in accrued interest payable and other liabilities on the Consolidated Balance Sheets.

The summary of the activity in the SBA recourse reserve is as follows:

	As of and For the Year Ended December 31,	
	2018	2017
	(In Thousands)	
Balance at the beginning of the period	$2,849	$1,750
SBA recourse provision	1,913	2,240
Charge-offs, net	(1,806)	(1,141)
Balance at the end of the period	$2,956	$2,849

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

Note 19 – Fair Value Disclosures

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The Corporation determines the fair values of its financial instruments based on the fair value hierarchy established in ASC Topic 820, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Fair value is defined as the price that would be received in an orderly transaction that is not a forced liquidation or distressed sale at the measurement date and is based on exit prices. Fair value includes assumptions about risk, such as nonperformance risk in liability fair values, and is a market-based measurement, not an entity-specific measurement. The standard describes three levels of inputs that may be used to measure fair value.

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

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

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

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

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

	December 31, 2018 Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total
	(In Thousands)			
Assets:				
Securities available-for-sale:				
U.S. government agency securities - government-sponsored enterprises	$—	$ 990	$ —	$ 990
Municipal securities	—	5,886	—	5,886
Mortgage backed securities - government issued	—	19,628	—	19,628
Mortgage backed securities - government-sponsored enterprises	—	109,478	—	109,478
Other securities	—	2,376	—	2,376
Interest rate swaps	—	4,637	—	4,637
Liabilities:				
Interest rate swaps	—	4,779	—	4,779

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

For assets and liabilities measured at fair value on a recurring basis, there were no transfers between the levels during the year ended December 31, 2018 or 2017 related to the above measurements.

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

	December 31, 2018 Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total
	(In Thousands)			
Impaired loans	$—	$13,935	$1,771	$15,706

Foreclosed properties	—	2,547	—	2,547
Loan servicing rights	—	—	1,278	1,278

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

Impaired loans were written down to the fair value of their underlying collateral less costs to sell of $15.7 million and $15.1 million at December 31, 2018 and 2017, respectively, through the establishment of specific reserves or by recording charge-offs when the carrying value exceeded the fair value of the underlying collateral of impaired loans. Valuation techniques consistent with the market approach, income approach or cost approach were used to measure fair value and primarily included observable inputs for the individual impaired loans being evaluated such as current appraisals, recent sales of similar assets or other observable market data, and are reflected within Level 2 of the hierarchy. In cases where an input is unobservable, typically when discounts are applied to appraisal values to adjust such values to current market conditions or to reflect net realizable value, the impaired loan balance is reflected within Level 3 of the hierarchy. The quantification of unobservable inputs for Level 3 impaired loan values range from 15% - 50% as of the measurement date of December 31, 2018. The weighted average of those unobservable inputs was 34%. The majority of the impaired loans in the Level 3 category are considered collateral dependent loans or are supported by a SBA guaranty.

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

Loan servicing rights represent the asset retained upon sale of the guaranteed portion of certain SBA loans. When SBA loans are sold, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. The servicing rights are subsequently measured using the amortization method, which requires amortization into interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

The Corporation periodically reviews this portfolio for impairment and engages a third-party valuation firm to assess the fair value of the overall servicing rights portfolio. Loan servicing rights do not trade in an active, open market with readily observable prices. While sales of loan servicing rights do occur, the precise terms and conditions typically are not readily available to allow for a “quoted price for similar assets” comparison. Accordingly, the Corporation utilizes an independent valuation from a third party which uses a discounted cash flow model to estimate the fair value of its loan servicing rights. The valuation model incorporates prepayment assumptions to project loan servicing rights cash flows based on the current interest rate scenario, which is then discounted to estimate an expected fair value of the loan servicing rights. The valuation model considers portfolio characteristics of the underlying serviced portion of the SBA loans and uses the following significant unobservable inputs: (1) constant prepayment rate (“CPR”) assumptions based on the SBA sold pools historical CPR as quoted in Bloomberg and (2) a discount rate of 10%. Due to the nature of the valuation inputs, loan servicing rights are classified in Level 3 of the fair value hierarchy.

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Fair Value of Financial Instruments

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

	December 31, 2018				
	Carrying Amount	Fair Value			
		Total	Level 1	Level 2	Level 3
	(In Thousands)				
Financial assets:					
Cash and cash equivalents	$86,546	$86,546	$67,246	$19,300	$ —
Securities available-for-sale	138,358	138,358	—	138,358	—
Securities held-to-maturity	37,731	37,409	—	37,409	—
Loans held for sale	5,287	5,816	—	5,816	—
Loans and lease receivables, net	1,597,230	1,589,323	—	13,935	1,575,388
Federal Home Loan Bank stock	7,240	N/A	N/A	N/A	N/A
Accrued interest receivable	5,684	5,684	5,684	—	—
Interest rate swaps	4,637	4,637	—	4,637	—
Financial liabilities:					
Deposits	1,455,299	1,453,482	1,026,648	426,834	—
Federal Home Loan Bank advances and other borrowings	298,944	294,127	—	294,127	—
Junior subordinated notes	10,033	9,955	—	—	9,955
Accrued interest payable	3,696	3,696	3,696	—	—
Interest rate swaps	4,779	4,779	—	4,779	—
Off-balance-sheet items:					
Standby letters of credit	59	59	—	—	59

N/A = The fair value is not applicable due to restrictions placed on transferability

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

N/A = The fair value is not applicable due to restrictions placed on transferability

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

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

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

Interest Rate Swaps: The carrying amount and fair value of existing derivative financial instruments are based upon independent valuation models, which use widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative contract. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The Corporation incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the

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respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Corporation considers the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts and guarantees.

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

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

Note 20 – Condensed Parent Only Financial Information

The following represents the condensed financial information of FBFS only:

Condensed Balance Sheets

	December 31, 2018	December 31, 2017
	(In Thousands)	
Assets		
Cash and due from banks	$3,699	$1,472
Investments in subsidiaries, at equity	206,973	196,810
Leasehold improvements and equipment, net	2,036	2,067
Other assets	5,444	5,993
Total assets	$218,152	$206,342
Liabilities and Stockholders' Equity		
Borrowed funds	$33,802	$33,742
Other liabilities	3,643	3,322
Total liabilities	37,445	37,064
Stockholders' equity	180,707	169,278
Total liabilities and stockholders' equity	$218,152	$206,342

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Condensed Statements of Income

	For the Year Ended December 31,		
	2018	2017	2016
	(In Thousands)		
Interest expense	$2,703	$2,744	$2,799
Non-interest income			
Consulting and rental income from consolidated subsidiaries	20,267	19,139	16,036
Other non-interest income	33	34	33
Total non-interest income	20,300	19,173	16,069
Non-interest expense	22,866	21,575	19,250
Loss before income tax benefit and equity in undistributed net income of consolidated subsidiaries	5,269	5,146	5,980
Income tax benefit	1,478	1,965	2,170
Loss before equity in undistributed net income of consolidated subsidiaries	3,791	3,181	3,810
Equity in undistributed net income of consolidated subsidiaries	20,094	15,086	18,719
Net income	$16,303	$11,905	$14,909

Condensed Statements of Cash Flows

	For the Year Ended December 31,		
	2018	2017	2016
	(In Thousands)		
Operating activities			
Net income	$16,303	$11,905	$14,909
Adjustments to reconcile net income to net cash used in operating activities:			
Equity in undistributed earnings of consolidated subsidiaries	(20,094)	(15,086)	(18,719)
Share-based compensation	1,004	1,078	994
Excess tax benefit from share-based compensation	(24)	(37)	(83)
Net increase (decrease) in other liabilities	321	(4,170)	1,198
Other, net	72	(2,233)	(3,162)
Net cash used in operating activities	(2,418)	(8,543)	(4,863)
Investing activities			
Dividends received from subsidiaries	10,034	14,534	13,534
Capital contributions to subsidiaries	—	—	(3,500)
Net cash provided by investing activities	10,034	14,534	10,034
Financing activities			
Net increase (decrease) in short-term borrowed funds	60	(1,000)	(1,500)
Proceeds from issuance of subordinated notes payable	—	9,090	—
Repayment of subordinated notes payable	—	(7,875)	—
Purchase of treasury stock	(533)	(323)	(467)
Cash dividends paid	(4,916)	(4,538)	(4,176)
Net cash used in financing activities	(5,389)	(4,646)	(6,143)
Net increase (decrease) in cash and due from banks	2,227	1,345	(972)
Cash and due from banks at the beginning of the period	1,472	127	1,099
Cash and due from banks at the end of the period	$3,699	$1,472	$127

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Note 21 – Condensed Quarterly Earnings (unaudited)

	2018				2017			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	(Dollars in Thousands, Except Per Share Data)							
Interest income	$24,522	$23,563	$22,468	$20,722	$19,504	$18,634	$19,225	$18,447
Interest expense	7,407	6,469	5,537	4,520	4,146	3,751	3,746	3,559
Net interest income	17,115	17,094	16,931	16,202	15,358	14,883	15,479	14,888
Provision for loan and lease losses	983	(546)	2,579	2,476	473	1,471	3,656	572
Non-interest income	4,648	4,871	3,982	4,667	3,525	4,339	4,738	4,063
Non-interest expense	18,244	15,746	14,467	13,907	14,859	14,231	14,221	13,560
Income before income tax expense	2,536	6,765	3,867	4,486	3,551	3,520	2,340	4,819
Income tax (benefit) expense	(1,528)	1,464	578	837	(486)	936	454	1,422
Net income	$4,064	$5,301	$3,289	$3,649	$4,037	$2,584	$1,886	$3,397
Per common share:								
Basic earnings	$0.46	$0.60	$0.38	$0.42	$0.46	$0.30	$0.22	$0.39
Diluted earnings	0.46	0.60	0.38	0.42	0.46	0.30	0.22	0.39
Dividends declared	0.14	0.14	0.14	0.14	0.13	0.13	0.13	0.13

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Report of Independent Registered Public Accounting Firm
Shareholders and the Board of Directors
First Business Financial Services, Inc.
Madison, Wisconsin

Opinions on the Financial Statements and Internal Control over Financial Reporting
We have audited the accompanying consolidated balance sheet of First Business Financial Services, Inc. (the "Company") as of December 31, 2018, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

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, 2018, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework: (2013) issued by COSO.

Basis for Opinions
The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's financial statements and an opinion on the Company's internal control over financial reporting based on our audit. 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 audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audit of the financial statements 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 audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting
A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly

reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

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

/s/ Crowe LLP

We have served as the Company’s auditor since 2017, which is the year the engagement letter was signed for the audit of the 2018 financial statements.
Oak Brook, Illinois
February 28, 2019

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

Opinion on the Consolidated Financial Statements

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

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the 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 consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ KPMG LLP

We served as the Company's auditor from 1999 to 2017.
Chicago, Illinois
March 9, 2018

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

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

The Corporation's management, with the participation of the Corporation's Chief Executive Officer and Chief Financial Officer, has evaluated the Corporation's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based upon that evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer have concluded that the Corporation's disclosure controls and procedures were effective as of December 31, 2018.

Changes in Internal Control over Financial Reporting

There was no change in the Corporation's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities and Exchange Act of 1934, as amended) that occurred during the quarter ended December 31, 2018 that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

Management's Annual Report on Internal Control over Financial Reporting

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

Management, under the supervision of the Chief Executive Officer and the Chief Financial Officer, assessed the effectiveness of the Corporation's internal control over financial reporting based on criteria for effective internal control over financial reporting established in Internal Control – Integrated Framework (2013), issued by the Committee of Sponsoring Organization of the Treadway Commission (COSO). Based on this assessment, management has determined that the Corporation's internal control over financial reporting was effective as of December 31, 2018.

Crowe LLP, the independent registered public accounting firm that audited the Consolidated Financial Statements of the Corporation included in this Annual Report on Form 10-K, has issued an attestation report on the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2018. The report, which expresses an unqualified opinion on the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2018, is included under the heading "Report of Independent Registered Public Accounting Firm."

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Item 9B. Other Information
None.

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

(a) Directors of the Registrant. The information included in the definitive Proxy Statement for the Annual Meeting of the Shareholders to be held on May 2, 2019 under the captions “Item 1 - Election of Directors,” “Corporate Governance Principles and Practices” and “Section 16(a) Beneficial Ownership Reporting Compliance” is incorporated herein by reference.

(b) Executive Officers of the Registrant. The information presented in Item 1 of this document is incorporated herein by reference.

(c) Code of Ethics. The Corporation has adopted a code of ethics applicable to all employees, including the principal executive officer, principal financial officer and principal accounting officer of the Corporation. The FBFS Code of Ethics is posted on the Corporation’s website at www.firstbusiness.com. The Corporation intends to satisfy the disclosure requirements under Item 5.05(c) of Form 8-K regarding any amendment to or waiver of the code with respect to its Chief Executive Officer, Chief Financial Officer, principal accounting officer, and persons performing similar functions, by posting such information to the Corporation’s website.

Item 11. Executive Compensation
Information with respect to compensation for our directors and officers included in the definitive Proxy Statement for the Annual Meeting of the Shareholders to be held on May 2, 2019 under the captions “Executive Compensation,” “Summary Compensation Table,” “Long Term Incentive Plans,” “Outstanding Equity Awards at December 31, 2018,” “Disclosure Regarding Termination and Change in Control Provisions” and “Director Compensation” is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters
Information with respect to security ownership of certain beneficial owners and management included in the definitive Proxy Statement for the Annual Meeting of the Shareholders to be held on May 2, 2019 under the caption “Principal Shareholders” is incorporated herein by reference.

Equity Compensation Plan Information

The following table summarizes certain information with respect to compensation plans under which equity securities of the Corporation are authorized for issuance as of December 31, 2018.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	—	$ —	164,621
Equity compensation plans not approved by security holders	—	—	—

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information with respect to certain relationships and related transactions included in the definitive Proxy Statement for the Annual Meeting of the Shareholders to be held on May 2, 2019 under the captions “Related Party Transactions” and “Corporate Governance Principles and Practices” is incorporated herein by reference.

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Item 14. Principal Accountant Fees and Services

Information with respect to principal accounting fees and services included in the definitive Proxy Statement for the Annual Meeting of the Shareholders to be held on May 2, 2019 under the caption “Miscellaneous” is incorporated herein by reference.

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

Exhibit No.	Exhibit Name
3.1	Amended and Restated Articles of Incorporation of First Business Financial Services, Inc. (Incorporated by reference to Exhibit 3.1 to the Annual Report on Form 10-K filed on March 10, 2017)
3.2	Amended and Restated Bylaws of First Business Financial Services, Inc. (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed on October 31, 2018)
	Pursuant to Item 601(b)(4)(iii) of Regulation S-K, the Registrant agrees to furnish to the Securities and Exchange Commission, upon request, any instrument defining the rights of holders of long-term debt not being registered that is not filed as an exhibit to this Annual Report on Form 10-K. No such instrument authorizes securities in excess of 10% of the total assets of the Registrant.
4.1	Rights Agreement, dated as of June 5, 2008, between the Registrant and Computershare Trust Company, N.A. (incorporated by reference to Exhibit 4.1 to the Annual Report on Form 10-K filed on March 10, 2017)
4.2	Form of Common Stock Certificate (incorporated by reference to Exhibit 4.3 to Amendment No. 1 to the Registration Statement on Form S-1 filed on November 26, 2012)
10.1*	2012 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q filed on July 27, 2012)
10.2*	Form of Restricted Stock Agreement (incorporated by reference to Exhibit 4.5 to the Registration Statement on Form S-8 filed on August 13, 2012)
10.3*	Form of Executive Change-in-Control and Severance Agreement (incorporated by reference to Exhibit 10.3 to the Annual Report on Form 10-K filed on March 10, 2017)
10.4*	Amended and Restated Agreement effective December 22, 2014 between First Business Bank and Corey A. Chambas (incorporated by reference to Exhibit 10.8 of the Registrant's Annual Report on Form 10-K filed on March 16, 2015)
10.5*	First Amendment of Agreement by and between First Business Bank and Corey Chambas (Amended and Restated December 22, 2014)(incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on December 29, 2016)
10.6*	Annual Cash Bonus Plan, effective January 1, 2019 (filed herewith in accordance with Item 10(d) of Regulation S-K)
10.7*	Offer Letter between the Company and David R. Seiler. accepted March 25, 2016 (incorporated by reference to Exhibit 99.1 to the Current Report on Form 8-K filed on April 8, 2016)

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10.8*	Form of Performance-Based Restricted Stock Unit Agreement (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed February 20, 2019)
21	Subsidiaries of the Registrant
23.1	Consent of Crowe LLP
23.2	Consent of KPMG LLP
31.1	Certification of the Chief Executive Officer
31.2	Certification of the Chief Financial Officer
32	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350
101	The following financial information from First Business Financial Services, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets as of December 31, 2018 and December 31, 2017, (ii) Consolidated Statements of Income for the years ended December 31, 2018, 2017 and 2016, (iii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2018, 2017 and 2016, (iv) Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2018, 2017 and 2016, (v) Consolidated Statements of Cash Flows for the years ended December 31, 2018, 2017 and 2016, and (vi) the Notes to Consolidated Financial Statements
*	Management contract or compensatory plan.

Item 16. Form 10-K Summary
None.

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Signatures

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

FIRST BUSINESS FINANCIAL SERVICES, INC.

February 28, 2019 /s/ Corey A. Chambas
Corey A. Chambas
Chief Executive Officer

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

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Signature	Title	Date
/s/ Corey A. Chambas Corey A. Chambas	Chief Executive Officer (principal executive officer)	February 28, 2019
/s/ Edward G. Sloane, Jr. Edward G. Sloane, Jr.	Chief Financial Officer (principal financial officer)	February 28, 2019
/s/ Peggy J. Stebbins Peggy J. Stebbins	Chief Accounting Officer & Controller (principal accounting officer)	February 28, 2019
/s/ Gerald L. Kilcoyne Gerald L. Kilcoyne	Chair of the Board of Directors	February 28, 2019
/s/ Laurie S. Benson Laurie S. Benson	Director	February 28, 2019
/s/ Mark D. Bugher Mark D. Bugher	Director	February 28, 2019
/s/ Carla C. Chavarria Carla C. Chavarria	Director	February 28, 2019
/s/ Jan A. Eddy Jan A. Eddy	Director	February 28, 2019
/s/ John J. Harris John J. Harris	Director	February 28, 2019
/s/ Ralph R. Kauten Ralph R. Kauten	Director	February 28, 2019
/s/ Timothy J. Keane Timothy J. Keane	Director	February 28, 2019
/s/ W. Kent Lorenz W. Kent Lorenz	Director	February 28, 2019
/s/ Daniel P. Olszewski Daniel P. Olszewski	Director	February 28, 2019
/s/ Carol P. Sanders Carol P. Sanders	Director	February 28, 2019