

**SHOREBANK CORPORATION
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001

SHOREBANK CORPORATION AND SUBSIDIARIES
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Crowe Chizek and Company LLC
Member Horwath International

REPORT OF INDEPENDENT AUDITORS

The Shareholders and Board of Directors
Shorebank Corporation
Chicago, Illinois

We have audited the accompanying consolidated balance sheets of Shorebank Corporation and subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Shorebank Corporation and subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As disclosed in Note 2 to the consolidated financial statements, effective January 1, 2002, the Corporation adopted new accounting guidance for goodwill and intangible assets.

Crowe Chizek and Company LLC

Crowe Chizek and Company LLC

Oak Brook, Illinois
April 11, 2003

SHOREBANK CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2002 and 2001
(in thousands)

	<u>2002</u>	<u>2001</u>
ASSETS		
Cash and due from banks	\$ 25,585	\$ 22,782
Federal funds sold	3,020	2,910
Cash and cash equivalents	28,605	25,692
Securities available-for-sale	445,994	496,047
Securities held-to-maturity	25,898	13,705
Federal Home Loan Bank stock	16,451	10,775
Other investments	1,319	1,732
Loans, net	778,330	699,333
Land, buildings and equipment, net	23,326	24,403
Accrued interest receivable	8,626	8,818
Goodwill	8,118	8,118
Core deposit intangible assets	2,513	3,022
Bank-owned life insurance	3,346	3,199
Other assets	10,140	10,027
	<u>\$ 1,352,666</u>	<u>\$ 1,304,871</u>
 LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits		
Non-interest bearing	\$ 89,901	\$ 92,921
Interest bearing	872,083	843,514
	961,984	936,435
Federal funds purchased	29,652	53,300
Notes payable	24,435	20,761
Other borrowed funds	225,950	191,250
Due to broker	-	7,992
Other liabilities	19,244	13,470
	1,261,265	1,223,208
 Shareholders' equity		
Preferred stock	3,620	3,998
Common stock	14	14
Additional paid-in capital	63,442	63,442
Retained earnings	19,093	12,715
Accumulated other comprehensive income	5,232	1,494
	91,401	81,663
	<u>\$ 1,352,666</u>	<u>\$ 1,304,871</u>

See accompanying notes to consolidated financial statements.

SHOREBANK CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2002 and 2001
(in thousands, except for per share amounts)

	<u>2002</u>	<u>2001</u>
Interest income		
Loans, including fees	\$ 57,813	\$ 53,839
Securities		
Taxable	26,994	30,233
Tax-exempt	1,805	2,064
Federal funds sold and other	153	671
	<u>86,765</u>	<u>86,807</u>
Interest expense		
Deposits	26,736	34,538
Borrowed funds	12,724	12,782
	<u>39,460</u>	<u>47,320</u>
Net interest income	47,305	39,487
Provision for loan losses	<u>3,966</u>	<u>4,479</u>
Net interest income after provision for loan losses	<u>43,339</u>	<u>35,008</u>
Noninterest income		
Gain on sale of securities	1,697	965
Real estate projects, net	210	71
Consulting income	7,579	5,918
Deposit service fees	6,444	6,500
Enterprise award earned	106	497
Other noninterest income	2,386	2,847
	<u>18,422</u>	<u>16,798</u>
Noninterest expense		
Salaries, wages and employee benefits	28,791	25,373
Occupancy expense	3,175	2,994
Equipment and data processing	3,655	3,722
Amortization of core deposit intangible assets	510	508
Amortization of goodwill	-	559
Provision for impairment of real estate projects	468	3,647
Uncollectible advances to real estate projects	1,140	670
Professional fees	990	596
Marketing expense	1,219	1,039
Other noninterest expense	12,198	9,289
	<u>52,146</u>	<u>48,397</u>
Income before income taxes	9,615	3,409
Provision for income taxes	<u>2,891</u>	<u>399</u>
Net income	<u>\$ 6,724</u>	<u>\$ 3,010</u>
Basic earnings per common share	\$ 422.98	\$ 181.22
Diluted earnings per share	\$ 416.08	\$ 181.01

See accompanying notes to consolidated financial statements.

SHOREBANK CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
Years ended December 31, 2002 and 2001
(in thousands)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (loss)	Total Shareholders' Equity
Balance at January 1, 2001	\$ 4,394	\$ 14	\$ 63,442	\$ 10,071	\$ (1,725)	\$ 76,196
Comprehensive income:						
Net income	-	-	-	3,010	-	3,010
Net increase in fair value of securities available-for-sale, net of tax	-	-	-	-	3,219	3,219
Total comprehensive income						6,229
Cash dividends declared on common stock	-	-	-	(155)	-	(155)
Cash dividends declared on preferred stock	-	-	-	(211)	-	(211)
Redemption of preferred stock	(396)	-	-	-	-	(396)
Balance at December 31, 2001	3,998	14	63,442	12,715	1,494	81,663
Comprehensive income:						
Net income	-	-	-	6,724	-	6,724
Net increase in fair value of securities available-for-sale, net of tax	-	-	-	-	3,738	3,738
Total comprehensive income						10,462
Cash dividends declared on common stock	-	-	-	(155)	-	(155)
Cash dividends declared on preferred stock	-	-	-	(191)	-	(191)
Redemption of preferred stock	(378)	-	-	-	-	(378)
Balance at December 31, 2002	<u>\$ 3,620</u>	<u>\$ 14</u>	<u>\$ 63,442</u>	<u>\$ 19,093</u>	<u>\$ 5,232</u>	<u>\$ 91,401</u>

See accompanying notes to consolidated financial statements.

SHOREBANK CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2002 and 2001
(in thousands)

	<u>2002</u>	<u>2001</u>
Cash flows from operating activities		
Net income	\$ 6,724	\$ 3,010
Adjustments to reconcile net income to net cash from operating activities		
Provision for loan losses	3,966	4,479
Depreciation and amortization	2,043	2,379
Uncollectible advances to real estate projects	1,140	670
Amortization of intangible assets	510	1,067
Gain on sale of securities	(1,697)	(965)
Discount accretion on securities	(2,558)	(3,945)
Federal Home Loan Bank stock dividends	(572)	(709)
Deferred income taxes	1,418	(609)
Provision for impairment loss on premises and equipment	250	-
Provision for impairment of real estate projects	468	3,647
Gain on settlement of debt	-	(350)
Increase in cash surrender value of bank-owned life insurance	(147)	(171)
Change in assets and liabilities		
Real estate held for development and sale	(396)	(2,159)
Accrued interest receivable	192	281
Accrued interest payable	13	(1,885)
Other assets	(1,710)	(3,902)
Other liabilities	2,910	2,764
Net cash from operating activities	12,554	3,602
Cash flows from investing activities		
Activity in available-for-sale securities:		
Sales and calls	281,822	346,866
Maturities and prepayments	221,322	69,495
Purchases	(451,335)	(461,535)
Activity in held-to-maturity securities:		
Maturities and prepayments	1,910	515
Purchases	(13,568)	(13,238)
Purchases of Federal Home Loan Bank stock, net	(5,104)	(40)
Change in other investments	413	(60)
Loan originations and payments, net	(83,436)	(127,801)
Capital expenditures, net	(1,216)	(2,680)
Net cash from investing activities	(49,192)	(188,478)

(Continued).

SHOREBANK CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2002 and 2001
(in thousands)

	<u>2002</u>	<u>2001</u>
Cash flows from financing activities		
Net change in deposits	\$ 25,549	\$ 120,475
Net change in borrowings under lines of credit	2,519	931
Advances on notes payable	8,178	-
Repayments on notes payable	(7,325)	(1,325)
Proceeds from Federal Home Loan Bank advances	64,850	41,090
Repayments of Federal Home Loan Bank advances	(32,000)	(20,000)
Net change in Federal Funds purchased	(23,648)	42,100
Net change in treasury, tax, and loan note	1,850	(417)
Preferred stock dividends	(191)	(211)
Common stock dividends	(155)	(155)
Redemption of preferred stock	(76)	(94)
Net cash from financing activities	<u>39,551</u>	<u>182,394</u>
 Change in cash and cash equivalents	 2,913	 (2,482)
Beginning cash and cash equivalents	<u>25,692</u>	<u>28,174</u>
Ending cash and cash equivalents	<u><u>\$ 28,605</u></u>	<u><u>\$ 25,692</u></u>
 Supplemental disclosures of cash flow information:		
Interest paid	\$ 39,447	\$ 49,205
Income taxes paid	2,100	1,385
 Supplemental noncash disclosures:		
Series B1 preferred stock exchanged for notes payable	\$ 107	\$ 107
Series D preferred stock exchanged for notes payable	137	137
Series B2 preferred stock exchanged for notes payable	58	58
Real estate acquired through foreclosure	473	1,529
Due to broker for purchases of securities	(7,992)	7,992

See accompanying notes to consolidated financial statements

SHOREBANK CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2002 and 2001

(in thousands, except where indicated)

NOTE 1 - NATURE OF OPERATIONS

Shorebank Corporation (which includes its subsidiaries and is referred to as the Corporation) is a bank holding company organized under the laws of the State of Illinois. The Corporation's principal subsidiary, ShoreBank, is a banking corporation organized under the laws of the State of Illinois. The Corporation and ShoreBank provide a broad range of financial services and offer various types of financial consulting services. Its primary deposit products are checking, savings, and time deposit accounts, and its primary lending products are multi-family and residential mortgage, commercial, and consumer loans. The Corporation is also engaged in related financial services through its other wholly-owned bank and non-bank subsidiaries as follows:

Shorebank Capital Corporation ("SCC") (a specialized small business investment company (SBIC) licensed by the SBA under Section 301(d));

Shorebank Development Corporation, Chicago (rehabilitation, construction and resale of residential properties for the benefit of low and moderate income families);

Shorebank Advisory Services, Inc. ("SAS") (consulting for programs designed to promote community welfare through economic rehabilitation and development of underinvested low income communities, both domestically and internationally);

Shorebank BIDCO, Inc. (a business and industrial development corporation formed to provide development capital for businesses in rural and economically underinvested areas in the upper peninsula of Michigan and urban areas near Detroit, Michigan);

Shorebank Cleveland Corporation (a bank holding company, which wholly owns ShoreBank, Cleveland, a community development bank, and ShorePlace Development Corporation, a real estate development company);

Shorebank Development Corporation, Detroit (a real estate development company); and

Shorebank Pacific Corporation (a bank holding company, which wholly owns ShoreBank, Pacific, an environmentally-focused community development bank).

The Corporation's primary purpose is community and neighborhood development and renewal. The primary beneficiaries have been low and moderate income families residing in neighborhoods in Chicago, Cleveland, Detroit, and rural communities located in the Upper Peninsula of Michigan and along the coast of the Pacific Northwest. The efforts of SAS allow the Corporation to extend its experience and expertise in development finance to other communities across the nation and around the world.

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SHOREBANK CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2002 and 2001

(in thousands, except where indicated)

NOTE 1 - NATURE OF OPERATIONS (Continued)

Certain employees and directors of the Corporation sit on the boards of directors of the Corporation's not-for-profit affiliates, which include: Shorebank Enterprise, Detroit; Shorebank Enterprise, Cleveland ("SEC"); Shorebank Enterprise, Pacific; Shorebank Neighborhood Institute ("SNI"); and Northern Initiatives. These entities seek to promote the social and economic welfare of low-to-moderate residents in the Corporation's target areas of Chicago, Cleveland, Detroit, the Upper Peninsula of Michigan, and the coast of the Pacific Northwest. Additional related parties include: TNI Development Corporation ("TNIDC"), a for-profit subsidiary of SNI that was set up to pursue real estate development; Shore Staffing Works, a subsidiary of SNI that provides temporary and permanent employment services; and ShoreBridge Capital, a for-profit limited liability company partially owned by SEC which provides mezzanine financing to companies in and around Cleveland. The Corporation does not have any ownership interest in these entities. Accordingly, the accounts of these affiliated entities are not consolidated with those of the Corporation.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Use of Estimates: The consolidated financial statements include those of the Corporation and all of its bank and non-bank subsidiaries. Significant intercompany balances and transactions have been eliminated. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. The allowance for loan losses, fair values of financial instruments, net realizable value of real estate under development, the fair value of derivative contracts, and the status of contingencies are particularly subject to change.

Securities: Securities are classified as available-for-sale when management may decide to sell those securities in response to changes in market interest rates, liquidity needs, changes in yields or alternative investments and for other reasons prior to maturity. They are carried at fair value.

Unrealized gains and losses on securities available-for-sale are a component of comprehensive income (loss) and included as a separate component of shareholders' equity, net of income taxes. Realized gains and losses on disposition are based on the net proceeds and the amortized cost of the securities sold, using the specific identification method. Securities are written down to fair value when a decline in fair value is not temporary. Interest income includes amortization and accretion of purchase premiums and discounts.

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2002 and 2001

(in thousands, except where indicated)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Securities are classified as held-to-maturity when management has the positive intent and the Corporation has the ability to hold those securities to maturity. They are stated at cost, adjusted for amortization of premiums and accretion of discounts.

Federal Home Loan Bank stock, a restricted equity security, is carried at cost.

Other investments consist primarily of investments in mezzanine loan funds, which are carried at cost, and an investment in a mutual fund, which is carried at fair value.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of unearned interest and deferred loan fees and costs. Loan fees and direct loan origination costs are deferred and amortized over the term of the loan as a yield adjustment. Loans held for sale are carried at the lower of cost or market, on an aggregate basis.

Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

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

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge offs, net of recoveries. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the loan portfolio, information about specific borrower situations and estimated collateral valuations, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2002 and 2001

(in thousands, except where indicated)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

A loan is impaired when full payment under the loan terms is not expected. Commercial and commercial real estate loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral, including Small Business Administration guarantees. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures.

Real Estate Held for Development and Sale: Rehabilitation and construction costs, and other project related costs, are capitalized as project costs. Project fee revenues are recognized under the percentage-of-completion method for long-term construction contracts. Under this method, revenues are recognized when there is available evidence of the ultimate proceeds and when the cost of completion estimates are reasonably dependable. Losses on projects are recognized at the time that such losses can be reasonably estimated. It is reasonably possible that these estimates of revenue and losses could change in the near term and the effect of the change could be material.

Real estate development projects are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of assets may not be recoverable. The Corporation determines recoverability by comparing current and future levels of income and cash flows, as well as the fair market value of the assets, to the carrying amount.

During 2002 and 2001, the Corporation recorded a provision for impairment of real estate development projects of \$468 and \$3,647 primarily due to changes in market conditions in Chicago.

Land, Buildings, and Equipment: Land is carried at cost. Buildings and equipment are stated at cost, less accumulated depreciation and amortization. Provisions for depreciation and amortization, included in operating expenses, are computed on the straight-line method over the estimated useful lives of the related assets. Leasehold improvements are amortized to occupancy expense over the term of the lease or the estimated useful lives of the improvements, whichever is shorter. The cost of maintenance and repairs is charged to income as incurred; significant repairs are capitalized. At the time of sale or disposition of an asset, the applicable cost and accumulated depreciation are removed from the accounts and any resulting gain or loss included in income.

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001
(in thousands, except where indicated)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Goodwill and Other Intangible Assets: Goodwill results from prior business acquisitions and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Upon adopting new accounting guidance on January 1, 2002, the Corporation ceased amortizing goodwill. Goodwill is assessed at least annually for impairment and any such impairment will be recognized in the period identified. The effect of ceasing goodwill amortization in 2002 was to increase net income by \$559.

Intangible assets consist of core deposits arising from whole bank acquisitions. They are initially measured at fair value and then are amortized on an accelerated method over their estimated useful lives, which is 12 years.

Foreclosed Assets: Assets acquired through or instead of loan foreclosure, included in other assets, are initially recorded at fair value when acquired, establishing a new cost basis. If fair value declines, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Revenue Recognition and Deferred Revenue: Fees for consulting services are recognized on the accrual basis at the time services are rendered after an estimated provision for unbillable amounts. Fees received in advance of services performed are recorded as deferred revenue.

Income Taxes: The provision of income taxes is the total of the current year income tax due and the change in deferred tax assets and liabilities. The Corporation recognizes deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of the Corporation's assets and liabilities and expected benefits of operating loss and credit carryforwards.

Deferred taxes are recognized for the estimated taxes ultimately payable or recoverable based on enacted tax laws. The effects of changes in enacted tax rates or laws are reflected in the financial statements in the periods they occur. A valuation allowance is maintained for deferred tax assets which may not ultimately be realized.

Cash Flows: Cash and cash equivalents includes cash, deposits with other financial institutions with original maturities of 90 days or less, and federal funds sold. Net cash flows are reported for loan and deposit transactions.

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2002 and 2001

(in thousands, except where indicated)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings per Share: Basic earnings per share are based on net income less preferred dividends divided by the weighted average number of common shares outstanding during the period.

Diluted earnings per share show the effect of additional common shares issuable under stock options and convertible securities, when their inclusion is dilutive.

Derivative Contracts: The Corporation utilizes various derivative contracts, currently interest rate caps and interest rate swaps, to reduce the interest rate exposure associated with its financial liabilities. The counterparties to these transactions are major financial institutions with credit ratings of "A" or better.

Derivatives not qualifying for hedge accounting treatment are carried at fair value and reported as part of other assets or other liabilities. Hedge ineffectiveness, if any, is calculated and recorded in current earnings. Changes in the fair value of these contracts are recorded as an addition to or reduction of interest expense.

Bank-Owned Life Insurance: Bank-owned life insurance represents insurance contracts purchased on certain employees. The amount represents ShoreBank's initial investment plus increases in cash surrender values of the policies.

Comprehensive Income: Comprehensive income consists of net income and unrealized gains and losses on securities available-for-sale, net of taxes, which is a separate component of shareholders' equity.

Long-term Assets: Land, buildings, and equipment, real estate projects, core deposit and other intangible assets, and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are written down to fair value through a charge to income.

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

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001
(in thousands, except where indicated)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Restrictions on Cash: Cash on hand or on deposit with the Federal Reserve Bank of \$1,988 and \$1,314 was required to meet regulatory reserve and clearing requirements at year end 2002 and 2001. These balances do not earn interest.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the amount of dividends payable by the subsidiary banks to the Corporation or by the Corporation to the shareholders.

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

Newly-Issued But Not Yet Effective Accounting Standards: New accounting standards on asset retirement obligations, restructuring activities and exit costs, operating leases, and early extinguishment of debt were issued in 2002. Management determined that when the new accounting standards are adopted in 2003, they will not have a material impact on the Corporation's financial condition or results of operations.

Reclassifications: Certain items in the prior year financial statements have been reclassified to conform to the current year presentation.

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2002 and 2001

(in thousands, except where indicated)

NOTE 3 – SECURITIES

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

	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
<u>2002</u>			
Securities issued by United States government agencies	\$ 197,740	\$ 2,951	\$ (53)
Obligations of states and political subdivisions			
Taxable	2,251	174	-
Tax-exempt	56,414	1,404	(137)
Collateralized mortgage obligations and mortgage-backed securities	187,933	4,137	(16)
Time deposits due from banks	1,504	-	-
Corporate bonds	152	-	-
	\$ 445,994	\$ 8,666	\$ (206)
<u>2001</u>			
United States Treasury securities	\$ 20,996	\$ 15	\$ (33)
Securities issued by United States government agencies	183,136	2,027	(982)
Obligations of states and political subdivisions			
Taxable	19,358	95	(12)
Tax exempt	57,513	334	(1,319)
Collateralized mortgage obligations and mortgage-backed securities	198,975	2,338	(353)
Corporate bonds	12,522	374	(52)
FNMA preferred stock	1,500	-	-
Time deposits due from banks	2,047	-	-
	\$ 496,047	\$ 5,183	\$ (2,751)

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001
(in thousands, except where indicated)

NOTE 3 - SECURITIES (Continued)

Securities held-to-maturity consist of principal protected unit investments totaling \$25,725 and \$13,238 at December 31, 2002 and 2001 and asset-backed securities totaling \$173 and \$467 at December 31, 2002 and 2001. Since no public market exists for these investments, management estimates that their fair value is equal to their amortized cost.

Sales of available-for-sale securities were as follows:

	<u>2002</u>	<u>2001</u>
Proceeds from sales and calls	\$ 281,822	\$ 346,866
Gross realized gains	1,807	1,347
Gross realized losses	(110)	(382)

The fair value and carrying amount of debt securities at December 31, 2002, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date, primarily mortgage-backed and asset-backed securities and collateralized mortgage obligations, are shown separately.

	<u>Available-for-sale</u>	<u>Held-to-maturity</u>	
	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 137,276	\$ -	\$ -
Due after one year through five years	56,478	-	-
Due after five years through ten years	43,777	-	-
Due after ten years	20,530	25,725	25,725
	<u>258,061</u>	<u>25,725</u>	<u>25,725</u>
Mortgage-backed securities, asset-backed securities and collateralized mortgage obligations	187,933	173	173
	<u>\$ 445,994</u>	<u>\$ 25,898</u>	<u>\$ 25,898</u>

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002 and 2001
(in thousands, except where indicated)

NOTE 3 - SECURITIES (Continued)

Securities with a carrying value of approximately \$276,755 and \$223,291 at December 31, 2002 and 2001, were pledged to secure public deposits, borrowings, and for other purposes. Securities issued by United States government agencies and local municipalities with a carrying value of \$202,169 at December 31, 2002 contained call features.

At year end 2002 and 2001, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

NOTE 4 - LOANS

Loans were classified as follows:

	<u>2002</u>	<u>2001</u>
Commercial	\$ 254,386	\$ 245,035
Commercial real estate	30,129	22,775
Multi-family real estate	235,788	257,982
Residential real estate	204,726	135,665
Real estate rehabilitation and construction	40,887	17,973
Consumer	22,675	29,300
	<hr/>	<hr/>
	788,591	708,730
Allowance for loan losses	(10,261)	(9,397)
	<hr/>	<hr/>
	<u>\$ 778,330</u>	<u>\$ 699,333</u>

Loans held for sale approximated \$17,500 at December 31, 2002 and are classified with residential real estate loans above. There were no loans held for sale at December 31, 2001.

NOTE 5 – ALLOWANCE FOR LOAN LOSSES

Activity in the allowance for loan losses was as follows:

	<u>2002</u>	<u>2001</u>
Beginning balance	\$ 9,397	\$ 8,769
Provision for loan losses charged to expense	3,966	4,479
Loans charged-off	(4,125)	(4,553)
Recoveries on loans previously charged-off	1,023	702
	<hr/>	<hr/>
Ending balance	<u>\$ 10,261</u>	<u>\$ 9,397</u>

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
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NOTE 5 – ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired loans were as follows:

	<u>2002</u>	<u>2001</u>
Year end loans with no allocated allowance for loan losses	\$ 5,374	\$ 7,770
Year end loans with allocated allowance for loan losses	4,329	940
	<hr/>	<hr/>
Total impaired loans	\$ 9,703	\$ 8,710
	<hr/> <hr/>	<hr/> <hr/>
Allowance for loan losses allocated to impaired loans	\$ 1,296	\$ 187
	<hr/> <hr/>	<hr/> <hr/>
Average of impaired loans	\$ 9,391	\$ 5,618
	<hr/> <hr/>	<hr/> <hr/>

Nonperforming loans were as follows:

Loans past due over 90 days still on accrual	\$ 9,153	\$ 10,675
Nonaccrual loans	12,361	11,812

Nonperforming loans and impaired loans are defined differently. Nonperforming loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. Interest income recognized on impaired loans in 2002 and 2001 was not material.

Included in the amount of impaired loans above are loans that are substantially guaranteed by the United States Small Business Administration (“SBA”). The principal amount of loans partially guaranteed by the SBA totaled \$3,789 and \$2,672 in 2002 and 2001.

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
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NOTE 6 - LAND, BUILDINGS AND EQUIPMENT

Land, buildings and equipment were comprised of the following:

	<u>2002</u>	<u>2001</u>
Land	\$ 2,868	\$ 2,810
Buildings and improvements	20,148	20,094
Furniture and equipment	11,495	10,505
Leasehold improvements	1,510	1,587
Construction in progress	128	353
	<u>36,149</u>	<u>35,349</u>
Less: Accumulated depreciation	(12,823)	(10,946)
	<u>\$ 23,326</u>	<u>\$ 24,403</u>

Rent expense for 2002 was \$624 and for 2001 was \$587. Rent commitments under noncancelable operating leases, subject to adjustments for changes in lessor's building operating expenses, were as follows as of December 31, 2002:

2003	\$ 537
2004	543
2005	506
2006	497
2007	511
2008 and thereafter	5,139
	<u>\$ 7,733</u>

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
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NOTE 7 – GOODWILL AND INTANGIBLE ASSETS

Goodwill is no longer amortized starting in 2002. The effect of not amortizing goodwill is summarized as follows:

	<u>2002</u>	<u>2001</u>
Reported net income	\$ 6,724	\$ 3,010
Add back: goodwill amortization	<u>-</u>	<u>559</u>
Adjusted net income	<u>\$ 6,724</u>	<u>\$ 3,569</u>
Basic earnings per share:		
Reported net income	\$ 422.98	\$ 181.22
Goodwill amortization	<u>-</u>	<u>36.20</u>
Adjusted net income	<u>\$ 422.98</u>	<u>\$ 217.42</u>
Diluted earnings per share:		
Reported net income	\$ 416.08	\$ 181.01
Goodwill amortization	<u>-</u>	<u>36.12</u>
Adjusted net income	<u>\$ 416.08</u>	<u>\$ 217.13</u>

Acquired intangible assets, consisting of core deposits, were as follows as of year-end:

	<u>2002</u>		<u>2001</u>	
	Gross Carrying <u>Amount</u>	Accumulated <u>Amortization</u>	Gross Carrying <u>Amount</u>	Accumulated <u>Amortization</u>
Core deposit intangibles	\$ 6,361	\$ 3,848	\$ 6,361	\$ 3,339

Estimated amortization expense for each of the next five years:

2003	\$ 509
2004	509
2005	509
2006	509
2007	477

Amortization of core deposit intangibles is not deductible for income tax purposes.

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
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NOTE 8 - TIME DEPOSITS

Time deposits in denominations of \$100 and over were \$472,921 and \$450,416 in 2002 and 2001. Included in these amounts are brokered wholesale time deposits totaling \$245,602 and \$199,293.

At December 31, 2002, the scheduled maturities of time deposits were as follows:

2003	\$ 337,852
2004	78,658
2005	84,660
2006	30,345
2007	18,363
2008 and thereafter	56,716
	<hr/>
	\$ 606,594
	<hr/> <hr/>

Included in deposits are \$2,966 of deposits to the company's not-for-profit affiliates, executive officers, and directors at December 31, 2002. Information was unavailable at December 31, 2001.

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
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NOTE 9 - NOTES PAYABLE

Notes payable were as follows:

	<u>2002</u>	<u>2001</u>
Borrowings under lines of credit, with interest payable quarterly at the Prime Rate (4.25% at December 31, 2002) through April 30, 2003.	\$ 3,450	\$ 931
Notes payable with principal payable quarterly. This note balance was repaid in 2002.	-	7,000
Trust preferred security obligation, with interest payable semi-annually at an annual rate of 10.875% through March 23, 2030, the final maturity date. The Corporation has options for early redemption, the first of which is March 1, 2010, with the prior approval of the Federal Reserve Bank of Chicago. For regulatory purposes, this obligation receives Tier 1 capital treatment.	10,000	10,000
Trust preferred security obligation, with interest payable semi-annually. Interest rate is 6-month LIBOR plus 3.70% (5.32% at December 31, 2002). The Corporation has options for early redemption, the first of which is April 22, 2007, with the prior approval of the Federal Reserve Bank of Chicago. For regulatory purposes, this obligation receives Tier 1 capital treatment.	8,000	-
Note payable to the Ford Foundation at 3% with interest due quarterly and principal payments due on June 17, 2004, 2005, and 2006.	1,463	1,463
Note payable to the Michigan Economic Development Corporation. Interest rate is 6.5%. Amounts borrowed under this agreement are due on December 31, 2009.	178	-
Mortgage note with an interest rate of 5%. Monthly principal and interest payments of \$4 are payable through January 2005, when the remaining unamortized principal matures.	437	460
Notes payable issued in exchange for preferred stock; interest rate adjusts quarterly at two-thirds of the ShoreBank prime rate. Principal is due on July 1, 2003, 2004, and 2005, plus quarterly interest.	907	907
	<u>\$ 24,435</u>	<u>\$ 20,761</u>

The borrowings under lines of credit are secured by all the common shares of ShoreBank. Before it was repaid in 2002, the \$7,000 notes payable was also secured by the ShoreBank stock.

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
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NOTE 9 - NOTES PAYABLE (Continued)

The line of credit and notes payable include the following financial covenants at December 31, 2002: (1) the Corporation and ShoreBank shall be adequately capitalized under the regulatory framework for prompt corrective action, (2) the Corporation and ShoreBank shall maintain a minimum Tier 1 capital to Average Total Assets percentage of not less than 4%, (3) the Corporation and ShoreBank shall maintain a total risk-based capital to risk-weighted assets ratio in excess of 8%, (4) the Corporation and ShoreBank shall maintain a Tier one capital to risk-weighted assets ratio in excess of 4%, (5) the Corporation and ShoreBank shall maintain a maximum nonperforming assets (excluding loans guaranteed by the Small Business Administration) to total loans (excluding loans guaranteed by the Small Business Administration) and other real estate owned of not more than 5.0%, (6) the Corporation and ShoreBank shall maintain a maximum nonperforming assets (excluding loans guaranteed by the Small Business Administration) to primary capital of not more than 50%, (7) the Corporation and ShoreBank shall maintain a loan loss reserve to total nonperforming (excluding loans guaranteed by the Small Business Administration) loans of not less than 30%, (8) the Corporation shall maintain tangible equity of not less than \$35,000, (9) ShoreBank shall maintain an aggregate tangible equity capital of not less than \$42,000, and (10) the Corporation shall maintain a ratio of adjusted net income to interest expense and scheduled payments of principal with respect to the note payable of not less than 1.3 to 1. The Corporation and ShoreBank complied with these covenants at December 31, 2002.

Maturities of notes payable at December 31, 2002 were as follows:

2003	\$	3,800
2004		600
2005		1,144
2006		713
2007		-
Thereafter		18,178
	\$	<u>24,435</u>

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
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NOTE 10 - OTHER BORROWED FUNDS

Other borrowed funds were as follows:

	<u>2002</u>	<u>2001</u>
Advances from the Federal Home Loan Banks of Chicago and Seattle (FHLB), due at various dates through August 29, 2011; interest due monthly at rates ranging from 1.53% to 7.36%	\$ 223,940	\$ 191,090
Treasury, tax and loan note	2,010	160
	\$ 225,950	\$ 191,250

The Corporation has pledged first mortgage loans on residential property and various securities as collateral against the outstanding advances from the FHLB.

Maturities of the FHLB advances at December 31, 2002 were as follows:

2003	\$ 17,940
2004	61,000
2005	55,000
2006	25,000
2007	5,000
2008 and thereafter	60,000
	\$ 223,940

FHLB advances at December 31, 2002 and 2001 included \$208,940 and \$181,090 in fixed rate advances.

At December 31, 2002, the Corporation had \$75,000 of FHLB advances that could be called after specified dates at the discretion of the FHLB with \$60,000 callable during 2003 and thereafter, and \$15,000 beginning in 2004.

(Continued)

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NOTE 11 - PREFERRED STOCK

Preferred stock was as follows (*share and per share amounts are not in thousands*):

	<u>2002</u>	<u>2001</u>
Series B1, \$1 par value, nonvoting preferred stock; 7% cumulative and redeemable; authorized 4,600 shares, less the number of B2 shares which are issued and outstanding; 42.78 and 64.17 shares outstanding at December 31, 2002 and 2001	\$ 214	\$ 321
Series B2, \$1 par value, convertible and nonconvertible voting preferred stock; 7% cumulative and redeemable; authorized 4,600 shares, less the number of Series B1 shares which are issued and outstanding; 15.4 and 26.9 shares outstanding at December 31, 2002 and 2001	77	134
Series C, \$1 par value, nonvoting preferred stock; 3.5% cumulative and redeemable; authorized 4,600 shares, less the number of Series B1 and Series B2 shares which are issued and outstanding; the remaining 15.18 shares outstanding at December 31, 2001 were redeemed in 2002	-	76
Series D, \$1 par value, nonvoting preferred stock; 3.5% cumulative and redeemable; authorized 4,600 shares, less the number of Series B1, Series B2 and Series C shares which are issued and outstanding; 55.2 and 82.8 shares outstanding at December 31, 2002 and 2001	276	414
Series E, \$1 par value, convertible nonvoting preferred stock; 5% cumulative and redeemable; 5,000 shares authorized, 3,053.125 shares outstanding	<u>3,053</u>	<u>3,053</u>
	<u>\$ 3,620</u>	<u>\$ 3,998</u>

(Continued)

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NOTE 11 - PREFERRED STOCK (Continued – *share and per share amounts are not in thousands*)

Certain shares of Series B2 preferred stock are convertible into voting common stock at the option of the holder at the rate of five shares of voting common stock for each two shares of preferred stock. The Corporation redeemed 11.5 shares in both 2002 and 2001, of Series B2 preferred stock in exchange for notes payable of the Corporation. At December 31, 2002, there were 10.8 nonconvertible shares and 4.6 convertible shares of Series B2 preferred stock outstanding and at December 31, 2001, there were 17.7 nonconvertible shares and 9.2 convertible shares of Series B2 preferred stock outstanding.

The Corporation is required, subject to approval by the Federal Reserve Bank of Chicago, to annually redeem 10% of the outstanding Series B1, B2 and D preferred stock for promissory notes of the Corporation that will bear interest at a rate equal to two-thirds of the then prevailing prime rate of interest. The Corporation reserves the right to redeem any or all of the Series B1, B2 and D preferred shares, at any time, at the redemption price of \$5,000 per share, plus all accumulated but unpaid dividends.

The Corporation is required, subject to approval by the Federal Reserve Bank of Chicago, to annually redeem varying percentages of outstanding Series C preferred stock at \$5,000 per share through 2002. The Corporation reserves the right to redeem any or all Series C preferred shares at any time. The remaining Series C shares were redeemed in 2002.

The Series E preferred stock is convertible into shares of nonvoting common stock in the ratio of five shares of preferred stock for one share of common stock. The Corporation may redeem any or all shares of Series E at \$1,000 per share, plus all accumulated but unpaid dividends.

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
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NOTE 12 - COMMON STOCK

The Corporation's \$1 par value common stock was as follows *(amounts are not in thousands)*:

	Authorized Shares	Issued and Outstanding Shares	Amount
Voting common stock	65,000	4,238	\$ 4,238
Nonvoting common stock	35,000	9,997	9,997
Jumbo nonvoting common stock	10,000	242	242
			\$ 14,477

Except for voting rights, the holders of nonvoting common stock have rights identical to the holders of voting common stock.

The jumbo shares contain the rights and privileges of 5 regular shares for purposes of dividends and rights on liquidation and are convertible into 5 shares of regular nonvoting common stock.

NOTE 13 - INCOME TAXES

Income taxes were comprised of the following:

	2002	2001
Current		
Federal	\$ 1,473	\$ 1,008
Deferred	1,403	(100)
Increase (decrease) in valuation allowance	15	(509)
	\$ 2,891	\$ 399

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
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NOTE 13 - INCOME TAXES (Continued)

The following is a reconciliation of income taxes computed at the federal statutory rate of 34% with the income taxes reported in the consolidated statements of income:

	<u>2002</u>	<u>2001</u>
Income taxes computed at statutory rates	\$ 3,269	\$ 1,159
Tax exempt income, net	(537)	(610)
State income taxes, net of federal benefit	47	(143)
Expiration of charitable contributions	-	509
Increase (decrease) in deferred tax asset valuation allowance	15	(509)
Intangible amortization	-	28
General business credits, including low income housing	7	(14)
Cash surrender value of bank-owned life insurance	(50)	(58)
Other	140	37
	\$ 2,891	\$ 399

The net deferred tax (liability) asset consisted of the following components:

	<u>2002</u>	<u>2001</u>
Gross deferred tax assets		
Allowance for loan losses	\$ 3,894	\$ 4,959
Charitable contributions	-	124
State operating loss carryforwards	548	506
Stock option plan	334	193
Other	268	53
	5,044	5,835
Deferred tax asset valuation allowance	(206)	(191)
	4,838	5,644

(Continued)

SHOREBANK CORPORATION AND SUBSIDIARIES
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NOTE 13 - INCOME TAXES (Continued)

	<u>2002</u>	<u>2001</u>
Gross deferred tax liabilities		
Depreciation	\$ (1,341)	\$ (1,291)
Income from real estate under development	(775)	(359)
Properties and equipment	(596)	(577)
Core deposit intangibles	(973)	(1,105)
FHLB stock dividends	(754)	(495)
Unrealized gain on securities available-for-sale	(3,234)	(938)
	<u>(7,673)</u>	<u>(4,765)</u>
Net deferred tax (liability) asset	\$ (2,835)	\$ 879

The Corporation had \$319 of charitable contribution carryforwards at December 31, 2001, which were utilized in 2002. The Corporation also had state operating loss carryforwards of \$11,252 at December 31, 2002, which expire in the years 2010 through 2021. The deferred tax asset valuation allowance of \$206 was established because certain of these carryforwards may not be used prior to their statutory expiration date.

(Continued)

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NOTE 14 - EARNINGS PER SHARE

Earnings per share were as follows *(share and per share amounts are not in thousands)*:

<u>Basic</u>	<u>2002</u>	<u>2001</u>
Net income	\$ 6,724	\$ 3,010
Less: Dividends on preferred stock	(191)	(211)
Net income available to common shareholders-basic	<u>\$ 6,533</u>	<u>\$ 2,799</u>
Weighted average voting and nonvoting common shares outstanding	14,235	14,235
Conversion of jumbo common shares to nonvoting common shares	<u>1,210</u>	<u>1,210</u>
Weighted average common shares outstanding-basic	<u>15,445</u>	<u>15,445</u>
Basic earnings per common share	<u>\$ 422.98</u>	<u>\$ 181.22</u>
<u>Diluted</u>		
Net income available to common shareholders-basic	\$ 6,533	\$ 2,799
Add back preferred dividends on series B2 preferred stock	2	3
Add back preferred dividends on series E preferred stock	<u>153</u>	<u>-</u>
Net income available to common shareholders-diluted	<u>\$ 6,688</u>	<u>\$ 2,802</u>
Weighted average common shares outstanding-basic	15,445	15,445
Conversion of Series B2 preferred stock	17	35
Conversion of Series E preferred stock	<u>611</u>	<u>-</u>
Weighted average common shares outstanding-diluted	<u>16,073</u>	<u>15,480</u>
Diluted earnings per common share	<u>\$ 416.08</u>	<u>\$ 181.01</u>

The Corporation's other potentially dilutive securities were not included in the computation of earnings per share for 2001 because the effect of excluding dividends on such securities would exceed the earnings allocable to the common stock to which such securities would be converted.

(Continued)

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NOTE 15 - RETIREMENT PLAN

The Corporation's employees, meeting certain service requirements, participate in a retirement plan. The Corporation's employees are allowed to make contributions to the Plan on a pre-tax basis up to allowable IRS limits. The Corporation matches 67% of each dollar contributed up to a maximum of 6% of the employee's salary. Additionally, the Corporation may contribute an additional amount determined by its Board of Directors based upon the overall earnings of the Corporation. The Corporation contributed \$1,145 and \$757 in 2002 and 2001.

NOTE 16 - INCENTIVE COMPENSATION AND STOCK OPTION PLANS *(amounts are not in thousands)*

The Corporation has a Special Incentive Compensation Plan for officers and other key executives of the Corporation and its subsidiaries and affiliates. The plan is a stock appreciation rights plan, tied to increases in the book value of common stock. No awards have been granted.

Additionally, the Corporation maintains a non-qualified stock option plan (1993 Stock Option Plan) which provides for the granting of options to purchase a maximum of 1,000 shares of common stock to selected officers and other key executives. The option price is set at the time the option is granted and may not be less than the Corporation's book value per share at the end of the prior year. Subject to certain restrictions and limitations, the Corporation is obligated to repurchase all or a portion of any shares purchased pursuant to options granted under this plan at the book value at the end of the year prior to the repurchase. Annual increases or decreases in the book value per share times the number of shares under option and not exercised are charged (credited) to expense as a component of compensation (\$309,000 in 2002 and \$209,000 in 2001). At the end of 2002, there were 407 option shares outstanding at an exercise price of \$3,814 per share, 220 option shares outstanding at an exercise price of \$4,632, and 50 option shares outstanding at an exercise price of \$4,731. These options expire from 2003 through 2026. During 2002, options for 34 shares were exchanged for cash totaling \$16,338 and no options were granted. During 2001, options for 44 shares were exchanged for cash totaling \$40,348 and 50 shares were granted.

The Corporation has implemented a Performance Unit Plan. Compensation components are tied to both financial and development performance. Participants are granted a fixed number of units, with the final value of the units contingent upon meeting stated company performance targets over a specified period. 6,543 units have been granted.

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NOTE 17 - OFF-BALANCE-SHEET RISK AND CONCENTRATIONS OF CREDIT RISK

The Corporation is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit, and unused lines of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of fees. Standby letters of credit and financial guarantees written are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Off-balance-sheet risk to credit loss exists to the face amount of these instruments, although material losses are not anticipated.

In order to control the credit risk associated with entering into commitments and issuing letters of credit, the Corporation subjects such activity to the same credit quality and monitoring controls as its lending activities. The contractual amounts of these credit-related instruments are summarized in the following table:

	<u>2002</u>	<u>2001</u>
Unused lines of credit	\$27,324	\$ 22,797
Commitments to extend credit, primarily at fixed rates	20,261	36,138
Standby letters of credit	6,514	6,214

Commitments to make loans are generally made for periods of 60 days or less. Fixed rate commitments have interest rates ranging from 2.37% to 11.50% and maturities ranging from 5 years to 30 years.

Since many commitments to extend credit expire without being used, the amounts above do not necessarily represent future cash commitments. Collateral may be obtained upon exercise of the commitment. The amount of collateral is determined using management's credit evaluation of the borrower, and may include commercial and residential real estate and other business and consumer assets.

(Continued)

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NOTE 17 - OFF-BALANCE-SHEET RISK AND CONCENTRATIONS OF CREDIT RISK (Continued)

The primary financial instruments where concentrations of credit risk may exist are securities, loans and deposit accounts in other financial institutions. The largest component of the Corporation's credit risk relates to the loan portfolio. Most loans are secured by specific collateral, including commercial and residential real estate and other business assets. Although the Corporation believes that it has a diversified loan portfolio, there is a large segment of loans secured by multi-family dwellings, which represent approximately 29.9% of the total amount of loans outstanding at December 31, 2002.

There are various contingent liabilities that are not reflected in the financial statements, including claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material effect on financial condition or results of operations.

NOTE 18 - DERIVATIVES

Derivatives, such as interest rate swaps and interest rate options, are used to limit the Corporation's exposure to interest rate changes. Interest rate swaps are transactions that generally involve the contractual exchange of fixed and floating rate interest payment obligations on a specified amount of notional principal for a specified period of time. Notional amounts are amounts on which calculations and payments are based, but which do not represent credit exposure; credit exposure is limited to the amount required to be received. These interest rate swaps have been designated as fair value hedges of certain brokered certificates of deposits. Summary information about interest rate swaps at year end follows.

	<u>2002</u>	<u>2001</u>
Notional amounts	\$ 65,000	\$ 55,000
Weighted average fixed rates	4.79%	6.29%
Weighted average variable rates	1.09%	2.25%
Weighted average maturity	6.2 years	8.5 years
Fair value	\$ 2,009	\$ (283)

(Continued)

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NOTE 18 - DERIVATIVES (Continued)

The Corporation also entered into various agreements with a securities broker to cap the rate the Corporation pays as a hedge against rising interest rates. This contract matures in November 2003. In accordance with Statement of Financial Accounting Standards No. 133, this contract is reflected in the balance sheet at its quoted fair value. This adjustment to fair value was not material in 2002.

NOTE 19 - RELATED PARTY TRANSACTIONS

Loans to directors and executive officers at December 31, 2002 and 2001 aggregated approximately \$1,345 and \$1,056.

The Corporation donated \$372 and \$284 in nonrefundable grants to the Corporation's not-for-profit affiliates in 2002 and 2001. The Corporation also had a loan outstanding to TNIDC in the amount of \$218 as of year-end 2002 and 2001.

NOTE 20 - REGULATORY MATTERS

The Corporation and its subsidiary banks are subject to various regulatory capital requirements administered by the federal banking agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Corporation's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Failure to meet capital requirements can initiate regulatory action.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. As of December 31, 2002 and 2001, the most recent regulatory notifications categorized the Bank and Corporation as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's and Corporation's categorization.

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NOTE 20 - REGULATORY MATTERS (Continued)

The actual capital amounts and ratios, consolidated and for ShoreBank, at year-end are as follows:

	<u>Actual</u>		<u>Minimum Required To Be Adequately Capitalized</u>		<u>To Be Well Capitalized Under the Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
Total capital (to risk-weighted assets)						
Consolidated, 2002	\$ 104,432	12.26%	\$ 68,122	8.00%	\$ 85,153	10.00%
Consolidated, 2001	89,427	12.12%	59,038	8.00%	73,798	10.00%
ShoreBank, 2002	86,162	11.27%	61,187	8.00%	76,483	10.00%
ShoreBank, 2001	73,459	10.81%	54,363	8.00%	67,954	10.00%
Tier 1 capital (to risk-weighted assets)						
Consolidated, 2002	94,171	11.06%	34,061	4.00%	51,092	6.00%
Consolidated, 2001	80,200	10.87%	29,519	4.00%	44,279	6.00%
ShoreBank, 2002	77,813	10.17%	30,593	4.00%	45,890	6.00%
ShoreBank, 2001	66,154	9.74%	27,182	4.00%	40,772	6.00%
Tier 1 capital (to average assets)						
Consolidated, 2002	94,171	7.10%	53,026	4.00%	66,283	5.00%
Consolidated, 2001	80,200	6.25%	51,321	4.00%	64,152	5.00%
ShoreBank, 2002	77,813	6.65%	46,819	4.00%	58,524	5.00%
ShoreBank, 2001	66,154	5.74%	46,091	4.00%	57,614	5.00%

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NOTE 21 - FAIR VALUES OF FINANCIAL INSTRUMENTS

The carrying amounts and estimated fair values of the Corporation's significant financial instruments at year-end were as follows:

	-----2002-----		-----2001-----	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	\$ 28,605	\$ 28,605	\$ 25,692	\$ 25,692
Securities	471,892	471,892	509,752	509,752
Loans	778,330	808,842	699,333	716,808
FHLB stock and other investments	17,770	17,770	12,507	12,507
Accrued interest receivable	8,626	8,626	8,818	8,818
Interest rate cap	-	-	359	359
Financial liabilities				
Deposits	(961,984)	(975,182)	(936,435)	(948,218)
Federal funds purchased	(29,652)	(29,652)	(53,300)	(53,300)
Notes payable	(24,435)	(26,075)	(20,761)	(18,096)
Other borrowed funds	(225,950)	(242,728)	(191,250)	(197,221)
Due to broker	-	-	(7,992)	(7,992)
Accrued interest payable	(4,288)	(4,288)	(4,275)	(4,275)
Off-balance-sheet assets (liabilities)				
Interest rate swaps	2,009	2,009	(283)	(283)

The methods and assumptions used to estimate values are described below.

Carrying amount is the estimated fair value for cash and cash equivalents, short-term borrowings, Federal Home Loan Bank stock, other investments, accrued interest receivable and payable, demand deposits, short-term debt, and variable rate loans or deposits that reprice frequently and fully. Security fair values are based on market prices or dealer quotes, and if no such information is available, on the rate and term of the security and information about the issuer. For fixed rate loans (including loans held for sale) or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values. The fair value of long-term borrowings is based on current rates for similar financing. The fair value of off-balance-sheet items is based on the current fees or cost that would be charged to enter into or terminate such arrangements. Interest rate swap and interest rate cap contract values are based on dealer quotes.

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NOTE 22 - OTHER COMPREHENSIVE INCOME

Components of other comprehensive income were as follows:

	<u>2002</u>	<u>2001</u>
Unrealized holding gains on available-for-sale securities	\$ 7,725	\$ 6,184
Adjustments for gains recognized in income	<u>(1,697)</u>	<u>(965)</u>
	6,028	5,219
Tax effect	<u>(2,290)</u>	<u>(2,000)</u>
Other comprehensive income	<u>\$ 3,738</u>	<u>\$ 3,219</u>

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NOTE 23 - PARENT COMPANY FINANCIAL STATEMENTS

The condensed financial statements of Shorebank Corporation, without subsidiaries, were as follows:

BALANCE SHEETS

	<u>2002</u>	<u>2001</u>
ASSETS		
Cash and cash equivalents	\$ 1,233	\$ 862
Accounts receivable and other assets	4,800	3,278
Investment in and advances to subsidiaries		
ShoreBank	91,870	77,295
Shorebank Development Corporation, Chicago	(105)	1,137
Shorebank Capital Corporation	3,205	3,436
Shorebank Advisory Services, Inc.	1,488	1,317
Shorebank BIDCO, Inc.	2,768	2,864
Shorebank Cleveland Corporation	7,786	7,306
Shorebank Pacific Corporation	6,301	5,232
Shorebank Development Corporation, Detroit	405	431
	<u>\$ 119,751</u>	<u>\$ 103,158</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Notes payable	\$ 22,355	\$ 18,838
Other liabilities	5,995	2,657
	28,350	21,495
Shareholders' equity	91,401	81,663
	<u>\$ 119,751</u>	<u>\$ 103,158</u>

(Continued)

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NOTE 23 - PARENT COMPANY FINANCIAL STATEMENTS (Continued)

STATEMENTS OF INCOME

	<u>2002</u>	<u>2001</u>
Income		
Dividends from subsidiaries	\$ 5,233	\$ 4,793
Management fees - subsidiaries and affiliates	817	787
Consulting revenues	542	334
Interest	420	503
	7,012	6,417
Expenses		
Salaries, wages and employee benefits	4,347	3,078
Donations to non-profit affiliates	372	284
Contract consulting fees - subsidiaries and affiliates	182	455
Interest	1,669	1,709
Other	2,813	904
	9,383	6,430
Loss before income taxes and equity in undistributed net income (loss) of subsidiaries	(2,371)	(13)
Income tax benefit	(2,659)	(1,854)
	288	1,841
Income before equity in undistributed net income (loss) of subsidiaries	288	1,841
Equity in undistributed net income (loss) of subsidiaries		
ShoreBank	8,347	5,317
Shorebank Development Corporation, Chicago	(1,633)	(3,112)
Shorebank Capital Corporation	(231)	280
Shorebank Advisory Services, Inc.	36	287
Shorebank BIDCO, Inc.	(95)	(855)
Shorebank Cleveland Corporation	199	21
Shorebank Pacific Corporation	(161)	(501)
Shorebank Development Corporation, Detroit	(26)	(268)
	6,436	1,169
Net income	\$ 6,724	\$ 3,010

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NOTE 23 - PARENT COMPANY FINANCIAL STATEMENTS (Continued)

STATEMENTS OF CASH FLOW

	<u>2002</u>	<u>2001</u>
Cash flows from operating activities		
Net income	\$ 6,724	\$ 3,010
Adjustments to reconcile net income to net cash from operating activities		
Equity in undistributed income of subsidiaries	(6,436)	(1,169)
Depreciation and amortization	86	131
Deferred income taxes	(329)	411
Loss from unconsolidated venture	186	-
Changes in assets and liabilities		
Accounts receivable and other assets	(162)	284
Accrued liabilities	2,138	(198)
Net cash from operating activities	2,207	2,469
Cash flows from investing activities		
Investment in subsidiaries	(3,500)	(47)
Investment in unconsolidated ventures	(662)	(335)
Advances to subsidiaries	(376)	(1,226)
Capital expenditures	(93)	(45)
Net cash from investing activities	(4,631)	(1,653)
Cash flows from financing activities		
Proceeds from notes payable	8,000	-
Payments on notes payable	(7,302)	(1,302)
Net proceeds from line of credit	2,519	931
Dividends paid on preferred stock	(191)	(211)
Dividends paid on common stock	(155)	(155)
Redemption of preferred stock	(76)	(94)
Net cash from financing activities	2,795	(831)
Change in cash and cash equivalents	371	(15)
Beginning cash and cash equivalents	862	877
Ending cash and cash equivalents	\$ 1,233	\$ 862

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NOTE 24 – SUBSEQUENT EVENTS

In January 2003, the Corporation obtained regulatory approval to merge Shorebank BIDCO, Inc., with Shorebank Capital Corporation. The merger was completed April 1, 2003. This transaction will be accounted for as an internal reorganization and will have no impact on the Corporation's consolidated financial statements. The surviving entity will be Shorebank Capital Corporation.