

MACKINAC FINANCIAL CORP /MI/
Form 10-Q
November 13, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2015

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from <> to <>

Commission file number: 0-20167

MACKINAC FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

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MICHIGAN
(State or other jurisdiction of
incorporation or organization)

38-2062816
(I.R.S. Employer Identification No.)

130 SOUTH CEDAR STREET, MANISTIQUE, MI
(Address of principal executive offices)

49854
(Zip Code)

Registrant's telephone number, including area code: **(888) 343-8147**

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

Yes No

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

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

As of November 10, 2015, there were outstanding 6,217,620 shares of the registrant's common stock, no par value.

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PART I. FINANCIAL INFORMATIONITEM 1. FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)

	September 30, 2015 (Unaudited)	December 31, 2014	September 30, 2014 (Unaudited)
ASSETS			
Cash and due from banks	\$ 28,581	\$ 21,947	\$ 22,399
Federal funds sold	10,000		2
Cash and cash equivalents	38,581	21,947	22,401
Interest-bearing deposits in other financial institutions	5,089	5,797	235
Securities available for sale	54,432	65,832	48,742
Federal Home Loan Bank stock	2,169	2,973	3,060
Loans:			
Commercial	446,327	433,566	383,759
Mortgage	156,764	148,984	119,039
Consumer	16,815	18,385	15,575
Total Loans	619,906	600,935	518,373
Allowance for loan losses	(5,779)	(5,140)	(5,279)
Net loans	614,127	595,795	513,094
Premises and equipment	12,670	12,658	9,821
Other real estate held for sale	2,296	3,010	1,843
Deferred tax asset	9,326	11,498	8,681
Deposit based intangibles	1,106	1,196	
Goodwill	3,805	3,805	
Other assets	11,371	19,274	6,066
TOTAL ASSETS	\$ 754,972	\$ 743,785	\$ 613,943
LIABILITIES AND SHAREHOLDERS' EQUITY			
LIABILITIES:			
Deposits:			
Noninterest bearing deposits	\$ 114,769	\$ 95,498	\$ 84,073
NOW, money market, interest checking	213,737	212,565	173,793
Savings	31,742	28,015	15,263
CDs<\$100,000	129,715	134,951	130,821
CDs>\$100,000	27,272	30,316	24,891

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Brokered	105,099	105,628	62,365
Total deposits	622,334	606,973	491,206
Federal funds purchased			7,500
Borrowings	49,593	49,846	44,909
Other liabilities	6,954	12,970	3,196
Total liabilities	678,881	669,789	546,811
SHAREHOLDERS EQUITY:			
Preferred stock - No par value:			
Authorized - 500,000 shares , None issued and outstanding			
Common stock and additional paid in capital - No par value Authorized			
- 18,000,000 shares Issued and outstanding - 6,249,595 ; 6,266,756 and			
5,564,815 respectively			
Retained earnings	14,229	11,804	12,923
Accumulated other comprehensive income			
Unrealized gains (losses) on available for sale securities	591	562	409
Minimum pension liability	(49)	(49)	
Total shareholders equity	76,091	73,996	67,132
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 754,972	\$ 743,785	\$ 613,943

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MACKINAC FINANCIAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in Thousands, Except per Share Data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015 (Unaudited)	2014 (Unaudited)	2015 (Unaudited)	2014 (Unaudited)
INTEREST INCOME:				
Interest and fees on loans:				
Taxable	\$ 8,019	\$ 6,651	\$ 23,986	\$ 19,305
Tax-exempt	3	4	9	27
Interest on securities:				
Taxable	282	230	845	711
Tax-exempt	35	14	129	41
Other interest income	46	34	148	114
Total interest income	8,385	6,933	25,117	20,198
INTEREST EXPENSE:				
Deposits	843	813	2,467	2,435
Borrowings	307	234	895	625
Total interest expense	1,150	1,047	3,362	3,060
Net interest income	7,235	5,886	21,755	17,138
Provision for loan losses	350	187	855	561
Net interest income after provision for loan losses	6,885	5,699	20,900	16,577
OTHER INCOME:				
Deposit service fees	196	168	624	517
Income from loans sold on the secondary market	301	212	750	455
SBA/USDA loan sale gains	40		440	548
Mortgage servicing income	9	313	239	415
Net security gains	133		402	
Other	94	75	292	174
Total other income	773	768	2,747	2,109
OTHER EXPENSE:				
Salaries and employee benefits	3,139	2,481	9,102	7,545
Occupancy	602	511	1,804	1,595
Furniture and equipment	370	305	1,159	927
Data processing	327	288	1,041	862
Advertising	153	114	399	344
Professional service fees	348	276	928	883
Loan and deposit	136	144	399	306
Writedowns and losses on other real estate held for sale	104	176	141	190
FDIC insurance assessment	135	92	383	267
Telephone	108	84	346	248
Other	692	655	1,868	1,964
Total other expenses	6,114	5,126	17,570	15,131

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Income before provision for income taxes	1,544		1,341		6,077		3,555
Provision for income taxes	526		455		2,074		1,203
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS							
	\$ 1,018	\$	886	\$	4,003	\$	2,352
INCOME PER COMMON SHARE:							
Basic	\$.16	\$.16	\$.64	\$.43
Diluted	\$.16	\$.16	\$.64	\$.42

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MACKINAC FINANCIAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS COMPREHENSIVE INCOME

(Dollars in Thousands)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	\$ 1,018	\$ 886	\$ 4,003	\$ 2,352
Other comprehensive income				
Change in securities available for sale:				
Unrealized gains (losses) arising during the period	297	(53)	370	292
Reclassification adjustment for gains included in net income	(133)		(402)	
Tax effect	(56)	13	61	(99)
Other comprehensive income (loss)	108	(40)	29	193
Total comprehensive income	\$ 1,126	\$ 846	\$ 4,032	\$ 2,545

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MACKINAC FINANCIAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Dollars in Thousands)

(Unaudited)

			Three Months Ended September 30, 2015			
	Shares of Common Stock	Common Stock and Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total	
Balance, beginning of period	6,239,250	\$ 61,461	\$ 13,851	\$ 434	\$ 75,746	
Net income for period			1,018		1,018	
Other comprehensive income						
Net unrealized gain on securities available for sale				108	108	
Actuarial loss on defined benefit pension obligation						
Total comprehensive income			1,018	108	1,126	
Stock compensation		144			144	
Issuance of common stock:						
Restricted stock award vesting	37,125					
Repurchase of common stock	(26,780)	(285)			(285)	
Dividend on common stock			(640)		(640)	
Balance, end of period	6,249,595	\$ 61,320	\$ 14,229	\$ 542	\$ 76,091	

			Three Months Ended September 30, 2014			
	Shares of Common Stock	Common Stock and Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total	
Balance, beginning of period	5,527,690	\$ 53,703	\$ 12,325	\$ 449	\$ 66,477	
Net income for period			886		886	
Other comprehensive income						
Net unrealized loss on securities available for sale				(40)	(40)	
Actuarial loss on defined benefit pension obligation						
Total comprehensive income			886	(40)	846	
Stock compensation		96			96	

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Issuance of common stock:								
Restricted stock award vesting	37,125							
Repurchase of common stock								
Dividend on common stock				(287)				(287)
Balance, end of period	5,564,815	\$	53,799	\$	12,924	\$	409	\$ 67,132

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MACKINAC FINANCIAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Dollars in Thousands)

(Unaudited)

			Nine Months Ended September 30, 2015			
	Shares of Common Stock	Common Stock and Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total	
Balance, beginning of period	6,266,756	\$ 61,679	\$ 11,804	\$ 513	\$ 73,996	
Net income for period			4,003		4,003	
Other comprehensive income						
Net unrealized gain on securities available for sale				29	29	
Actuarial loss on defined benefit pension obligation						
Total comprehensive income			4,003	29	4,032	
Stock compensation		432			432	
Issuance of common stock:						
Restricted stock award vesting	53,319					
Repurchase of common stock	(70,480)	(791)			(791)	
Dividend on common stock			(1,578)		(1,578)	
Balance, end of period	6,249,595	\$ 61,320	\$ 14,229	\$ 542	\$ 76,091	

			Nine Months Ended September 30, 2014			
	Shares of Common Stock	Common Stock and Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total	
Balance, beginning of period	5,541,390	\$ 53,621	\$ 11,412	\$ 216	\$ 65,249	
Net income for period			2,352		2,352	
Other comprehensive income						
Net unrealized gain on securities available for sale				193	193	
Actuarial loss on defined benefit pension obligation						
Total comprehensive income			2,352	193	2,545	
Stock compensation		321			321	

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Issuance of common stock:								
Restricted stock award vesting	37,125							
Repurchase of common stock	(13,700)		(143)					(143)
Dividend on common stock					(840)			(840)
Balance, end of period	5,564,815	\$	53,799	\$	12,924	\$	409	\$ 67,132

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MACKINAC FINANCIAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2015	2014
<u>Cash Flows from Operating Activities:</u>		
Net income	\$ 4,003	\$ 2,352
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,265	1,115
Provision for loan losses	855	561
Deferred income taxes, net	2,074	1,203
(Gain) on sales/calls of securities	(402)	
(Gain) on sale of loans sold in the secondary market	(604)	(358)
Origination of loans held for sale in the secondary market	(36,827)	(21,395)
Proceeds from sale of loans in the secondary market	37,431	21,753
Loss on sale of premises, equipment, and other real estate held for sale	6	77
Writedown of other real estate held for sale	135	142
Stock compensation	432	321
Change in other assets	7,993	(141)
Change in other liabilities	(6,016)	(204)
Net cash provided by operating activities	10,345	5,426
<u>Cash Flows from Investing Activities:</u>		
Net (increase) in loans	(19,185)	(35,022)
Net decrease (increase) in interest bearing deposits in other financial institutions	708	(225)
Purchase of securities available for sale	(16,390)	(8,257)
Proceeds from maturities, sales, calls or paydowns of securities available for sale	27,546	4,059
Proceeds from FHLBI repurchases of excess stock	804	
Capital expenditures	(1,123)	(1,156)
Proceeds from sale of premises, equipment, and other real estate	1,190	876
Net cash (used in) investing activities	(6,450)	(39,725)
<u>Cash Flows from Financing Activities:</u>		
Net increase in deposits	15,361	24,907
Increase in federal funds purchased		7,500
Net activity on lines of credit	121	7,330
Net (decrease) in borrowings	(374)	(273)
Repurchase of common stock	(791)	(143)
Dividend on common stock	(1,578)	(840)
Net cash provided by financing activities	12,739	38,481
Net increase in cash and cash equivalents	16,634	4,182
Cash and cash equivalents at beginning of period	21,947	18,219
Cash and cash equivalents at end of period	\$ 38,581	\$ 22,401

Supplemental Cash Flow Information:

Cash paid during the year for:

Interest	\$	3,345	\$	3,058
Income taxes		150		75

Noncash Investing and Financing Activities:

Transfers of Foreclosures from Loans to Other Real Estate Held for Sale		674		488
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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Basis of Presentation

The unaudited condensed consolidated financial statements of Mackinac Financial Corporation (the Corporation) have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine-month period ended September 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. The unaudited consolidated financial statements and footnotes thereto should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2014.

In order to properly reflect some categories of other income and other expenses, reclassifications of expense and income items have been made to prior period numbers. The net other income and other expenses was not changed due to these reclassifications.

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 revenue and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of investment securities, the valuation of foreclosed real estate, deferred tax assets, and mortgage servicing rights.

Acquired Loans

Loans acquired with evidence of credit deterioration since inception and for which it is probable that all contractual payments will not be received are accounted for under ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30). These loans are recorded at fair value at the time of acquisition, with no carryover of the related allowance for loan losses. Fair value of acquired loans is determined using a discounted cash flow methodology based on assumptions about the amount and timing of principal and interest payments, principal prepayments and principal defaults and losses, and current market rates. In recording the fair values of acquired impaired loans at acquisition date, management calculates a non-accretable difference (the credit component of the purchased loans) and an accretable difference (the yield component of the purchased loans).

Over the life of the acquired loans, management continues to estimate cash flows expected to be collected on pools of loans sharing common risk characteristics, which are treated in the aggregate when applying various valuation techniques. Management evaluates at each balance sheet date whether the present value of our pools of loans determined using the effective interest rates has decreased significantly and if so, recognizes a provision for loan loss in our consolidated statement of income. For any significant increases in cash flows expected to be collected, we adjust the amount of the accretable yield recognized on a prospective basis over the pool's remaining life.

Performing acquired loans are accounted for under Financial Accounting Standards Board (FASB) Topic 310-20, *Receivables - Nonrefundable Fees and Other Costs*. Performance of certain loans may be monitored and based on management's assessment of the cash flows and other facts available, portions of the accretable difference may be delayed or suspended if management deems appropriate. The Corporation's policy for determining when to discontinue accruing interest on performing acquired loans and the subsequent accounting for such loans is essentially the same as the policy for originated loans.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses

The allowance for loan losses includes specific allowances related to commercial loans, when they have been judged to be impaired. A loan is impaired when, based on current information, it is probable that the Corporation will not collect all amounts due in accordance with the contractual terms of the loan agreement. These specific allowances are based on discounted cash flows of expected future payments using the loan's initial effective interest rate or the fair value of the collateral if the loan is collateral dependent.

The Corporation continues to maintain a general allowance for loan losses for loans not considered impaired. The allowance for loan losses is maintained at a level which management believes is adequate to provide for possible loan losses. Management periodically evaluates the adequacy of the allowance using the Corporation's past loan loss experience, known and inherent risks in the portfolio, composition of the portfolio, current economic conditions, and other factors. The allowance does not include the effects of expected losses related to future events or future changes in economic conditions. This evaluation is inherently subjective since it requires material estimates that may be susceptible to significant change. Loans are charged against the allowance for loan losses when management believes the collectability of the principal is unlikely. In addition, various regulatory agencies periodically review the Corporation's allowance for loan losses. These agencies may require additions to the allowance for loan losses based on their judgments of collectability.

In management's opinion, the allowance for loan losses is adequate to cover probable losses relating to specifically identified loans, as well as probable losses inherent in the balance of the loan portfolio as of the balance sheet date.

Stock Compensation Plans

On May 22, 2012, the Company's shareholders approved the Mackinac Financial Corporation 2012 Incentive Compensation Plan, under which current and prospective employees, non-employee directors and consultants may be awarded incentive stock options, non-statutory stock options, shares of restricted stock units (RSUs), or stock appreciation rights. The aggregate number of shares of the Company's common stock issuable under the plan is 575,000, which included 392,152 option shares outstanding at that time. Awards are made at the discretion of management. Compensation cost equal to the fair value of the award is recognized over the vesting period.

The Corporation, in August 2012, March 2014 and March 2015, granted RSUs to members of the Board of Directors and Management. In August 2012, 148,500 RSUs were granted at a market value of \$7.91 and will vest equally over a four year term. In exchange for the grant of these RSUs various previously issued stock option awards were surrendered. In March 2014, 52,774 RSUs were granted at a market value of \$12.95, also vesting equally over a four year term. In March 2015, 37,730 RSUs were granted at a market value of \$11.15, also vesting over a four year term. The RSUs were awarded at no cost to the employee. Compensation cost to be recognized over the four year vesting periods, is \$1.175 million, \$.683 million and \$.421 million, respectively. On August 31, 2013, 2014 and 2015, the Corporation issued 37,125 shares of its common stock for vested RSUs, in each year. In March 2015, the Corporation issued 13,194 shares of its common stock for vested RSUs. In May 2015, the Corporation granted 3,000 shares under the Incentive Compensation Plan, which were immediately vested and issued.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued guidance on the recognition of revenue from contracts with customers. Revenue recognition will depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also requires disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The guidance permits two methods of adoption: retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application. The guidance is effective January 1, 2018 and early adoption is permitted only as of January 1, 2017. The company is currently evaluating the impact of the new guidance and the method of adoption in the consolidated financial results.

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. EARNINGS PER SHARE

Diluted earnings per share, which reflects the potential dilution that could occur if outstanding stock options were exercised and stock awards were fully vested and resulted in the issuance of common stock that then shared in our earnings, is computed by dividing net income by the weighted average number of common shares outstanding and common stock equivalents, after giving effect for dilutive shares issued.

The following shows the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2015 and 2014 (dollars in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
(Numerator):				
Net income	\$ 1,018	\$ 886	\$ 4,003	\$ 2,352
(Denominator):				
Weighted average shares outstanding - basic	6,238,963	5,540,200	6,247,416	5,532,966
Effect of dilutive stock options and vesting of restricted stock units	39,046	71,722	31,400	70,268
Weighted average shares outstanding - diluted	6,278,009	5,611,922	6,278,816	5,603,234
Income per common share				
Basic	\$.16	\$.16	\$.64	\$.43
Diluted	\$.16	\$.16	\$.64	\$.42

4. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities available for sale as of September 30, 2015, December 31, 2014 and September 30, 2014 are as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
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September 30, 2015

US Agencies - MBS	\$	3,543	\$	22	\$	(8)	\$	3,557
US Agencies		25,321		277				25,598
Corporate Bonds		14,742		75		(2)		14,815
Obligations of states and political subdivisions		9,929		536		(3)		10,462
Total securities available for sale	\$	53,535	\$	910	\$	(13)	\$	54,432

December 31, 2014

US Treasury	\$	5,287	\$	3	\$	(10)	\$	5,280
US Agencies		22,667		144		(94)		22,717
Corporate Bonds		12,558		116				12,674
US Agencies - MBS		13,461		262		(35)		13,688
Obligations of states and political subdivisions		10,930		685		(142)		11,473
Total securities available for sale	\$	64,903	\$	1,210	\$	(281)	\$	65,832

September 30, 2014

US Agencies - MBS	\$	6,142	\$	241	\$		\$	6,383
US Agencies		22,725		41		(273)		22,493
Corporate Bonds		12,621		172				12,793
Obligations of states and political subdivisions		6,383		439				6,822
Other		251						251
Total securities available for sale	\$	48,122	\$	893	\$	(273)	\$	48,742

The Corporation has evaluated gross unrealized losses that exist within the portfolio and considers them temporary in nature. The Corporation has both the ability and the intent to hold the investment securities until their respective maturities and therefore does not anticipate the realization of the temporary losses.

The amortized cost and estimated fair value of investment securities pledged to secure FHLB borrowings and customer relationships were \$5.394 million and \$5.460 million, respectively, at September 30, 2015.

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. LOANS

The composition of loans is as follows (dollars in thousands):

	September 30, 2015	December 31, 2014	September 30, 2014
Commercial real estate	\$ 310,025	\$ 315,387	\$ 272,803
Commercial, financial, and agricultural	120,804	101,895	98,714
One to four family residential real estate	144,807	139,553	110,310
Construction :			
Consumer	11,957	9,431	8,729
Commerical	15,498	16,284	12,242
Consumer	16,815	18,385	15,575
Total loans	\$ 619,906	\$ 600,935	\$ 518,373

The Corporation completed the acquisition of Peninsula Financial Corporation (PFC) on December 5, 2014. The acquired loans were divided into loans with evidence of credit quality deterioration, which are accounted for under ASC 310-30 (acquired impaired) and loans that do not meet that criteria, which are accounted for under ASC 310-20 (acquired nonimpaired). The acquired impaired loans totaled \$10.312 million. The Corporation recorded all acquired loans at fair value taking into account a number of factors, including remaining life, estimated loss, estimated value of the underlying collateral and net present values of cash flows. In the first nine months of 2015, the Corporation had positive resolution of one acquired nonperforming loan which resulted in the recognition of approximately \$.429 million of the accretable interest.

The table below details the acquired portfolio at September 30, 2015 (dollars in thousands):

	Acquired Impaired	Acquired Non-impaired	Acquired Total
Loans acquired - contractual payments	\$ 10,391	\$ 47,660	\$ 58,051
Nonaccretable difference	(1,370)		(1,370)
Expected cash flows	9,021	47,660	56,681
Accretable yield	(503)	(1,517)	(2,020)
Carrying balance at September 30, 2015	\$ 8,518	\$ 46,143	\$ 54,661

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The table below presents a rollforward of the accretable yield on acquired loans for the nine months ended September 30, 2015 (dollars in thousands):

	Acquired Impaired	Acquired Non-impaired	Acquired Total
Balance, December 31, 2014	\$ 744	\$ 2,042	\$ 2,786
Accretion	(429)	(525)	(954)
Reclassification from nonaccretable difference	188		188
Balance at September 30, 2015	\$ 503	\$ 1,517	\$ 2,020

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. LOANS (Continued)

An analysis of the allowance for loan losses for nine months ended September 30, 2015, the year ended December 31, 2014 and the nine months ended September 30, 2014 is as follows (dollars in thousands):

	September 30, 2015	December 31, 2014	September 30, 2014
Balance at beginning of period	\$ 5,140	\$ 4,661	\$ 4,661
Loans charged off	(365)	(1,046)	(185)
Recoveries on loans previously charged off	149	325	242
Provision	855	1,200	561
Balance at end of period	\$ 5,779	\$ 5,140	\$ 5,279

In the first nine months of 2015, net charge-offs were \$.216 million, or .05% of average loans, compared to net recoveries of \$.057 million, in the same period in 2014. In the first nine months of 2015, the Corporation recorded a provision for loan loss of \$.855 million compared to \$.561 million in the first nine months of 2014. The Corporation's allowance for loan loss reserve policy calls for a measurement of the adequacy of the reserve at each quarter end. This process includes an analysis of the loan portfolio to take into account increases in loans outstanding and portfolio composition, historical loss rates, and specific reserve requirements of nonperforming loans.

A breakdown of the allowance for loan losses and recorded balances in loans at September 30, 2015 is as follows (dollars in thousands):

	Commercial real estate	Commercial, financial and agricultural	Commercial construction	One to four family residential real estate	Consumer construction	Consumer	Unallocated	Total
<i>Three Months Ended</i>								
<i>September 30, 2015</i>								
<i>Allowance for loan loss</i>								
<i>reserve:</i>								
Beginning balance ALLR	\$ 2,550	\$ 2,571	\$ 128	\$ 282	\$ 5	\$ 27	\$ 37	\$ 5,600
Charge-offs	(52)	(57)		(62)		(36)		(207)
Recoveries	28	3				5		36
Provision	(221)	355	(17)	74	2	46	111	350
Ending balance ALLR	\$ 2,305	\$ 2,872	\$ 111	\$ 294	\$ 7	\$ 42	\$ 148	\$ 5,779

Nine Months Ended
September 30, 2015

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Allowance for loan loss

reserve:

Beginning balance ALLR	\$	2,813	\$	1,539	\$	142	\$	285	\$	6	\$	13	\$	342	\$	5,140
Charge-offs		(52)		(157)				(92)				(64)				(365)
Recoveries		120		3				1		1		24				149
Provision		(576)		1,487		(31)		100				69		(194)		855
Ending balance ALLR	\$	2,305	\$	2,872	\$	111	\$	294	\$	7	\$	42	\$	148	\$	5,779

At September 30, 2015

Loans:

Ending balance	\$	310,025	\$	120,804	\$	15,498	\$	144,807	\$	11,957	\$	16,815	\$		\$	619,906
Ending balance ALLR		(2,305)		(2,872)		(111)		(294)		(7)		(42)		(148)		(5,779)
Net loans	\$	307,720	\$	117,932	\$	15,387	\$	144,513	\$	11,950	\$	16,773	\$	(148)	\$	614,127

Ending balance ALLR:

Individually evaluated	\$	518	\$	1,927	\$		\$	56	\$		\$	23	\$		\$	2,524
Collectively evaluated		1,787		945		111		238		7		19		148		3,255
Acquired with deteriorated credit quality																
Total	\$	2,305	\$	2,872	\$	111	\$	294	\$	7	\$	42	\$	148	\$	5,779

Ending balance Loans:

Individually evaluated	\$	1,924	\$	4,728	\$		\$	394	\$		\$	46	\$		\$	7,092
Collectively evaluated		303,390		115,897		15,496		140,789		11,957		16,767				604,296
Acquired with deteriorated credit quality		4,711		179		2		3,624				2				8,518
Total	\$	310,025	\$	120,804	\$	15,498	\$	144,807	\$	11,957	\$	16,815	\$		\$	619,906

Impaired loans, by definition, are individually evaluated.

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. LOANS (Continued)

A breakdown of the allowance for loan losses and recorded balances in loans as of and for the twelve months ended December 31, 2014 is as follows (dollars in thousands):

	Commercial real estate	Commercial, financial and agricultural	Commercial construction	One to four family residential real estate	Consumer construction	Consumer	Unallocated	Total
<i>Allowance for loan loss reserve:</i>								
Beginning balance ALLR	\$ 1,849	\$ 1,378	\$ 80	\$ 516	\$ 25	\$ 148	\$ 665	\$ 4,661
Charge-offs	(19)	(663)		(290)		(74)		(1,046)
Recoveries	131	78	50	22		44		325
Provision	852	746	12	37	(19)	(105)	(323)	1,200
Ending balance ALLR	\$ 2,813	\$ 1,539	\$ 142	\$ 285	\$ 6	\$ 13	\$ 342	\$ 5,140
<i>Loans:</i>								
Ending balance	\$ 315,387	\$ 101,895	\$ 16,284	\$ 139,553	\$ 9,431	\$ 18,385	\$	\$ 600,935
Ending balance ALLR	(2,813)	(1,539)	(142)	(285)	(6)	(13)	(342)	(5,140)
Net loans	\$ 312,574	\$ 100,356	\$ 16,142	\$ 139,268	\$ 9,425	\$ 18,372	\$ (342)	\$ 595,795
<i>Ending balance ALLR:</i>								
Individually evaluated	\$ 704	\$ 492	\$	\$ 19	\$	\$ 1	\$	\$ 1,216
Collectively evaluated	2,109	1,047	142	266	6	12	342	3,924
Acquired with deteriorated credit quality								
Total	\$ 2,813	\$ 1,539	\$ 142	\$ 285	\$ 6	\$ 13	\$ 342	\$ 5,140
<i>Ending balance Loans:</i>								
Individually evaluated	\$ 1,374	\$ 863	\$	\$ 768	\$	\$ 72	\$	\$ 3,077
Collectively evaluated	308,661	100,330	16,126	134,908	9,216	18,305		587,546
Acquired with deteriorated credit quality	5,352	702	158	3,877	215	8		10,312
Total	\$ 315,387	\$ 101,895	\$ 16,284	\$ 139,553	\$ 9,431	\$ 18,385	\$	\$ 600,935

Impaired loans, by definition, are individually evaluated.

A breakdown of the allowance for loan losses and recorded balances in loans at September 30, 2014 is as follows (dollars in thousands):

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	Commercial real estate	Commercial, financial and agricultural	Commercial construction	One to four family residential real estate	Consumer construction	Consumer	Unallocated	Total
<i>Three Months Ended</i>								
<i>September 30, 2014</i>								
<i>Allowance for loan loss</i>								
<i>reserve:</i>								
Beginning balance ALLR	\$ 1,630	\$ 1,669	\$ 40	\$ 345	\$ 15	\$ 111	\$ 1,287	\$ 5,097
Charge-offs	(18)	(9)		(28)		(15)		(70)
Recoveries	31	16	3	4		11		65
Provision	(1)	(153)	1	80	3	1	256	187
Ending balance ALLR	\$ 1,642	\$ 1,523	\$ 44	\$ 401	\$ 18	\$ 108	\$ 1,543	\$ 5,279

<i>Nine Months Ended</i>								
<i>September 30, 2014</i>								
<i>Allowance for loan loss</i>								
<i>reserve:</i>								
Beginning balance ALLR	\$ 1,849	\$ 1,378	\$ 80	\$ 516	\$ 25	\$ 148	\$ 665	\$ 4,661
Charge-offs	(19)	(74)		(44)		(48)		(185)
Recoveries	105	75	9	18		35		242
Provision	(293)	144	(45)	(89)	(7)	(27)	878	561
Ending balance ALLR	\$ 1,642	\$ 1,523	\$ 44	\$ 401	\$ 18	\$ 108	\$ 1,543	\$ 5,279

<i>At September 30, 2014</i>								
<i>Loans:</i>								
Ending balance	\$ 272,803	\$ 98,714	\$ 12,242	\$ 110,310	\$ 8,729	\$ 15,575	\$	\$ 518,373
Ending balance ALLR	(1,642)	(1,523)	(44)	(401)	(18)	(108)	(1,543)	(5,279)
Net loans	\$ 271,161	\$ 97,191	\$ 12,198	\$ 109,909	\$ 8,711	\$ 15,467	\$ (1,543)	\$ 513,094

<i>Ending balance ALLR:</i>								
Individually evaluated	\$ 312	\$ 1,104	\$	\$ 167	\$	\$ 32	\$	\$ 1,615
Collectively evaluated	1,330	419	44	234	18	76	1,543	3,664
Total	\$ 1,642	\$ 1,523	\$ 44	\$ 401	\$ 18	\$ 108	\$ 1,543	\$ 5,279

<i>Ending balance Loans:</i>								
Individually evaluated	\$ 378	\$ 1,730	\$	\$ 1,202	\$	\$ 61	\$	\$ 3,371
Collectively evaluated	272,425	96,984	12,242	109,108	8,729	15,514		515,002
Total	\$ 272,803	\$ 98,714	\$ 12,242	\$ 110,310	\$ 8,729	\$ 15,575	\$	\$ 518,373

Impaired loans, by definition, are individually evaluated.

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. **LOANS** (Continued)

As part of the management of the loan portfolio, risk ratings are assigned to all commercial loans. Through the loan review process, ratings are modified as believed to be appropriate to reflect changes in the credit. Our ability to manage credit risk depends in large part on our ability to properly identify and manage problem loans.

To do so, we operate a credit risk rating system under which our credit management personnel assign a credit risk rating to each loan at the time of origination and review loans on a regular basis to determine each loan's credit risk rating on a scale of 1 through 8, with higher scores indicating higher risk. The credit risk rating structure used is shown below.

In the context of the credit risk rating structure, the term Classified is defined as a problem loan which may or may not be in a nonaccrual status, dependent upon current payment status and collectability.

Strong (1)

Borrower is not vulnerable to sudden economic or technological changes. They have strong balance sheets and are within an industry that is very typical for our markets or type of lending culture. Borrowers also have strong financial and cash flow performance and excellent collateral (low loan to value or readily available to liquidate collateral) in conjunction with an impeccable repayment history.

Good (2)

Borrower shows limited vulnerability to sudden economic change. These borrowers have above average financial and cash flow performance and a very good repayment history. The balance sheet of the company is also very good as compared to peer and the company is in an industry that is familiar to our markets or our type of lending. The collateral securing the deal is also very good in terms of its type, loan to value, etc.

Average (3)

Borrower is typically a well-seasoned business, however may be susceptible to unfavorable changes in the economy, and could be somewhat affected by seasonal factors. The borrowers within this category exhibit financial and cash flow performance that appear average to slightly above average when compared to peer standards and they show an adequate payment history. Collateral securing this type of credit is good, exhibiting above average loan to values, etc.

Acceptable/Acceptable Watch (4)

A borrower within this category exhibits financial and cash flow performance that appear adequate and satisfactory when compared to peer standards and they show a satisfactory payment history. The collateral securing the request is within supervisory limits and overall is acceptable. Borrowers rated acceptable could also be newer businesses that are typically susceptible to unfavorable changes in the economy, and more than likely could be affected by seasonal factors.

Special Mention (5)

The borrower may have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. Examples of this type of credit include a start-up company fully based on projections, a documentation issue that needs to be corrected or a general market condition that the borrower is working through to get corrected.

Substandard (6)

Substandard loans are classified assets exhibiting a number of well-defined weaknesses that jeopardize normal repayment. The assets are no longer adequately protected due to declining net worth, lack of earning capacity, or insufficient collateral offering the distinct possibility of the loss of a portion of the loan principal. Loans classified as substandard clearly represent troubled and deteriorating credit situations requiring constant supervision.

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(Unaudited)

5. **LOANS** (Continued)

Doubtful (7)

Loans in this category exhibit the same, if not more pronounced weaknesses used to describe the substandard credit. Loans are frozen with collection improbable. Such loans are not yet rated as Charge-off because certain actions may yet occur which would salvage the loan.

Charge-off/Loss (8)

Loans in this category are largely uncollectible and should be charged against the loan loss reserve immediately.

General Reserves:

For loans with a credit risk rating of 5 or better and any loans with a risk rating of 6 or 7 with no specific reserve, reserves are established based on the type of loan collateral, if any, and the assigned credit risk rating. Determination of the allowance is inherently subjective as it requires significant estimates, including the amounts and timing of expected future cash flows on impaired loans, estimated losses on pools of homogenous loans based on historical loss experience, and consideration of current environmental factors and economic trends, all of which may be susceptible to significant change.

Using a historical average loss by loan type as a base, each loan graded as higher risk is assigned a specific percentage. The residential real estate and consumer loan portfolios are assigned a loss percentage as a homogenous group. If, however, on an individual loan the projected loss based on collateral value and payment histories are in excess of the computed allowance, the allocation is increased for the higher anticipated loss. These computations provide the basis for the allowance for loan losses as recorded by the Corporation.

Commercial construction loans in the amount of \$2.447 million, \$3.251 million and \$2.883 million for the periods ended September 30, 2015, December 31, 2014 and September 30, 2014, respectively did not receive a specific risk rating. These amounts represent loans made for land development and unimproved land purchases.

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Below is a breakdown of loans by risk category as of September 30, 2015 (dollars in thousands):

	(1) Excellent	(2) Good	(3) Average	(4) Acceptable/ Acceptable Watch	(5) Sp. Mention	(6) Substandard	(7) Doubtful	Rating Unassigned	Total
Commercial real estate	\$ 3,594	\$ 26,806	\$ 113,266	\$ 159,045		\$ 7,314			\$ 310,025
Commercial, financial and agricultural	13,854	5,641	48,918	45,976		6,415			120,804
Commercial construction		404	2,911	8,970		766		2,447	15,498
One to four family residential real estate	617	1,171	3,388	3,736		4,618		131,277	144,807
Consumer construction								11,957	11,957
Consumer	27		20	4				16,764	16,815
Total loans	\$ 18,092	\$ 34,022	\$ 168,503	\$ 217,731		\$ 19,113		\$ 162,445	\$ 619,906

Below is a breakdown of loans by risk category as of December 31, 2014 (dollars in thousands):

	(1) Strong	(2) Good	(3) Average	(4) Acceptable/ Acceptable Watch	(5) Sp. Mention	(6) Substandard	(7) Doubtful	Rating Unassigned	Total
Commercial real estate	\$ 859	\$ 28,740	\$ 129,791	\$ 147,624		\$ 8,373			\$ 315,387
Commercial, financial and agricultural	3,227	4,577	33,794	57,295		3,002			101,895
Commercial construction	80	441	2,282	9,324		906		3,251	16,284
One-to-four family residential real estate	297	1,074	3,207	5,882		5,745		123,348	139,553
Consumer construction								9,431	9,431
Consumer	53		3	10		11		18,308	18,385
Total loans	\$ 4,516	\$ 34,832	\$ 169,077	\$ 220,135		\$ 18,037		\$ 154,338	\$ 600,935

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. LOANS (Continued)

Below is a breakdown of loans by risk category as of September 30, 2014 (dollars in thousands):

	(1) Excellent	(2) Good	(3) Average	(4) Acceptable/ Acceptable Watch	(5) Sp. Mention	(6) Substandard	(7) Doubtful	Rating Unassigned	Total
Commercial real estate	\$ 1,741	\$ 24,827	\$ 116,621	\$ 128,126	\$	\$ 1,488	\$	\$	\$ 272,803
Commercial, financial and agricultural	1,736	4,472	34,547	53,311		4,648			98,714
Commercial construction		444	1,578	6,935		402		2,883	12,242
One to four family residential real estate		295	1,046	4,119	60			104,790	110,310
Consumer construction								8,729	8,729
Consumer			4	21				15,550	15,575
Total loans	\$ 3,477	\$ 30,038	\$ 153,796	\$ 192,512	\$ 60	\$ 6,538	\$	\$ 131,952	\$ 518,373

Impaired Loans

Nonperforming loans are those which are contractually past due 90 days or more as to interest or principal payments, on nonaccrual status, or loans, the terms of which have been renegotiated to provide a reduction or deferral on interest or principal. Interest income recorded during impairment for the three and nine months ended September 30, 2015 was \$.076 million and \$.704 million, respectively. Additional interest income that would have been recognized during these periods was \$.140 million and \$.971 million, respectively. For the three and nine months ended September 30, 2014, the amounts that would have been recognized were \$.040 million and \$.093 million, respectively.

The accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loans are considered impaired when, based on current information and events, it is probable the Corporation will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loans basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, 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. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Purchased loans acquired in a business combination are recorded at estimated fair value on their purchase date with no carryover of the related allowance for loan losses. In determining the estimated fair value of purchased loans, management considers a number of factors including the remaining life of the acquired loans, estimated prepayments, estimated loss ratios, estimated value of the underlying collateral, net present value of cash flows expected to be received, among others. Purchased loans are accounted for in accordance with guidance for certain loans acquired in a transfer (ASC 310-30), when the loans have evidence of credit deterioration since origination and it is probable at the date of acquisition that the acquirer will not collect all contractually required principal and interest payments. The difference between contractually required payments and the cash flows expected to be collected at acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in expected cash flows will result in a reversal of the provision for loan losses to the extent of prior charges and then an adjustment to accretable yield, which would have a positive impact on interest income. The ASC 310-30 mark on impaired loans totaled \$2.978 million as of the acquisition date. The accretable yield related to these impaired loans was estimated at \$.744 million. The Corporation recorded \$.429 million due to the positive resolution of one large acquired nonperforming commercial loan relationship in the first quarter of 2015 and no accretable yield of the loan mark in 2014.

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. LOANS (Continued)

The following is a summary of impaired loans and their effect on interest income (dollars in thousands):

	Nonaccrual Basis	Accrual Basis	QTD Average Investment	YTD Average Investment	Valuation Reserve Related	Three Months Ended Interest Income Recognized During Impairment	Interest Income on Accrual Basis During Impairment	Nine Months Ended Interest Income Recognized During Impairment	Interest Income on Accrual Basis
<i>September 30, 2015</i>									
<i>With no valuation reserve:</i>									
Commercial real estate	\$ 692	\$ 3,978	\$ 4,740	\$ 5,344	\$	\$ 41	\$ 45	\$ 574	\$ 611
Commercial, financial and agricultural		179	219	357		2	2	21	23
Commercial construction				103				3	7
One to four family residential real estate	1,017	2,584	3,968	4,401		33	37	105	150
Consumer construction	21	2	76	117					1
Consumer	5	2	20	20				1	1
<i>With a valuation reserve:</i>									
Commercial real estate	\$ 929	\$	\$ 929	\$ 686	\$ 118	\$	\$ 6	\$	\$ 26
Commercial, financial and agricultural	4,706		4,747	3,935	1,927		50		140
Commercial construction									
One to four family residential real estate	597		576	546	84				12
Consumer construction									
Consumer	61		20	20					
<i>Total:</i>									
Commercial real estate	\$ 1,621	\$ 3,978	\$ 5,669	\$ 6,030	\$ 118	\$ 41	\$ 51	\$ 574	\$ 637
Commercial, financial and agricultural	4,706	179	4,966	4,292	1,927	2	52	21	163
				103				3	7

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Commercial construction									
One to four family residential real estate	1,614	2,584	4,544	4,947	84	33	37	105	162
Consumer construction	21	2	76	117					1
Consumer	66	2	40	40				1	1
Total	\$ 8,028	\$ 6,745	\$ 15,295	\$ 15,529	\$ 2,129	\$ 76	\$ 140	\$ 704	\$ 971

	Nonaccrual Basis	Accrual Basis	Average Investment	Related Valuation Reserve	Interest Income Recognized During Impairment	Interest Income on Accrual Basis
<i>As of and for the year ended December 31, 2014</i>						
<i>With no valuation reserve:</i>						
Commercial real estate	\$ 632	\$ 5,352	\$ 532	\$	\$	\$ 7
Commercial, financial and agricultural	74	702	685			27
Commercial construction		158	11			
One to four family residential real estate	1,844	3,877	656			25
Consumer construction	274	215	15			
Consumer		8	1			1
<i>With a valuation reserve:</i>						
Commercial real estate	\$ 227	\$	\$ 229	\$ 227	\$	\$ 18
Commercial, financial and agricultural	774		1,109	484		45
Commercial construction						
One to four family residential real estate	114		116	9		7
Consumer construction						
Consumer						
<i>Total:</i>						
Commercial real estate	\$ 859	\$ 5,352	\$ 761	\$ 227	\$	\$ 25
Commercial, financial and agricultural	848	702	1,794	484		72
Commercial construction		158	11			
One to four family residential real estate	1,958	3,877	772	9		32
Consumer construction	274	215	15			
Consumer		8	1			1
Total	\$ 3,939	\$ 10,312	\$ 3,354	\$ 720	\$	\$ 130

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. LOANS (Continued)

	Nonaccrual	Accrual	QTD	YTD	Related	Three Months Ended	Nine Months Ended
	Basis	Basis	Average	Average	Valuation Reserve	Interest Income Recognized	Interest Income Recognized
			Investment	Investment		During Impairment	During Impairment
						Accrual Basis	Accrual Basis
<i>September 30, 2014</i>							
<i>With no valuation reserve:</i>							
Commercial real estate	\$	\$	\$	\$	\$	\$	\$
Commercial, financial and agricultural							
Commercial construction							
One to four family residential real estate							
Consumer construction							
Consumer							
<i>With a valuation reserve:</i>							
Commercial real estate	\$ 227	\$	\$ 340	\$ 427	\$ 227	\$ 4	\$ 20
Commercial, financial and agricultural	1,735		1,770	1,268	1,104	28	52
Commercial construction							
One to four family residential real estate	733		489	434	147	7	20
Consumer construction							
Consumer			11	14		1	1
<i>Total:</i>							
Commercial real estate	\$ 227	\$	\$ 340	\$ 427	\$ 227	\$ 4	\$ 20
Commercial, financial and agricultural	1,735		1,770	1,268	1,104	28	52
Commercial construction							
One to four family residential real estate	733		489	434	147	7	20
Consumer construction							
Consumer			11	14		1	1
Total	\$ 2,695	\$	\$ 2,610	\$ 2,143	\$ 1,478	\$ 40	\$ 93

A summary of past due loans at September 30, 2015, December 31, 2014 and September 30, 2014 is as follows (dollars in thousands):

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	September 30, 2015			December 31, 2014			September 30, 2014		
	30-89 days Past Due (accruing)	90+ days Past Due/ Nonaccrual	Total	30-89 days Past Due (accruing)	90+ days Past Due/ Nonaccrual	Total	30-89 days Past Due (accruing)	90+ days Past Due/ Nonaccrual	Total
Commercial real estate	\$ 380	\$ 1,621	\$ 2,001	\$ 1,857	\$ 859	\$ 2,716	\$ 540	\$ 227	\$ 767
Commercial, financial and agricultural	46	4,706	4,752	104	848	952	306	1,735	2,041
Commercial construction	347	21	368				55		55
One to four family residential real estate	1,109	1,614	2,723	1,412	1,958	3,370	414	733	1,147
Consumer construction				38	274	312			
Consumer	37	66	103	88		88	55		55
Total past due loans	\$ 1,919	\$ 8,028	\$ 9,947	\$ 3,499	\$ 3,939	\$ 7,438	\$ 1,370	\$ 2,695	\$ 4,065

A roll-forward of nonaccrual activity for the three months ended September 30, 2015 (dollars in thousands):

	For the Three Months Ended September 30, 2015						
	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer Construction	Consumer	Total
NONACCRUAL							
Beginning balance	\$ 2,398	\$ 4,905	\$	\$ 2,157	\$ 23	\$ 29	\$ 9,512
Principal payments	(181)	(112)	(1)	(393)	(2)	(13)	(702)
Charge-offs	(52)			(62)		(36)	(150)
Advances							
Class transfers							
Transfers to OREO				(74)			(74)
Transfers to accruing	(892)	(87)		(139)			(1,118)
Transfers from accruing	320		104	151		76	651
Other	28		(103)	(26)		10	(91)
Ending balance	\$ 1,621	\$ 4,706	\$	\$ 1,614	\$ 21	\$ 66	\$ 8,028

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. LOANS (Continued)

A roll-forward of nonaccrual activity for the three months ended September 30, 2014 (dollars in thousands):

	For the Three Months Ended September 30, 2014						Total
	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer Construction	Consumer	
NONACCRUAL							
Beginning balance	\$ 454	\$ 1,808	\$	\$ 383	\$	\$ 7	\$ 2,652
Principal payments	(2)	(79)		(7)			(88)
Charge-offs	(18)	(3)		(10)		(7)	(38)
Advances							
Class transfers							
Transfers to OREO	(207)						(207)
Transfers to accruing							
Transfers from accruing		3		368			371
Other		6		(1)			5
Ending balance	\$ 227	\$ 1,735	\$	\$ 733	\$	\$	\$ 2,695

A roll-forward of nonaccrual activity for the nine months ended September 30, 2015 (dollars in thousands):

	For the Nine Months Ended September 30, 2015						Total
	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer Construction	Consumer	
NONACCRUAL							
Beginning balance	\$ 859	\$ 848	\$	\$ 1,958	\$ 274	\$	\$ 3,939
Principal payments	(282)	(2,108)	(1)	(449)	(2)	(21)	(2,863)
Charge-offs	(52)	(100)		(92)		(64)	(308)
Advances							

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Class transfers			250			(250)			
Transfers to OREO						(303)			(303)
Transfers to accruing	(1,291)	(88)				(199)			(1,578)
Transfers from accruing	2,350	6,154	104			794		122	9,524
Other	37		(353)			(95)	(1)	29	(383)
Ending balance	\$ 1,621	\$ 4,706	\$	\$	\$ 1,614	\$	\$ 21	\$ 66	\$ 8,028

A roll-forward of nonaccrual activity for the nine months ended September 30, 2014 (dollars in thousands):

	For the Nine Months Ended September 30, 2014						
	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer Construction	Consumer	Total
NONACCRUAL							
Beginning balance	\$ 572	\$ 811	\$	\$ 611	\$	\$ 30	\$ 2,024
Principal payments	(104)	(160)		(29)		(4)	(297)
Charge-offs	(18)	(56)		(13)		(32)	(119)
Advances							
Class transfers							
Transfers to OREO	(233)			(257)			(490)
Transfers to accruing		(10)		(127)			(137)
Transfers from accruing		1,142		539		6	1,687
Other	10	8		9			27
Ending balance	\$ 227	\$ 1,735	\$	\$ 733	\$	\$	\$ 2,695

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. **LOANS** (Continued)

A roll-forward of nonperforming loan activity during the year ended December 31, 2014 (dollars in thousands):

	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer Construction	Consumer	Total
NONACCRUAL							
Beginning balance	\$ 572	\$ 811	\$	\$ 611	\$	\$ 30	\$ 2,024
Principal payments	(104)	(692)		(35)		(4)	(835)
Charge-offs	(18)	(435)		(206)		(32)	(691)
Advances							
Transfers to OREO	(233)			(357)			(590)
Transfers to accruing		(10)		(127)			(137)
Transfers from accruing		1,167		685		6	1,858
Acquired impaired loans	632			1,375	274		2,281
Other	10	7		12			29
Ending balance	\$ 859	\$ 848	\$	\$ 1,958	\$ 274	\$	\$ 3,939

Troubled Debt Restructuring

Troubled debt restructurings (TDR) are determined on a loan-by-loan basis. Generally restructurings are related to interest rate reductions, loan term extensions and short term payment forbearance as means to maximize collectability of troubled credits. If a portion of the TDR loan is uncollectible (including forgiveness of principal), the uncollectible amount will be charged off against the allowance at the time of the restructuring. In general, a borrower must make at least six consecutive timely payments before the Corporation would consider a return of a restructured loan to accruing status in accordance with FDIC guidelines regarding restoration of credits to accrual status.

The Corporation has, in accordance with generally accepted accounting principles and per recently enacted accounting standard updates, evaluated all loan modifications to determine the fair value impact of the underlying asset. The carrying amount of the loan is compared to the expected payments to be received, discounted at the loan's original rate, or for collateral dependent loans, to the fair value of the collateral.

A summary of troubled debt restructurings occurring during the periods indicated is as follows (dollars in thousands):

	Nine months ended September 30, 2015		Twelve months ended December 31, 2014		Nine months ended September 30, 2014	
	Number of Modifications	Recorded Investment	Number of Modifications	Recorded Investment	Number of Modifications	Recorded Investment
Commercial real estate	3	\$ 1,216		\$		\$
Commercial, financial and agricultural	3	268				
Commercial construction	4	266				
One to four family residential real estate	20	1,538	1	89		
Consumer construction						
Consumer						
Total troubled debt restructurings	30	\$ 3,288	1	\$ 89		\$

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. LOANS (Continued)

A roll-forward of troubled debt restructuring during the three months ended September 30, 2015 (dollars in thousands):

	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer and Consumer Construction	Total
ACCRUING						
Beginning balance	\$ 1,647	\$ 1,441	\$ 844	\$ 1,229	\$	\$ 5,161
Principal payments	(270)	(13)	(5)	(20)		(308)
Charge-offs						
Advances						
New restructured						
Transferred out of TDR						
Transfers to nonaccrual						
Ending Balance	\$ 1,377	\$ 1,428	\$ 839	\$ 1,209	\$	\$ 4,853
NONACCRUAL						
Beginning balance	\$ 476	\$	\$	\$ 346	\$	\$ 822
Principal payments	(10)			(10)		(20)
Charge-offs						
Advances						
New restructured						
Transfers to foreclosed properties						
Transfers from accruing						
Ending Balance	\$ 466	\$	\$	\$ 336	\$	\$ 802
TOTALS						
Beginning balance	\$ 2,123	\$ 1,441	\$ 844	\$ 1,575	\$	\$ 5,983
Principal payments	(280)	(13)	(5)	(30)		(328)
Charge-offs						
Advances						
New restructured						
Transfers out of TDRs						
Transfers to nonaccrual						
Transfers to foreclosed properties						

Transfers from accruing

Ending Balance	\$	1,843	\$	1,428	\$	839	\$	1,545	\$	5,655
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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. **LOANS** (Continued)

A roll-forward of troubled debt restructuring during the three months ended September 30, 2014 (dollars in thousands):

	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer and Consumer Construction	Total
ACCRUING						
Beginning balance	\$ 1,007	\$ 1,186	\$ 858	\$ 98	\$	\$ 3,149
Principal payments			(3)	(1)		(4)
Charge-offs						
Advances						
New restructured						
Transferred out of TDR						
Transfers to nonaccrual						
Ending Balance	\$ 1,007	\$ 1,186	\$ 855	\$ 97	\$	\$ 3,145
NONACCRUAL						
Beginning balance	\$	\$ 508	\$	\$ 89	\$	\$ 597
Principal payments						
Charge-offs						
Advances						
New restructured						
Transfers to foreclosed properties						
Transfers from accruing						
Ending Balance	\$	\$ 508	\$	\$ 89	\$	\$ 597
TOTALS						
Beginning balance	\$ 1,007	\$ 1,694	\$ 858	\$ 187	\$	\$ 3,746
Principal payments			(3)	(1)		(4)
Charge-offs						
Advances						
New restructured						
Transfers out of TDRs						
Transfers to nonaccrual						
Transfers to foreclosed properties						
Transfers from accruing						

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Ending Balance \$ 1,007 \$ 1,694 \$ 855 \$ 186 \$ 3,742

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. LOANS (Continued)

A roll-forward of troubled debt restructuring during the nine months ended September 30, 2015 (dollars in thousands):

	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer and Consumer Construction	Total
ACCRUING						
Beginning balance	\$ 1,007	\$ 1,186	\$ 852	\$ 60	\$	\$ 3,105
Principal payments	(277)	(26)	(13)	(34)		(350)
Charge-offs						
Advances						
New restructured	647	268		1,243		2,158
Transferred out of TDRs						
Transfers to nonaccrual				(60)		(60)
Ending Balance	\$ 1,377	\$ 1,428	\$ 839	\$ 1,209	\$	\$ 4,853
NONACCRUAL						
Beginning balance	\$	\$	\$	\$	\$	\$
Principal payments	(105)		(266)	(19)		(390)
Charge-offs						
Advances						
New restructured	571		266	295		1,132
Transfers to foreclosed properties						
Transfers from accruing				60		60
Ending Balance	\$ 466	\$	\$	\$ 336	\$	\$ 802
TOTALS						
Beginning balance	\$ 1,007	\$ 1,186	\$ 852	\$ 60	\$	\$ 3,105
Principal payments	(382)	(26)	(279)	(53)		(740)
Charge-offs						
Advances						
New restructured	1,218	268	266	1,538		3,290
Transfers out of TDR						
Transfers to nonaccrual				(60)		(60)
Transfers to foreclosed properties				60		60

Transfer from accruing

Ending Balance	\$	1,843	\$	1,428	\$	839	\$	1,545	\$	5,655
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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. LOANS (Continued)

A roll-forward of troubled debt restructuring during the nine months ended September 30, 2014 (dollars in thousands):

	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer and Consumer Construction	Total
ACCRUING						
Beginning balance	\$ 3,520	\$ 1,186	\$ 858	\$ 99	\$	\$ 5,663
Principal payments	(2,513)		(3)	(4)		(2,520)
Charge-offs						
Advances						
New restructured						
Transferred out of TDRs				91		91
Transfers to nonaccrual				(89)		(89)
Ending Balance	\$ 1,007	\$ 1,186	\$ 855	\$ 97	\$	\$ 3,145
NONACCRUAL						
Beginning balance	\$	\$ 523	\$	\$ 91	\$	\$ 614
Principal payments		(15)				(15)
Charge-offs						
Advances						
New restructured						
Transfers to foreclosed properties				(91)		(91)
Transfers from accruing				89		89
Ending Balance	\$	\$ 508	\$	\$ 89	\$	\$ 597
TOTALS						
Beginning balance	\$ 3,520	\$ 1,709	\$ 858	\$ 190	\$	\$ 6,277
Principal payments	(2,513)	(15)	(3)	(4)		(2,535)
Charge-offs						
Advances						
New restructured						
Transfers out of TDR				91		91
Transfers to nonaccrual				(89)		(89)
Transfers to foreclosed properties				89		89
Transfer from accruing				(91)		(91)

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Ending Balance	\$	1,007	\$	1,694	\$	855	\$	186	\$	3,742
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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. LOANS (Continued)

A roll-forward of troubled debt restructuring during the year ended December 31, 2014 (dollars in thousands):

	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer and Consumer Construction	Total
ACCRUING						
Beginning balance	\$ 3,520	\$ 1,186	\$ 858	\$ 99	\$	\$ 5,663
Principal payments	(2,513)		(6)	(4)		(2,523)
Charge-offs				(37)		(37)
Advances						
New restructured						
Transferred out of TDR				91		91
Transfers to nonaccrual				(89)		(89)
Ending Balance	\$ 1,007	\$ 1,186	\$ 852	\$ 60	\$	\$ 3,105
NONACCRUAL						
Beginning balance	\$	\$ 523	\$	\$ 91	\$	\$ 614
Principal payments		(319)				(319)
Charge-offs		(204)		(37)		(241)
Advances						
New restructured						
Transfers to foreclosed properties				(143)		(143)
Transfers from accruing				89		89
Ending Balance	\$	\$	\$	\$	\$	\$
TOTALS						
Beginning balance	\$ 3,520	\$ 1,709	\$ 858	\$ 190	\$	\$ 6,277
Principal payments	(2,513)	(319)	(6)	(4)		(2,842)
Charge-offs		(204)		(74)		(278)
Advances						
New restructured						
Transfers out of TDRs				91		91
Transfers to nonaccrual				(89)		(89)
Transfers to foreclosed properties				(143)		(143)

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Transfers from accruing					89		89
Ending Balance	\$	1,007	\$	1,186	\$	852	\$ 60 3,105

The above includes loans with revolving privileges which are scoped out of ASC 310-30 and certain loans which the Corporation elected to treat under the cost recovery method of accounting.

Insider Loans

The Bank, in the ordinary course of business, grants loans to the Corporation's executive officers and directors, including their families and firms in which they are principal owners. Activity in such loans is summarized below (dollars in thousands):

	Nine months ended September 30, 2015		Year ended December 31, 2014		Nine months ended September 30, 2014	
Loans outstanding, beginning of period	\$	8,789	\$	9,043	\$	9,043
New loans				33		33
Net activity on revolving lines of credit		88		1,390		1,052
Principal payments		(2,596)		(1,677)		(1,614)
Loans outstanding, end of period	\$	6,281	\$	8,789	\$	8,514

There were no loans to related parties classified substandard as of September 30, 2015, December 31, 2014 or September 30, 2014. In addition to the outstanding balances above, there were unfunded commitments of \$3.255 million to related parties at September 30, 2015.

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MACKINAC FINANCIAL CORPORATION

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(Unaudited)

6. GOODWILL AND OTHER INTANGIBLE ASSETS

During the fourth quarter of 2014, the Corporation recorded \$3.805 million of goodwill and \$1.206 million of deposit based intangible assets associated with the acquisition of PFC.

The excess of the cost of acquired entities over the fair value of identifiable assets acquired less liabilities assumed is recorded as goodwill. In accordance with FASB ASC 350 (SFAS No. 142, *Goodwill and Other Intangible Assets*), amortization of goodwill and indefinite-lived assets is not recorded. However, the recoverability of goodwill and other intangible assets are annually tested for impairment. Intangible assets, including core deposits and customer business relationships, are amortized primarily on straight-line basis over their estimated useful lives. The Corporation is currently amortizing the deposit based intangible over a ten-year estimated life.

The deposit based intangible is reported net of accumulated amortization at \$1.106 million at September 30, 2015. Amortization expense in the first nine months of 2015 is \$.090 million. Amortization expense for the next five years is expected to be at \$.121 million per year.

7. SERVICING RIGHTS

Mortgage Loans

Mortgage servicing rights (MSRs) are recorded when loans are sold in the secondary market with servicing retained. As of September 30, 2015, the Corporation had obligations to service approximately \$229.769 million of residential first mortgage loans. The valuation of MSRs is based upon the net present value of the projected revenues over the expected life of the loans being serviced, as reduced by estimated internal costs to service these loans. The fair value of the capitalized servicing rights approximates the carrying value. On a quarterly basis, management evaluates the MSRs for impairment. The key economic assumptions used in determining the fair value of the mortgage servicing rights include an annual constant prepayment speed of 9.34% and a discount rate of 9.19% for September 30, 2015.

The following summarizes mortgage servicing rights capitalized and amortized, along with the aggregate activity in related valuation allowances (dollars in thousands):

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	Nine Months Ended September 30, 2015	Year Ended December 31, 2014	Nine Months Ended September 30, 2014
Balance at beginning of period	\$ 1,994	\$ 1,129	\$ 1,129
Additions from loans sold with servicing retained	200	636	375
MSRs acquired in Peninsula transaction		539	
Amortization	(396)	(310)	(218)
Balance at end of period	\$ 1,798	\$ 1,994	\$ 1,286
Balance of loan servicing portfolio	\$ 229,769	\$ 223,549	\$ 144,051
Mortgage servicing rights as % of portfolio	.78%	.89%	.89%

Commercial Loans

The Corporation also retains the servicing on commercial loans that have been sold. These loans were originated and underwritten under the SBA and USDA government guarantee programs, in which the guaranteed portion of the loan was sold to a third party with servicing retained. The balance of these sold loans with servicing retained at September 30, 2015 was approximately \$65.830 million. The Corporation valued these servicing rights at \$.177 million as of September 30, 2015. This valuation was established in consideration of the discounted cash flow of expected servicing income over the life of the loans.

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

8. BORROWINGS

Borrowings consist of the following at September 30, 2015, December 31, 2014 and September 30, 2014 (dollars in thousands):

	September 30, 2015	December 31, 2014	September 30, 2014
Federal Home Loan Bank fixed rate advances at September 30, 2015 with a weighted average rate of 1.68% maturing in 2016, 2018 and 2019	\$ 35,000	\$ 35,000	\$ 35,000
Correspondent bank line of credit - holding company	11,250	8,000	4,500
Bank line of credit - wholly-owned asset based lending subsidiary	239	3,367	1,830
Correspondent bank term note, current floor rate of 4%, maturing December 28, 2017	2,400	2,700	2,800
USDA Rural Development, fixed-rate note payable, maturing August 24, 2024, interest payable at 1%	704	779	779
	\$ 49,593	\$ 49,846	\$ 44,909

The Federal Home Loan Bank borrowings are collateralized at September 30, 2015 by the following: a collateral agreement on the Corporation's one to four family residential real estate loans with a book value of approximately \$36.919 million; mortgage related and municipal securities with an amortized cost and estimated fair value of \$5.394 million and \$5.460 million, respectively; and Federal Home Loan Bank stock owned by the Bank totaling \$2.169 million. Prepayment of the advances is subject to the provisions and conditions of the credit policy of the Federal Home Loan Bank of Indianapolis in effect as of September 30, 2015.

The USDA Rural Development borrowing is collateralized by loans totaling \$.116 million originated and held by the Corporation's wholly owned subsidiary, First Rural Relending, and an assignment of a demand deposit account in the amount of \$.653 million, and guaranteed by the Corporation.

The Corporation currently has two banking borrowing relationships. The first relationship consists of a non-revolving line of credit and a term note. The line of credit bears interest at 90-day LIBOR plus 2.75%, with a floor rate of 4.00% and has an initial term that expires on December 28, 2017. The term note bears the same interest and matures on March 22, 2017 and requires quarterly principal payments of

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\$100,000 beginning June 30, 2014. This relationship is secured by all of the outstanding mBank stock. The second borrowing relationship consists of a \$10 million revolving line of credit. The balance of this line of credit was paid in October 2015, when the borrowing relationship was terminated by the Corporation.

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

9. DEFINED BENEFIT PENSION PLAN

The Corporation acquired the Peninsula Financial Corporation noncontributory defined benefit pension plan. Effective December 31, 2005, the plan was amended to freeze participation in the plan; therefore, no additional employees are eligible to become participants in the plan. The benefits are based on years of service and the employee's compensation at the time of retirement. The Plan was amended effective December 31, 2010, to freeze benefit accrual for all participants. Expected contributions to the Plan in 2015 are \$.114 million. The anticipated distributions over the next five years and thereafter are detailed in the table below:

2015	\$	132,026
2016		130,003
2017		127,902
2018		128,608
2019		126,361
Thereafter		701,944
Total	\$	1,346,844

At September 30, 2015, the plan's assets had a fair value of \$2.107 million and the Corporation had a net liability of \$1.183 million. The accumulated benefit obligation was \$3.290 million.

Assumptions in the actuarial valuation are:

2015

Weighted average discount rate	3.98%
Rate of increase in future compensation levels	N/A
Expected long-term rate of return on plan assets	8.00%

The expected long-term rate of return on plan assets reflects management's expectations of long-term average rates of return on funds invested to provide for benefits included in the projected benefit obligation. The expected return is based on the outlook for inflation, fixed income returns and equity returns, while also considering historical returns, asset allocation and investment strategy. The discount rate assumption is based on investment yields available on AA rated long-term corporate bonds.

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The primary investment objective is to maximize growth of the pension plan assets to meet the projected obligations to the beneficiaries over a long period of time, and to do so in a manner that is consistent with the Corporation's risk tolerance. The intention of the plan sponsor is to invest the plan assets in mutual funds with the following asset allocation:

	Target Allocation	Actual Allocation
Equity securities	50% to 70%	60%
Fixed income securities	30% to 50%	40%

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MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

10. STOCK COMPENSATION PLANS

On May 22, 2012, the Company's shareholders approved the Mackinac Financial Corporation 2012 Incentive Compensation Plan, under which current and prospective employees, non-employee directors and consultants may be awarded incentive stock options, non-statutory stock options, RSUs, or stock appreciation rights. The aggregate number of shares of the Company's common stock issuable under the plan is 575,000, which included 392,152 option shares outstanding at that time. Awards are made at the discretion of management. Compensation cost equal to the fair value of the award is recognized over the vesting period.

Restricted Stock Awards

The Corporation's restricted stock awards require certain service-based or performance requirements and have a vesting period of four years. Compensation expense is recognized on a straight-line basis over the vesting period. Shares are subject to certain restrictions and risk of forfeiture by the participants.

The Corporation, in August 2012 and March 2014, granted RSUs to members of the Board of Directors and Management. In August 2012, 148,500 RSUs were granted at a market value of \$7.91 and will vest equally over a four year term. In exchange for the grant of these RSUs various previously issued stock option awards were surrendered. In March 2014, 52,774 RSUs were granted at a market value of \$12.95, also vesting equally over a four year term. In March 2015, 37,730 RSUs were granted at a market value of \$11.15, also vesting over a four year term. The RSUs were awarded at no cost to the employee. Compensation cost to be recognized over the four year vesting periods, is \$1.175 million, \$.683 million and \$.421 million, respectively. On August 31, 2013, 2014 and 2015, the Corporation issued 37,125 shares of its common stock for vested RSUs, in each year. In March 2015, the Corporation issued 13,194 shares of its common stock for vested RSUs. In May 2015, the Corporation granted 3,000 shares, which were immediately vested and issued.

A summary of changes in our nonvested shares for the period follows:

	Number Outstanding	Weighted Average Grant Date Fair Value
Nonvested balance at January 1, 2015	127,024	\$ 10.07
Granted during the period	40,730	11.15
Vested during the period	(53,319)	9.34
Nonvested balance at September 30, 2015	114,435	\$ 10.72

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A summary of stock option transactions for the nine months ended September 30, 2015 and 2014, and the year ended December 31, 2014, is as follows:

	September 30, 2015	December 31, 2014	September 30, 2014
Outstanding shares at beginning of year	20,000	237,152	237,152
Granted during the period			
Exercised during the period		(70,502)	
Expired / forfeited during the period	(10,000)	(146,650)	
Outstanding shares at end of period	10,000	20,000	237,152
Exercisable shares at end of period	2,000	4,000	124,861
Weighted average exercise price per share at end of period	\$ 10.65	\$ 11.33	\$ 9.80
Shares available for grant at end of period			

There were no options granted in the first nine months of 2015 and 2014.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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10. STOCK COMPENSATION PLANS (Continued)

Following is a summary of the options outstanding and exercisable at September 30, 2015.

Exercise Price	Outstanding	Number Exercisable	Unvested Options	Weighted Average Remaining Contractual Life-Years
\$ 10.65	10,000	2,000	8,000	1.21

Options issued since the Corporation's recapitalization in December of 2004 call for 20% immediate vesting upon issue and subsequent vesting to occur over a two to five year period, based upon the market value appreciation of the underlying Corporation's stock. Compensation related to these options was expensed based upon the vesting period without consideration given to market value appreciation. There are no future compensation expenses related to existing option programs.

11. INCOME TAXES

A valuation allowance is provided against deferred tax assets when it is more likely than not that some or all of the deferred tax asset will not be realized. The net operating loss carryforwards expire twenty years from the date they originated. These carryforwards, if not utilized, will begin to expire in the year 2023. A portion of the NOL and all of the credit carryforwards are subject to the limitations for utilization as set forth in Section 382 of the Internal Revenue Code. The annual limitation is \$1.400 million for the NOL and the equivalent value of tax credits, which is approximately \$.476 million. These limitations for use were established in conjunction with the recapitalization of the Corporation in December 2004.

The Corporation has reported deferred tax assets of \$9.326 million at September 30, 2015, which is net of a valuation allowance of \$.760 million. Management evaluated the deferred tax valuation allowance as of September 30, 2015 and determined that no adjustment to the valuation was warranted. The remaining valuation allowance pertains to the existing tax credit carryovers, which will only be utilized after all net operating loss carryforwards. Since a portion of these tax credits may expire before that occurs, a valuation allowance for these has been established. The Corporation will continue to evaluate the future benefits from these carryforwards in order to determine if any adjustment to the deferred tax asset is warranted.

12. FAIR VALUE MEASUREMENTS

Fair value estimates, methods, and assumptions are set forth below for the Corporation's financial instruments:

Cash, cash equivalents, and interest-bearing deposits - The carrying values approximate the fair values for these assets.

Securities - Fair values are based on quoted market prices where available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Federal Home Loan Bank stock - Federal Home Loan Bank stock is carried at cost, which is its redeemable value and approximates its fair value, since the market for this stock is limited.

Loans - Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, residential mortgage, and other consumer. The fair value of loans is calculated by discounting scheduled cash flows using discount rates reflecting the credit and interest rate risk inherent in the loan.

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12. FAIR VALUE MEASUREMENTS (Continued)

The methodology in determining fair value of nonaccrual loans is to average them into the blended interest rate at 0% interest. This has the effect of decreasing the carrying amount below the risk-free rate amount and, therefore, discounts the estimated fair value.

Impaired loans are measured at the estimated fair value of the expected future cash flows at the loan's effective interest rate or the fair value of the collateral for loans which are collateral dependent. Therefore, the carrying values of impaired loans approximate the estimated fair values for these assets.

Deposits - The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits and savings, is equal to the amount payable on demand at the reporting date. The fair value of time deposits is based on the discounted value of contractual cash flows applying interest rates currently being offered on similar time deposits.

Borrowings - Rates currently available for debt with similar terms and remaining maturities are used to estimate the fair value of existing debt. The fair value of borrowed funds due on demand is the amount payable at the reporting date.

Accrued interest - The carrying amount of accrued interest approximates fair value.

Off-balance-sheet instruments - The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements, the current interest rates, and the present creditworthiness of the counterparties. Since the differences in the current fees and those reflected to the off-balance-sheet instruments at year-end are immaterial, no amounts for fair value are presented.

The following table presents information for financial instruments at September 30, 2015, December 31, 2014 and September 30, 2014 (dollars in thousands):

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	Level in Fair Value Hierarchy	September 30, 2015		December 31, 2014		September 30, 2014	
		Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:							
Cash and cash equivalents	Level 1	\$ 38,581	\$ 38,581	\$ 21,947	\$ 21,947	\$ 22,401	\$ 22,401
Interest-bearing deposits	Level 2	5,089	5,089	5,797	5,797	235	235
Securities available for sale	Level 2	54,432	54,432	65,832	65,832	48,742	48,742
Federal Home Loan Bank stock	Level 2	2,169	2,169	2,973	2,973	3,060	3,060
Net loans	Level 3	614,127	614,746	595,795	596,429	513,094	513,117
Accrued interest receivable	Level 3	1,821	1,821	1,680	1,680	1,457	1,457
Total financial assets		\$ 716,219	\$ 716,838	\$ 694,024	\$ 694,658	\$ 588,989	\$ 589,012
Financial liabilities:							
Deposits	Level 2	\$ 622,334	\$ 621,944	\$ 606,973	\$ 606,534	\$ 491,206	\$ 491,912
Borrowings	Level 2	49,593	50,258	49,846	50,280	44,909	45,285
Accrued interest payable	Level 3	222	222	205	205	184	184
Total financial liabilities		\$ 672,149	\$ 672,424	\$ 657,024	\$ 657,019	\$ 536,299	\$ 537,381

Limitations - Fair value estimates are made at a specific 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 holdings 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 on-and off-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. Significant assets and liabilities that are not considered financial assets or liabilities include premises and equipment, other assets, and other liabilities. 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 have not been considered in the estimates.

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12. FAIR VALUE MEASUREMENTS (Continued)

The following is information about the Corporation's assets and liabilities measured at fair value on a recurring basis at September 30, 2015, and the valuation techniques used by the Corporation to determine those fair values.

Level 1: In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the Corporation has the ability to access.

Level 2: Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3: Level 3 inputs are unobservable inputs, including inputs available in situations where there is little, if any, market activity for the related asset or liability.

The fair value of all investment securities at September 30, 2015, December 31, 2014 and September 30, 2014 were based on level 2 inputs. There are no other assets or liabilities measured on a recurring basis at fair value. For additional information regarding investment securities, please refer to Note 4 Investment Securities.

The Corporation had no Level 3 assets or liabilities on a recurring basis as of September 30, 2015, December 31, 2014 or September 30, 2014.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Corporation's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

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The Corporation also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These assets include certain impaired loans and other real estate owned. The Corporation has estimated the fair values of these assets using Level 3 inputs, specifically discounted cash flow projections.

Assets Measured at Fair Value on a Nonrecurring Basis at September 30, 2015

(dollars in thousands)	Balance at September 30, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses for Three Months Ended September 30, 2015	Total Losses for Nine Months Ended September 30, 2015
Assets						
Impaired loans	\$ 14,774	\$	\$	\$ 14,774	\$ 117	\$ 259
Other real estate owned	2,296			2,296	104	141
				\$	\$ 221	\$ 400

Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2014

(dollars in thousands)	Balance at December 31, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses for Year Ended December 31, 2014
Assets					
Impaired loans	\$ 1,658	\$	\$	\$ 1,658	\$ 857
Other real estate owned	3,010			3,010	280
				\$	\$ 1,137

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

12. FAIR VALUE MEASUREMENTS (Continued)

Assets Measured at Fair Value on a Nonrecurring Basis at September 30, 2014

(dollars in thousands)	Balance at September 30, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses for Three Months Ended September 30, 2014	Total Losses for Nine Months Ended September 30, 2014
Assets						
Impaired loans	\$ 2,695	\$	\$	\$ 2,695	\$ 10	\$ 440
Other real estate owned	1,843			1,843	176	190
					\$ 186	\$ 630

The Corporation had no investments subject to fair value measurement on a nonrecurring basis.

Impaired loans categorized as Level 3 assets consist of non-homogeneous loans that are considered impaired. The Corporation estimates the fair value of the loans based on the present value of expected future cash flows using management's best estimate of key assumptions. These assumptions include future payment ability, timing of payment streams, and estimated realizable values of available collateral (typically based on outside appraisals).

13. SHAREHOLDERS EQUITY

In December 2014, the Corporation consummated the previously announced acquisition of Peninsula Financial Corporation with a combination of cash and Mackinac Financial Corporation (MFNC) stock. Peninsula Financial Corporation was a bank holding company with The Peninsula Bank as its wholly-owned subsidiary. PFC was headquartered in Ishpeming, Michigan with six branch locations. The purchase price of the acquisition was \$12.420 million with a combination of cash and MFNC common stock. MFNC issued 695,361 shares of its common stock and an increase shareholder equity of \$7.804 million in recording this transaction, after the reduction for issuance costs of \$.130 million. The Corporation recorded assets with a fair value of \$112.766 million, including loans of \$67.139 million, as well as \$100.950 million of deposits.

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The Corporation currently has a share repurchase program. The program is conducted under authorizations from time to time by the Board of Directors. The Corporation repurchased 70,480 shares thus far in 2015, 13,700 shares in 2014 and 55,594 shares in 2013. The share repurchases were conducted under Board authorizations made and publically announced of \$600,000 on February 27, 2013, \$600,000 on December 17, 2013 and an additional \$750,000 on April 28, 2015. None of these authorizations has an expiration date.

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14. COMMITMENTS, CONTINGENCIES AND CREDIT RISK**Financial Instruments With Off-Balance-Sheet Risk**

The Corporation is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets.

The Corporation's exposure to credit loss, in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit, is represented by the contractual amount of those instruments. The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. These commitments are as follows (dollars in thousands):

	September 30, 2015	December 31, 2014	September 30, 2014
Commitments to extend credit:			
Variable rate	\$ 46,732	\$ 44,134	\$ 54,962
Fixed rate	24,546	24,191	19,092
Standby letters of credit - Variable rate	4,061	6,072	5,730
Credit card commitments - Fixed rate	3,570	3,267	3,286
	\$ 78,909	\$ 77,664	\$ 83,070

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 a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the party. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The commitments are structured to allow for 100%

collateralization on all standby letters of credit.

Credit card commitments are commitments on credit cards issued by the Corporation's subsidiary and serviced by other companies. These commitments are unsecured.

Legal Proceedings and Contingencies

In the normal course of business, the Corporation is involved in various legal proceedings. For expanded discussion on the Corporation's legal proceedings, see Part II, Item 1, "Legal Proceedings" in this report.

Concentration of Credit Risk

The Bank grants commercial, residential, agricultural, and consumer loans throughout Michigan. The Bank's most prominent concentration in the loan portfolio relates to commercial real estate loans to operators of nonresidential buildings. This concentration at September 30, 2015 represents \$102.897 million, or 23.05%, compared to \$100.912 million, or 26.30%, of the commercial loan portfolio on September 30, 2014. The remainder of the commercial loan portfolio is diversified in such categories as hospitality and tourism, real estate agents and managers, new car dealers, gaming, petroleum, forestry, agriculture and construction. Due to the diversity of the Bank's locations, the ability of debtors of residential and consumer loans to honor their obligations is not tied to any particular economic sector.

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Forward Looking Statements/Risk Factors

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Corporation intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and is including this statement for purposes of these safe harbor provisions. Forward-looking statements which are based on certain assumptions and describe future plans, strategies, or expectations of the Corporation, are generally identifiable by use of the words believe, expect, intend, anticipate, estimate, project, or similar expressions. The Corporation's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors that could cause actual results to differ from the results in forward-looking statements include, but are not limited to:

RISK FACTORS

Risks Related to our Lending and Credit Activities

- *Our business may be adversely affected by conditions in the financial markets and economic conditions generally, as our borrowers' ability to repay loans and the value of the collateral securing our loans decline.*
- *Weakness in the markets for residential or commercial real estate, including the secondary residential mortgage loan markets, could reduce our net income and profitability.*
- *As a community banking organization, the Corporation's success depends upon local and regional economic conditions and has different lending risks than larger banks.*

We manage our credit exposure through careful monitoring of loan applicants and loan concentrations in particular industries and through loan approval and review procedures. We have established an evaluation process designed to determine the adequacy of our allowance for loan losses. While this evaluation process uses historical and other objective information, the classification of loans and the establishment of loan losses is an estimated based on experience, judgment and expectations regarding borrowers and economic conditions, as well as regulator judgments. We can make no assurance that our loan loss reserves will be sufficient to absorb future loan losses or prevent a material adverse effect on its business, profitability or financial condition.

- *Our allowance for loan losses may be insufficient.*

Continuing deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans, and other factors, both within and outside of our control, may require an increase in our allowance for loan losses.

Risks Related to Our Operations

- *We are subject to interest rate risk.*

Our earnings and cash flows are largely dependent upon our net interest income, which is the difference between interest income on interest-earning assets such as loans and securities and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. There are many factors which influence interest rates that are beyond our control, including but not limited to general economic conditions and governmental policy, in particular, the policies of the FRB.

- *Changes in our accounting policies or in accounting standards could materially affect how we report our financial results and condition.*
- *Our controls and procedures may fail or be circumvented.*
- *Impairment of deferred income tax assets could require charges to earnings, which could result in an adverse impact on our results of operations.*

In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that some allowance requires management to evaluate all available evidence, both negative and positive. Positive evidence necessary to overcome the negative evidence includes whether future taxable income in sufficient amounts and character within the carry back and carry forward periods is available under the tax law, including the use of tax planning strategies. When negative evidence (e.g. cumulative losses in recent years, history of operating loss or tax credit carry forwards expiring unused) exists, more positive evidence than negative evidence will be necessary. At September 30, 2015, net deferred tax assets are approximately \$9.326 million. If a valuation allowance becomes necessary with respect to such balance, it could have a material adverse effect on our business, results of operations and financial condition.

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- *Our information systems may experience an interruption or breach in security.*

Risks Related to Legal and Regulatory Compliance

- *We operate in a highly regulated environment, which could increase our cost structure or have other negative impacts on our operations.*
- *The full impact of the recently implemented Dodd-Frank Act is currently unknown and subject to significant uncertainty.*

Strategic Risks

- *Maintaining or increasing our market share may depend on lowering prices and market acceptance of new products and services.*
- *Future growth or operating results may require us to raise additional capital but that capital may not be available.*

Reputation Risks

- *Unauthorized disclosure of sensitive or confidential client or customer information, whether through a breach of our computer system or otherwise, could severely harm our business.*

Liquidity Risks

- *We could experience an unexpected inability to obtain needed liquidity.*

The ability of a financial institution to meet its current financial obligations is a function of its balance sheet structure, its ability to liquidate assets and its access to alternative sources of funds. We seek to ensure our funding needs are met by maintaining an appropriate level of liquidity through asset/liability management.

Risks Related to an Investment in Our Common Stock

- *Limited trading activity for shares of our common stock may contribute to price volatility.*
- *Our securities are not an insured deposit.*
- *You may not receive dividends on your investment in common stock.*

Our ability to pay dividends is dependent upon our receipt of dividends from the Bank, which is subject to regulatory restrictions. Such restrictions, which govern state-chartered banks, generally limit the payment of dividends on bank stock to the bank's undivided profits after all payments of all necessary expenses, provided that the bank's surplus equals or exceeds its capital.

These risks and uncertainties should be considered in evaluating forward-looking statements. Further information concerning the Corporation and its business, including additional factors that could materially affect the Corporation's financial results, is included in the Corporation's filings with the Securities and Exchange Commission. All forward-looking statements contained in this report are based upon information presently available and the Corporation assumes no obligation to update any forward-looking statements.

The following discussion will cover results of operations, asset quality, financial position, liquidity, interest rate sensitivity, and capital resources for the periods indicated. The information included in this discussion is intended to assist readers in their analysis of, and should be read in conjunction with, the consolidated financial statements and related notes and other supplemental information presented elsewhere in this report. This discussion should be read in conjunction with the consolidated financial statements and footnotes contained in the Corporation's Annual Report and Form 10-K for the year-ended December 31, 2014. Throughout this discussion, the term "Bank" refers to mBank, the principal banking subsidiary of the Corporation.

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MACKINAC FINANCIAL CORPORATION

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion will cover results of operations, asset quality, financial position, liquidity, interest rate sensitivity, and capital resources for the periods indicated. The information included in this discussion is intended to assist readers in their analysis of, and should be read in conjunction with, the consolidated financial statements, the related notes, and other supplemental information presented elsewhere in this report. This discussion should also be read in conjunction with the consolidated financial statements and footnotes contained in the Corporation's Annual Report and Form 10-K for the year-ended December 31, 2014. Throughout this discussion, the term "Bank" refers to mBank, the principal banking subsidiary of the Corporation.

FINANCIAL OVERVIEW

The Corporation recorded third quarter 2015 net income available to common shareholders of \$1.018 million or \$.16 per share compared to net income of \$.886 million, or \$.16 per share for the third quarter of 2014. The 2015 third quarter results include one-time charges related to (i) the transfer of our asset based lending subsidiary assets to mBank, which charges included unamortized debt issue costs and a prepayment penalty, and (ii) regulatory audit costs incurred in connection with our approval as an SBA preferred lender. Income for the nine months ended September 30, 2015 totaled \$4.003 million, or \$.64 per share, compared to \$2.352 million, or \$.43 per share for the same period in 2014.

Weighted average shares totaled 6,247,416 shares for the nine month period in 2015 and 6,238,963 shares in the third quarter 2015, compared to 5,532,966 shares for the nine month period in 2014 and 5,540,200 shares in the third quarter 2014.

The net interest margin for the third quarter of 2015 increased to \$7.235 million, or 4.18%, compared to \$5.886 million, or 4.18% in the third quarter of 2014. The nine month margin in 2015 was \$21.755 million, or 4.29% compared to \$17.138 million, or 4.20% in 2014.

Total assets of the Corporation at September 30, 2015 were \$754.972 million, an increase of \$141.029 million, or 22.97% from the \$613.943 million in total assets reported at September 30, 2014 and an increase of \$11.187 million, or 1.50%, from total assets of \$743.785 million at year-end 2014. The loan portfolio increased \$18.971 million, or 3.16%, from December 31, 2014 balances of \$600.935 million. Deposits totaled \$622.334 million at September 30, 2015, an increase of \$15.361 million from the \$606.973 million at December 31, 2014.

The acquisition of Peninsula Financial Corporation ("PFC"), the holding company for Peninsula Bank, in December 2014 added approximately \$125 million in assets, \$70 million in loan balances and \$100 million in deposits to our organization. In connection with this acquisition, we increased shareholders' equity by \$7.804 million, issued 695,361 shares of our common stock and added approximately 350 new shareholders.

FINANCIAL CONDITION

Cash and Cash Equivalents

Cash and cash equivalents increased \$16.634 million during the first nine months of 2015. See further discussion of the change in cash and cash equivalents in the Liquidity section.

Investment Securities

Securities available for sale decreased \$11.400 million from December 31, 2014 to September 30, 2015, with the balance on September 30, 2015, totaling \$54.432 million. Investment securities are utilized in an effort to manage interest rate risk and liquidity. As of September 30, 2015, investment securities with an estimated fair value of \$5.460 million were pledged.

Loans

Through the first nine months of 2015, loan balances increased by \$18.971 million, or 3.16%, from December 31, 2014 balances of \$600.935 million. During the first nine months of 2015, the Bank had total loan production of \$175.409 million, which included \$36.827 million of secondary market loan production. This loan production,

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however, was offset by loan principal runoff, paydowns and amortization, SBA/USDA loan sales of \$5.996 million, and nonperforming loans transferred to other real estate owned (OREO) in the amount of \$.674 million.

Management continues to actively manage the loan portfolio, seeking to identify and resolve problem assets at an early stage. Management believes a properly positioned loan portfolio provides the most attractive earning asset yield available to the Corporation and, with a diligent loan approval process and exception reporting, management can effectively manage the risk in the loan portfolio. Management intends to continue loan growth within its markets for mortgage, consumer, and commercial loan products while concentrating on loan quality, industry concentration issues, and competitive pricing.

Following is a summary of the loan portfolio at September 30, 2015, December 31, 2014 and September 30, 2014 (dollars in thousands):

	September 30, 2015	Percent of Total	December 31, 2014	Percent of Total	September 30, 2014	Percent of Total
Commercial real estate	\$ 310,025	50.01%	\$ 315,387	52.48%	\$ 272,803	52.63%
Commercial, financial, and agricultural	120,804	19.49	101,895	16.96	98,714	19.04
One to four family residential real estate	144,807	23.36	139,553	23.22	110,310	21.28
Construction:						
Consumer	11,957	1.93	9,431	1.57	8,729	1.68
Commercial	15,498	2.50	16,284	2.71	12,242	2.36
Consumer	16,815	2.71	18,385	3.06	15,575	3.01
Total loans	\$ 619,906	100.00%	\$ 600,935	100.00%	\$ 518,373	100.00%

Following is a table showing the significant industry types in the commercial loan portfolio as of September 30, 2015, December 31, 2014 and September 30, 2014 (dollars in thousands):

	September 30, 2015			December 31, 2014			September 30, 2014		
	Outstanding Balance	Percent of Loans	Percent of Capital	Outstanding Balance	Percent of Loans	Percent of Capital	Outstanding Balance	Percent of Loans	Percent of Capital
Real estate - operators of nonresidential buildings	\$ 102,897	23.05%	135.23%	\$ 106,644	24.60%	144.12%	\$ 100,912	26.30	150.32%
Hospitality and tourism	41,156	9.22	54.09	46,211	10.66	62.45	42,538	11.08	63.36
Lessors of residential buildings	25,911	5.81	34.05	19,776	4.56	26.73	16,262	4.24	24.22
Gasoline stations and convenience stores	17,077	3.83	22.44	13,841	3.19	18.71	11,626	3.03	17.32
Commercial construction	15,498	3.47	20.37	16,284	3.76	22.01	12,242	3.19	18.24
Lessors of other real estate property	7,088	1.59	9.32	9,130	2.11	12.34	9,067	2.36	13.51
Other	236,700	53.03	311.07	221,680	51.12	299.58	191,112	49.80	284.68
Total Commercial Loans	\$ 446,327	100.00%		\$ 433,566	100.00%		\$ 383,759	100.00%	

Management recognizes the additional risk presented by the concentration in certain segments of the portfolio. On a historical basis, the Corporation's highest concentration of credit risk was the hospitality and tourism industry. Management does not consider the current loan concentrations in hospitality and tourism to be problematic, and has no intention of further reducing loans to this industry segment. Management does not believe that its current portfolio composition has increased exposure related to any specific industry concentration as of September 30, 2015. The current concentration of real estate related loans represents a broad customer base composed of a high percentage of owner occupied developments.

Our residential real estate portfolio predominantly includes one to four family adjustable rate mortgages that have repricing terms generally from one to three years, construction loans to individuals and bridge financing loans for qualifying customers. As of September 30, 2015, our residential loan portfolio totaled \$156.764 million, or 25.29% of our total outstanding loans.

Due to the seasonal nature of many of the Corporation's commercial loan customers, loan payment terms provide flexibility by structuring payments to coincide with the customer's business cycle. The lending staff evaluates the collectability of the past due loans based on documented collateral values and payment history. The Corporation discontinues the accrual of interest on loans when, in the opinion of management, there is an indication that the borrower may be unable to meet the payments as they become due. Upon such discontinuance, all unpaid accrued interest is reversed. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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Management analyzes the allowance for loan losses in detail on a monthly basis to determine whether the losses inherent in the portfolio are properly reserved for. Net charge-offs for the nine months ended September 30, 2015 amounted to \$.216 million, compared to net recoveries of \$.057 million, for the same period in 2014. The current reserve balance is representative of the relevant risk inherent within the Corporation's loan portfolio. Additions or reductions to the reserve in future periods will be dependent upon a combination of future loan growth, nonperforming loan balances and charge-off activity.

The table below shows period end balances of nonperforming assets (dollars in thousands):

	September 30, 2015	December 31, 2014	September 30, 2014
Nonperforming Assets:			
Nonaccrual Loans	\$ 7,226	\$ 3,939	\$ 2,098
Loans past due 90 days or more			
Restructured loans	802		597
Total nonperforming loans	8,028	3,939	2,695
Other real estate owned	2,296	3,010	1,843
Total nonperforming assets	\$ 10,324	\$ 6,949	\$ 4,538
Nonperforming loans as a % of loans	1.30%	.66%	.52%
Nonperforming assets as a % of assets	1.37%	.93%	.74%
Reserve for Loan Losses:			
At period end	\$ 5,779	\$ 5,140	\$ 5,279
As a % of loans	.93%	.86%	1.02%
As a % of nonperforming loans	71.99%	130.49%	195.88%
As a % of nonaccrual loans	79.98%	130.49%	251.62%
Texas ratio*	13.41%	9.37%	6.27%

*calculated by taking total nonperforming assets divided by total equity plus reserve for loan losses

Nonperforming assets at \$10.324 million have increased in 2015 by \$3.375 million from the \$6.949 million at 2014 year end. This increase in nonperforming assets is due almost entirely to one large credit, with September 30, 2015 balances of \$4.823 million. This is a local loan relationship, which the bank entered into in 2011 as part of a Chapter 11 bankruptcy reorganization. This relationship was established in conjunction with several other state and federal government lending parties who provided various loan guarantees, in order to preserve a long standing paper mill in our headquarters market and save over 150 jobs. The Corporation's exposure to this credit was analyzed and a specific reserve was established to determine the adequacy of the allowance for loan losses was calculated.

The following ratios provide additional information relative to the Corporation's credit quality (dollars in thousands):

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	September 30, 2015	At Period End December 31, 2014	September 30, 2014
Total loans, at period end	\$ 619,906	\$ 600,935	\$ 518,373
Average loans for the period	\$ 607,284	\$ 509,749	\$ 496,383

	Nine Months Ended September 30, 2015	For the Period Ended Twelve Months Ended December 31, 2014	Nine Months Ended September 30, 2014
Net charge-offs (recoveries) during the period	\$ 216	\$ 721	\$ (57)
Net charge-offs to average loans, annualized	.05%	.14%	N/M%

Management continues to address market issues impacting its loan customer base. In conjunction with the Corporation's senior lending staff and the bank regulatory examinations, management reviews the Corporation's loans, related collateral evaluations, and the overall lending process. The Corporation also utilizes an outside loan consultant to perform a review of the loan portfolio. Historically, this independent review has provided findings similar to management as to the overall adequacy of the loan loss reserve and has substantiated the Corporation's loan rating system. In 2015, the Corporation continues to utilize a consultant for loan review.

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As of September 30, 2015, the allowance for loan losses represented .93% of total loans. At September 30, 2015, the allowance included specific reserves in the amount of \$2.524 million, as compared to specific reserves of \$1.216 million at December 31, 2014 and \$1.615 million at September 30, 2014. In management's opinion, the allowance for loan losses is adequate to cover probable losses related to specifically identified loans, as well as probable losses inherent in the balance of the loan portfolio.

As part of the process of resolving problem credits, the Corporation may acquire ownership of collateral which secured such credits. The Corporation carries this collateral in other real estate on the balance sheet.

The following table represents the activity in other real estate for the periods indicated (dollars in thousands):

	Nine Months Ended September 30 2015	Year Ended December 31, 2014	Nine Months Ended September 30 2014
Balance at beginning of period	\$ 3,010	\$ 1,884	\$ 1,884
Net purchase accounting adjustments	(57)	1,193	\$
Other real estate transferred from loans due to foreclosure	674	588	488
Other real estate sold, net of purch accounting adjustments	(1,190)	(375)	(339)
Writedowns on other real estate held for sale, incl purch acct adj	(135)	(228)	(142)
Loss on sale of other real estate held for sale	(6)	(52)	(48)
Balance at end of period	\$ 2,296	\$ 3,010	\$ 1,843

During the first nine months of 2015, the Corporation received real estate in lieu of loan payments of \$.674 million. Other real estate is initially valued at the lower of cost or the fair value less selling costs. After the initial receipt, management periodically re-evaluates the recorded balances and any additional reductions in the fair value result in a write-down of other real estate.

Deposits

The Corporation had an increase in deposits in the first nine months of 2015. Total deposits increased by \$15.361 million, or 2.53 %, in the first nine months of 2015. The increase in deposits for the first nine months of 2015 is composed of a decrease in noncore deposits of \$3.573 million and an increase in core deposits of \$18.934 million. In recent years, the Corporation has strategically emphasized the growth of core deposits. This strategic initiative is supported with an individual incentive plan, along with the introduction of several new deposit products and competitive deposit pricing. Most recently, we have experienced some declines in core deposits. A portion of these decreases can be attributed to individual customer deposit reductions due to various business related needs. Management also utilizes brokered deposits as a funding source, which provides flexibility in managing interest rate risk for fixed rate longer term loan fundings.

Management continues to monitor existing deposit products in order to stay competitive as to both terms and pricing. It is the intent of management to be aggressive in its markets to grow core deposits with an emphasis placed on transactional deposits.

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The following table represents detail of deposits at the end of the periods indicated (dollars in thousands):

	September 30, 2015	% of Total	December 31, 2014	% of Total	September 30, 2014	% of Total
Noninterest bearing NOW, money market, checking	\$ 114,769	18.44%	\$ 95,498	15.73%	\$ 84,073	17.11%
Savings	213,737	34.34	212,565	35.02	173,793	35.38
Certificates of Deposit <\$100,000	31,742	5.10	28,015	4.62	15,263	3.11
Total core deposits	129,715	20.84	134,951	22.23	130,821	26.63
Certificates of Deposit >\$100,000	489,963	78.72	471,029	77.60	403,950	82.23
Brokered CDs	27,272	4.38	30,316	5.00	24,891	5.07
Total non-core deposits	105,099	16.90	105,628	17.40	62,365	12.70
Total deposits	\$ 622,334	100.00%	\$ 606,973	100.00%	\$ 491,206	100.00%

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Borrowings

The Corporation also utilizes FHLB borrowings as a source of funding. At September 30, 2015, this source of funding totaled \$35 million and the Corporation secured this funding by pledging loans and investments. The \$35 million of FHLB borrowings has a weighted average maturity of 1.85 years and a weighted average rate of 1.68% at September 30, 2015. The Corporation also has a USDA Rural Development loan held by its wholly owned subsidiary, First Rural Relending that has an outstanding balance of \$.704 million, with a fixed interest rate of 1% that matures in August 2024.

In addition to the above, the Corporation currently has two banking borrowing relationships. The first relationship consists of a line of credit and a term note. The line of credit bears interest at 90-day LIBOR plus 2.75%, with a floor rate of 4.00% and has an initial term that expires on December 28, 2017. The term note bears the same interest and matures on March 22, 2017 and requires quarterly principal payments of \$100,000 beginning June 30, 2014. The second borrowing relationship consists of a \$10 million revolving line of credit, which can be increased to \$25 million upon request, used to support asset based lending activities at a wholly-owned subsidiary that currently bears interest at 90-day LIBOR plus 2.75% and has an initial term that expires on September 10, 2016.

Shareholders Equity

Total shareholders equity increased \$2.095 million from December 31, 2014 to September 30, 2015. Contributing to the increase in shareholders equity was net income available to common shareholders of \$4.003 million, a reduction for cash dividends on common stock of \$1.578 million, increases due to stock compensation of \$.432 million, an increase in the market value of securities of \$.029 million and a decrease due to the repurchase of common stock of \$.791 million.

In December 2014, the Corporation consummated the previously announced acquisition of PFC with a combination of cash and the Corporation's common stock. PFC was a bank holding company with The Peninsula Bank as its wholly-owned subsidiary. PFC was headquartered in Ishpeming, Michigan with six branch locations. The purchase price of the acquisition was \$12.420 million with a combination of cash and the Corporation's common stock. The Corporation issued 695,361 shares of its common stock and an increase in shareholder equity of \$7.804 million in recording this transaction, after the reduction for issuance costs of \$.130 million. The Corporation recorded assets with a fair value of \$112.766 million, including loans of \$67.139 million, as well as \$100.950 million of deposits.

RESULTS OF OPERATIONS

Summary

The Corporation reported net income available to common shareholders of \$4.003 million, or \$.64 per share, in the first nine months of 2015, compared to \$2.352 million or \$.43 per share for the first nine months of 2014. The year to date results include a provision for loan losses of \$.855 million. Operating results for the same period in 2014 include a provision for loan losses of \$.561 million.

Net Interest Income

Net interest income is the Corporation's primary source of core earnings. Net interest income represents the difference between the average yield earned on interest earning assets and the average rate paid on interest bearing obligations. The net interest income is impacted by economic and competitive factors that influence rates, loan demand, and the availability of funding.

Net interest margin on a fully taxable equivalent basis amounted to \$7.255 million, 4.19% of average earning assets, in the third quarter of 2015, compared to \$5.896 million, and 4.19% of average earning assets, in the third quarter of 2014. In the first nine months of 2015, net interest margin increased to \$21.827 million, 4.31% of average earning assets, compared to \$17.173 million, 4.21% of average earning assets, for the same period in 2014.

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The following table presents the amount of interest income from average interest-earning assets and the yields earned on those assets, as well as the interest expense on average interest-bearing obligations and the rates paid on those obligations. All average balances are daily average balances.

(dollars in thousands)	Three Months Ended								2015-2014			
	Average Balances			Average Rates		Interest		Income/	Volume		Rate/	
	September 30, 2015	September 30, 2014	Increase/ (Decrease)	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014	Expense Variance	Variance	Variance	Variance	
Loans (1,2,3)	\$ 614,315	\$ 509,618	\$ 104,697	5.18%	5.18%	\$ 8,027	\$ 6,657	\$ 1,370	\$ 1,368	\$ 2	\$	
Taxable securities	49,578	43,933	5,645	2.26	2.08	282	230	52	30	20	2	
Nontaxable securities (2)	9,888	1,821	8,067	1.97	4.58	49	21	28	93	(12)	(53)	
Federal funds sold	5,219	2	5,217	.08		1		1			1	
Other interest-earning assets	7,423	3,295	4,128	2.46	4.09	46	34	12	43	(14)	(17)	
Total earning assets	686,423	558,669	127,754	4.86	4.93	8,405	6,942	1,463	1,534	(4)	(67)	
Reserve for loan losses	(5,565)	(5,254)	(311)									
Cash and due from banks	31,319	28,900	2,419									
Fixed Assets	12,703	9,687	3,016									
Other Real Estate	2,342	1,839	503									
Other assets	23,931	13,999	9,932									
Total assets	\$ 751,153	\$ 607,840	\$ 143,313									
NOW and money market deposits	\$ 158,155	\$ 112,236	\$ 45,919	.32%	.34%	\$ 127	\$ 95	\$ 32	\$ 39	\$ (5)	\$ (2)	
Interest checking	52,706	48,292	4,414	.18	.22	24	27	(3)	2	(5)		
Savings deposits	30,688	15,309	15,379	.10	.10	8	4	4	4			
CDs <\$100,000	133,671	139,471	(5,800)	1.02	1.17	344	413	(69)	(17)	(54)	2	
CDs >\$100,000	28,075	24,177	3,898	1.07	1.23	76	75	1	12	(10)	(1)	
Brokered deposits	107,951	71,335	36,616	0.97	1.10	264	198	66	102	(24)	(12)	
Borrowings	50,458	44,296	6,162	2.41	2.10	307	234	73	33	36	4	
Total interest-bearing liabilities	561,704	455,116	106,588	.81	.91	1,150	1,046	104	175	(62)	(9)	
Demand deposits	113,282	83,779	29,503									
Other liabilities	(195)	2,387	(2,582)									
Shareholders equity	76,362	66,558	9,804									
Total liabilities and shareholders equity	\$ 751,153	\$ 607,840	\$ 143,313									
Rate spread				4.05%	4.02%							
Net interest margin/revenue				4.19%	4.19%	\$ 7,255	\$ 5,896	\$ 1,359	\$ 1,359	\$ 58	\$ (58)	

(1) For purposes of these computations, nonaccruing loans are included in the daily average loan amounts outstanding.

(2) The amount of interest income on loans and nontaxable securities has been adjusted to a tax equivalent basis, using a 34% tax rate

(3) Interest income on loans includes fees

(dollars in thousands)	Nine Months Ended								2015-2014			
	Average Balances			Average Rates		Interest		Income/	Volume		Rate/	
	September 30, 2015	September 30, 2014	Increase/ (Decrease)	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014	Expense Variance	Variance	Variance	Variance	
Loans (1,2,3)	\$ 607,284	\$ 496,383	\$ 110,901	5.28%	5.21%	\$ 23,999	\$ 19,346	\$ 4,653	\$ 4,322	\$ 270	\$ 61	
Taxable securities	50,468	44,238	6,230	2.24	2.15	845	711	134	100	30	4	

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Nontaxable securities (2)	10,224	1,719	8,505	2.58	4.82	197	62	135	307	(29)	(143)
Federal funds sold	1,761	2	1,759	.08		1		1			1
Other interest-earning assets	8,019	3,176	4,843	2.45	4.80	147	114	33	174	(56)	(85)
Total earning assets	677,756	545,518	132,238	4.97	4.96	25,189	20,233	4,956	4,903	215	(162)
Reserve for loan losses	(5,419)	(5,024)	(395)								
Cash and due from banks	25,675	23,025	2,650								
Fixed Assets	12,684	9,907	2,777								
Other Real Estate	2,505	2,002	503								
Other assets	27,392	14,573	12,819								
Total assets	\$ 740,593	\$ 590,001	\$ 150,592								
NOW and money market deposits	\$ 158,082	\$ 108,476	\$ 49,606	.30%	.26%	\$ 357	\$ 209	\$ 148	\$ 96	\$ 36	\$ 16
Interest checking	52,208	42,946	9,262	.19	.22	73	71	2	15	(11)	(2)
Savings deposits	29,637	14,683	14,954	.10	.10	22	11	11	11		
CDs <\$100,000	131,796	145,385	(13,589)	1.04	1.20	1,029	1,306	(277)	(122)	(171)	16
CDs >\$100,000	28,878	23,540	5,338	1.07	1.29	231	228	3	52	(40)	(9)
Brokered deposits	101,395	70,571	30,824	1.00	1.16	755	610	145	266	(85)	(38)
Borrowings	53,223	42,069	11,154	23.25	1.99	895	625	270	166	82	24
Total interest-bearing liabilities	555,219	447,670	107,549	.81	.91	3,362	3,060	302	484	(189)	7
Demand deposits	104,815	73,898	30,917								
Other liabilities	5,123	2,571	2,552								
Shareholders equity	75,436	65,862	9,574								
Total liabilities and shareholders equity	\$ 740,593	\$ 590,001	\$ 150,592								
Rate spread				4.16%	4.05%						
Net interest margin/revenue				4.31%	4.21%	\$ 21,827	\$ 17,173	\$ 4,654	\$ 4,419	\$ 404	\$ (169)

- (1) For purposes of these computations, nonaccruing loans are included in the daily average loan amounts outstanding.
- (2) The amount of interest income on loans and nontaxable securities has been adjusted to a tax equivalent basis, using a 34% tax rate
- (3) Interest income on loans includes fees

In the past several years of a low interest rate environment, the Corporation repriced all of its brokered deposits along with the majority of its bank time deposits. This repricing of liabilities is the primary reason for the increased interest margin, on a fully taxable equivalent basis in recent reported periods.

During this relatively low interest environment, the Corporation has also repriced a significant portion of its loan portfolio. Management has been diligent when repricing maturing or new loans in establishing interest rate floors in order to maintain our improved interest rate spread. The Corporation is anticipating some margin pressure in future periods as we continue to see extremely competitive pricing on new and renewable loans.

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The Corporation records a provision for loan losses when it believes it is necessary to adjust the allowance for loan losses to maintain an adequate level after considering factors such as loan charge-offs and recoveries, changes in identified levels of risk in the loan portfolio, changes in the mix of loans in the portfolio, loan growth, and other economic factors. During the first nine months of 2015, the Corporation determined through this analysis that a \$.855 million provision for loan loss was required, compared to \$.561 million in the first nine months of 2014. There were net charge-offs of \$.216 million in the first nine months of 2015, compared to recoveries of \$.057 million for the same period in 2014.

Other Income

Other income, at \$2.747 million in the first nine months of 2015, increased \$.638 million from the \$2.109 million in the same period in 2014. Included in other income were net security gains of \$.402 million, as well as increased income from secondary market loans sold and deposit service fees.

Management continues to evaluate deposit products and services for ways to better serve its customer base and also enhance service fee income through a broad array of products that price services based on income contribution and cost attributes.

The following table details other income for the three and nine months ended September 30, 2015 and 2014 (dollars in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2015	2014	Increase/(Decrease)		2015	2014	Increase/(Decrease)	
			Dollars	Percent			Dollars	Percent
Deposit service fees	\$ 196	\$ 168	\$ 28	16.67%	\$ 624	\$ 517	\$ 107	20.70%
Income from loans sold in the secondary market	301	212	89	41.98	750	455	295	64.84
SBA/USDA loan sale gains	40		40	100.00	440	548	(108)	(19.71)
Mortgage servicing income	9	313	(304)	(97.12)	239	415	(176)	(42.41)
Net security gains	133		133	N/A	402		402	N/A
Other noninterest income	94	75	19	25.33	292	174	118	67.82
Total other income	\$ 773	\$ 768	\$ 5	0.65%	\$ 2,747	\$ 2,109	\$ 638	30.25%

Other Expense

For the first nine months of 2015, the Corporation recorded other expenses of \$17.570 million, compared to \$15.131 million in 2014, an increase of \$2.439 million. The 2015 increase from the first nine months of 2014 was largely attributable to the PFC acquisition in December 2014 in terms of salaries and benefits, occupancy expense of acquired branch offices and some early 2015 data processing costs prior to conversion. We

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remain diligent in monitoring and controlling our overall expense base, which continues to reside at below peer levels.

The following table details other expense for the three and nine months ended September 30, 2015 and 2014 (dollars in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2015	2014	Increase/(Decrease) Dollars	Percentage	2015	2014	Increase/(Decrease) Dollars	Percentage
Salaries and employee benefits	\$ 3,139	\$ 2,481	\$ 658	26.52%	\$ 9,102	\$ 7,545	\$ 1,557	20.64%
Occupancy	602	511	91	17.81	1,804	1,595	209	13.10
Furniture and equipment	370	305	65	21.31	1,159	927	232	25.03
Data processing	327	288	39	13.54	1,041	862	179	20.77
Advertising	153	114	39	34.21	399	344	55	15.99
Professional service fees	348	276	72	26.09	928	883	45	5.10
Loan and deposit	136	144	(8)	(5.56)	399	306	93	30.39
Writedowns and losses on other real estate held for sale	104	176	(72)	(40.91)	141	190	(49)	(25.79)
FDIC insurance premiums	135	92	43	46.74	383	267	116	43.45
Telephone	108	84	24	28.57	346	248	98	39.52
Other	692	655	37	5.65	1,868	1,964	(96)	(4.89)
Total other expense	\$ 6,114	\$ 5,126	\$ 988	19.27%	\$ 17,570	\$ 15,131	\$ 2,439	16.12%

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Federal Income Taxes

The Corporation recorded a deferred tax expense for the nine months ended September 30, 2015 of \$2.074 million, compared to \$1.203 million a year earlier.

The Corporation has reported deferred tax assets of \$9.326 million at September 30, 2015, which is net of a valuation allowance of \$.760 million. Management evaluated the deferred tax valuation allowance as of September 30, 2015 and determined that no adjustment to the valuation was warranted. The remaining valuation allowance pertains to the existing tax credit carryovers, which will only be utilized after all net operating loss carryforwards. Since a portion of these tax credits may expire before that occurs, a valuation allowance has been established. The Corporation will continue to evaluate the future benefits from these carryforwards in order to determine if any adjustment to the deferred tax asset is warranted.

A valuation allowance is provided against deferred tax assets when it is more likely than not that some or all of the deferred tax asset will not be realized. The net operating loss carryforwards expire twenty years from the date they originated. These carryforwards, if not utilized, will begin to expire in the year 2023. A portion of the NOL and all of the credit carryforwards are subject to the limitations for utilization as set forth in Section 382 of the Internal Revenue Code. The annual limitation is \$1.400 million for the NOL and the equivalent value of tax credits, which is approximately \$.476 million. These limitations for use were established in conjunction with the recapitalization of the Corporation in December 2004.

LIQUIDITY

Liquidity is defined as the ability to generate cash at a reasonable cost to fulfill lending commitments and support asset growth, while satisfying the withdrawal demands of customers and make payments on existing borrowing commitments. The Bank's principal sources of liquidity are core deposits and loan and investment payments and prepayments. Providing a secondary source of liquidity is the available for sale investment portfolio. As a final source of liquidity, the Bank can exercise existing credit arrangements.

Current balance sheet liquidity consists of \$28.581 million in cash and due from balances, \$10.000 million in fed funds sold, and \$49.472 million of unpledged investment securities. Although current liquidity is deemed adequate, management will increase on hand liquidity in the near term by acquiring brokered CDs in order to fund anticipated loan growth.

During the first nine months of 2015, the Corporation increased cash and cash equivalents by \$16.634 million. As shown on the Corporation's condensed consolidated statement of cash flows, liquidity was impacted by cash used in investing activities, with a net increase in loans of \$19.185 million. Offsetting the net decrease used by investing activities was cash provided by financing activities, primarily a net increase in deposits of \$15.361 million. The management of bank liquidity for funding of loans and deposit maturities and withdrawals includes monitoring projected loan fundings and scheduled prepayments and deposit maturities within a 30 day period, a 30- to 90- day period and from 90 days until the end of the year. This funding forecast model is completed weekly.

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The Corporation's primary source of liquidity on a stand-alone basis is dividends from the Bank. The Corporation also has a line of credit with a correspondent bank with current availability of \$.750 million. The Corporation's current plan for dividends from the Bank are dependent upon the profitability of the Bank, growth of assets at the Bank and the level of capital needed to stay well capitalized.

Liquidity is managed by the Corporation through its Asset and Liability Committee (ALCO). The ALCO Committee meets monthly to discuss asset and liability management in order to address liquidity and funding needs to provide a process to seek the best alternatives for investments of assets, funding costs, and risk management. The liquidity position of the Bank is managed daily, thus enabling the Bank to adapt its position according to market fluctuations. Core deposits are important in maintaining a strong liquidity position as they represent a stable and relatively low cost source of funds. The Bank's liquidity is best illustrated by the mix in the Bank's core and noncore funding dependence ratio, which explains the degree of reliance on noncore liabilities to fund long-term assets.

Core deposits are herein defined as demand deposits, NOW (negotiable order withdrawals), money markets, savings and certificates of deposit under \$100,000. Noncore funding consists of certificates of deposit greater than \$100,000, brokered deposits, and FHLB and Farmers Home Administration borrowings. At September 30, 2015, the Bank's core deposits in relation to total funding were 72.92% compared to 74.31% at September 30, 2014. These ratios

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indicate that at September 30, 2015, that the Bank had slightly increased its reliance on noncore deposits and borrowings to fund the Bank's long-term assets, namely loans and investments. The Bank believes that by maintaining adequate volumes of short-term investments and implementing competitive pricing strategies on deposits, it can ensure adequate liquidity to support future growth. The Bank also has correspondent lines of credit available to meet unanticipated short-term liquidity needs. As of September 30, 2015, the Bank had \$28.375 million of unsecured lines available and additional funding sources available if secured. The bank believes that its liquidity position remains strong to meet both present and future financial obligations and commitments, events or uncertainties that have resulted or are reasonably likely to result in material changes with respect to the Bank's liquidity.

From a long-term perspective, the Corporation's strategy is to increase core deposits in the Corporation's local markets. Management continually evaluates deposit products offered in order to remain competitive in its goal of increasing core deposits. The Corporation also has the ability to augment local deposit growth efforts with wholesale CD funding.

CAPITAL AND REGULATORY

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

Quantitative measures established by regulation to ensure capital adequacy require the Corporation to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. Management has determined that, as of September 30, 2015, the Corporation is well capitalized.

Effective January 1, 2015, the Corporation was subject to new capital requirements due to the Basel III regulation, including:

- A new minimum ratio of Common Equity Tier I Capital to risk-weighted assets of 4.5%;
- An increase in the minimum required amount of Additional Tier 1 Capital to 6% of risk-weighted assets;
- A continuation of the current minimum required amount of Total Capital (Tier 1 plus Tier 2) of 8% of risk-weighted assets; and
- A minimum leverage ratio of Tier I Capital to total assets equal to 4% in all circumstances.

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In order to be well-capitalized under the new guidelines, a depository institution must maintain a Common Equity Tier 1 Capital ratio of 6.5% or more; an Additional Tier 1 Capital ratio of 8% or more; a Total Capital ratio of 10% or more; and a leverage ratio of 5% or more.

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The Corporation's and the Bank's actual capital and ratios compared to generally applicable regulatory requirements as of September 30, 2015 are as follows (dollars in thousands):

	Actual Amount	Ratio		Adequacy Purposes Amount	Ratio		Well-Capitalized Amount	Ratio
Total capital to risk weighted assets:								
Consolidated	\$ 72,580	11.2%	≥	\$ 51,965	≥ 8.0%	≥	\$ 64,957	≥ 10.0%
mBank	\$ 78,411	12.2%	≥	\$ 51,296	≥ 8.0%	≥	\$ 64,120	≥ 10.0%
Tier 1 capital to risk weighted assets:								
Consolidated	\$ 66,801	10.3%	≥	\$ 38,974	≥ 6.0%	≥	\$ 51,965	≥ 8.0%
mBank	\$ 72,805	11.4%	≥	\$ 38,472	≥ 6.0%	≥	\$ 51,296	≥ 8.0%
Common equity Tier 1 capital to risk weighted assets:								
Consolidated	\$ 66,801	10.3%	≥	\$ 29,231	≥ 4.5%	≥	\$ 42,222	≥ 6.5%
mBank	\$ 72,805	11.4%	≥	\$ 28,854	≥ 4.5%	≥	\$ 41,678	≥ 6.5%
Tier 1 capital to average assets:								
Consolidated	\$ 66,801	9.0%	≥	\$ 29,660	≥ 4.0%	≥	\$ 37,075	≥ 5.0%
mBank	\$ 72,805	9.9%	≥	\$ 29,355	≥ 4.0%	≥	\$ 36,693	≥ 5.0%

Regulatory capital is not the same as shareholders' equity reported in the accompanying condensed consolidated financial statements. Certain assets cannot be considered assets for regulatory purposes, such as acquisition intangibles and noncurrent deferred tax benefits.

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MACKINAC FINANCIAL CORPORATION

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK

In general, the Corporation attempts to manage interest rate risk by investing in a variety of assets which afford it an opportunity to reprice assets and increase interest income at a rate equal to or greater than the interest expense associated with repricing liabilities.

Interest rate risk is the exposure of the Corporation to adverse movements in interest rates. The Corporation derives its income primarily from the excess of interest collected on its interest-earning assets over the interest paid on its interest-bearing obligations. The rates of interest the Corporation earns on its assets and owes on its obligations generally are established contractually for a period of time. Since market interest rates change over time, the Corporation is exposed to lower profitability if it cannot adapt to interest rate changes. Accepting interest rate risk can be an important source of profitability and shareholder value; however, excess levels of interest rate risk could pose a significant threat to the Corporation's earnings and capital base. Accordingly, effective risk management that maintains interest rate risk at prudent levels is essential to the Corporation's safety and soundness.

Loans are the most significant earning asset. Management offers commercial and real estate loans priced at interest rates which fluctuate with various indices such as the prime rate or rates paid on various government issued securities. In addition, the Corporation prices the majority of fixed rate loans so it has an opportunity to reprice the loan within 12 to 36 months.

As of September 30, 2015, the Corporation has established interest rate floors on approximately \$144.691 million of its variable rate commercial loans. These interest rate floors will result in a lag on the repricing of these variable rate loans when and if interest rates increase in future periods. Approximately \$114.105 million of the floor rate loan balances will reprice with a 100 basis point increase on the prime rate, with another \$29.619 million repricing in the next 100 basis point prime rate increase.

The Corporation also has \$54.432 million of securities providing for scheduled monthly principal and interest payments as well as unanticipated prepayments of principal as of September 30, 2015. These cash flows are then reinvested into other earning assets at current market rates. The Corporation also has federal funds sold to correspondent banks as well as other interest-bearing deposits with correspondent banks. These funds are generally repriced on a daily basis.

As of September 30, 2015, the Corporation has \$360.248 million of transactional accounts, of which \$114.769 million consists of noninterest bearing demand deposit balances. Transaction account balances have increased significantly in the last year due in part to the Corporation's focus on these low costs accounts by developing new attractive products and increased sales efforts to municipalities, schools and businesses. These transactional account balances provide additional repricing flexibility in changing interest rate environments since they have no scheduled maturities and interest rates can be reset at any time.

Other deposit products have a variety of terms ranging from deposits whose interest rates can change on a weekly basis to certificates of deposit with repricing terms of up to five years. Longer term deposits generally include penalty provisions for early withdrawal.

Beyond general efforts to shorten the loan pricing periods and extend deposit maturities, management can manage interest rate risk by managing the maturity periods of securities purchased, selling securities available for sale, and borrowing funds with targeted maturity periods, among other strategies. Also, the rate of interest rate changes can impact the actions taken since the rate environment affects borrowers and depositors differently.

Exposure to interest rate risk is reviewed on a regular basis. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect of interest rate changes on net interest income and to structure the composition of the balance sheet to minimize interest rate risk and at the same time maximize income. Management realizes certain risks are inherent and that the goal is to identify and minimize the risks. Tools used by management include maturity and repricing analysis and interest rate sensitivity analysis. The Bank has monthly asset/liability meetings with an outside consultant to review its current position and strategize about future opportunities on risks relative to pricing and positioning of assets and liabilities.

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The difference between repricing assets and liabilities for a specific period is referred to as the gap. An excess of repricable assets over liabilities is referred to as a positive gap. An excess of repricable liabilities over assets is referred to as a negative gap. The cumulative gap is the summation of the gap for all periods to the end of the period for which the cumulative gap is being measured.

Assets and liabilities scheduled to reprice are reported in the following time frames. Those instruments with a variable interest rate tied to an index and considered immediately repricable are reported in the 1- to 90-day time frame. The estimates of principal amortization and prepayments are assigned to the following time frames.

The following is the Corporation's repricing opportunities at September 30, 2015 (dollars in thousands):

	1-90 Days	91 - 365 Days	>1-5 Years	Over 5 Years	Total
Interest-earning assets:					
Loans	\$ 238,359	\$ 146,142	\$ 233,039	\$ 2,366	\$ 619,906
Securities	8,462	1,881	36,439	7,650	54,432
Other (1)	12,954	1,171	3,133		17,258
Total interest-earning assets	259,775	149,194	272,611	10,016	691,596
Interest-bearing obligations:					
NOW, money market, savings, interest checking	245,479				245,479
Time deposits	41,277	77,605	37,993	112	156,987
Brokered CDs	26,416	35,539	43,144		105,099
Borrowings	100	10,300	38,868	325	49,593
Total interest-bearing obligations	313,272	123,444	120,005	437	557,158
Gap	\$ (53,497)	\$ 25,750	\$ 152,606	\$ 9,579	\$ 134,438
Cumulative gap	\$ (53,497)	\$ (27,747)	\$ 124,859	\$ 134,438	

(1) Includes Federal Home Loan Bank Stock

The above analysis indicates that at September 30, 2015, the Corporation had a cumulative liability sensitivity gap position of \$27.747 million within the one-year time frame. The Corporation's cumulative liability sensitive gap suggests that if market interest rates were to increase in the next twelve months, the Corporation has the potential to earn less net interest income. This is because more liabilities would reprice at higher rates than assets. Conversely, if market interest rates decrease in the next twelve months, the above gap position suggests the Corporation's net interest income would increase. A limitation of the traditional gap analysis is that it does not consider the timing or magnitude of non-contractual repricing or expected prepayments. In addition, the gap analysis treats savings, NOW, and money market accounts as repricing within 90 days, while experience suggests that these categories of deposits are actually comparatively resistant to rate sensitivity.

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At December 31, 2014, the Corporation had a cumulative liability sensitivity gap position of \$8.027 million within the one-year time frame.

The borrowings in the gap analysis include \$35.000 million of FHLB advances that have a weighted average maturity of 1.85 years and a weighted average rate of 1.68%.

The Corporation's primary market risk exposure is interest rate risk and, to a lesser extent, liquidity risk and foreign exchange risk. The Corporation has no market risk sensitive instruments held for trading purposes. The Corporation has limited agricultural-related loan assets and therefore has minimal significant exposure to changes in commodity prices. Any impact that changes in foreign exchange rates and commodity prices would have on interest rates are assumed to be insignificant.

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Evaluating the exposure to changes in interest rates includes assessing both the adequacy of the process used to control interest rate risk and the quantitative level of exposure. The Corporation's interest rate risk management process seeks to ensure that appropriate policies, procedures, management information systems, and internal controls are in place to maintain interest rate risk at prudent levels with consistency and continuity. In evaluating the quantitative level of interest rate risk, the Corporation assesses the existing and potential future effects of changes in interest rates on its financial condition, including capital adequacy, earnings, liquidity, and asset quality.

In addition to changes in interest rates, the level of future net interest income is also dependent on a number of variables, including: the growth, composition and levels of loans, deposits, and other earning assets and interest-bearing obligations, and economic and competitive conditions; potential changes in lending, investing, and deposit strategies; customer preferences; and other factors.

FOREIGN EXCHANGE RISK

In addition to managing interest rate risk, management also actively manages risk associated with foreign exchange. The Corporation provides foreign exchange services, makes loans to, and accepts deposits from, Canadian customers primarily at its banking offices in Sault Ste. Marie, Michigan. To protect against foreign exchange risk, the Corporation monitors the volume of Canadian deposits it takes in and then invests these Canadian funds in Canadian commercial loans and securities. Management believes the exposure to short-term foreign exchange risk is minimal and at an acceptable level for the Corporation.

OFF-BALANCE-SHEET RISK

Derivative financial instruments include futures, forwards, interest rate swaps, option contracts and other financial instruments with similar characteristics. The Corporation currently does not enter into futures, forwards, swaps, or options. However, the Corporation is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit and involve to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the condensed consolidated balance sheets. 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 and may require collateral from the borrower if deemed necessary by the Corporation. Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party up to a stipulated amount and with specified terms and conditions.

Commitments to extend credit and standby letters of credit are not recorded as an asset or liability by the Corporation until the instrument is exercised.

IMPACT OF INFLATION AND CHANGING PRICES

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and results of operations in historical dollars without considering the change in

the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of the Corporation's operations. Nearly all the assets and liabilities of the Corporation are financial, unlike industrial or commercial companies. As a result, the Corporation's performance is directly impacted by changes in interest rates, which are indirectly influenced by inflationary expectations. The Corporation's ability to match the interest sensitivity of its financial assets to the interest sensitivity of its financial liabilities tends to minimize the effect of changes in interest rates on the Corporation's performance. Changes in interest rates do not necessarily move to the same extent as changes in the price of goods and services.

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ITEM 4 CONTROLS AND PROCEDURES

As of September 30, 2015, we carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934. Our management, which includes our principal executive officer and our principal financial officer, does not expect that our disclosure controls and procedures will prevent all errors and all fraud.

A control system, no matter how well conceived and operated, can provide only reasonable, but not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints; additionally, the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Corporation have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is also based, in part, upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate due to changes in conditions; also the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Our principal executive officer and principal accounting officer have concluded, based on our evaluation of our disclosure controls and procedures, that our disclosure controls and procedures, as defined, under Rule 13a-15 of the Securities Exchange Act of 1934 are effective as of September 30, 2015.

Changes in Internal Control Over Financial Reporting

There were no changes in the Corporation's internal control over financial reporting that occurred during the quarter ended September 30, 2015 that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

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MACKINAC FINANCIAL CORPORATION

PART II. OTHER INFORMATION**Item 1. Legal Proceedings**

The Corporation and its subsidiaries are subject to routine litigation incidental to the business of banking.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The Corporation currently has a share repurchase program. The program is conducted under authorizations from time to time by the Board of Directors. The shares reported in the table below are covered by Board authorizations made and publically announced for \$600,000 on February 27, 2013, an additional \$600,000 on December 17, 2013 and an additional \$750,000 on April 28, 2015. None of these authorizations has an expiration date.

Issuer purchase of Equity Securities

Period of purchases	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of a publically announced plan or program	Maximum dollars yet to be used for stock purchases
July 1, 2015 to July 31, 2015	7,000	\$ 10.82	7,000	\$ 715,226
August 1, 2015 to August 31, 2015	9,280	\$ 10.75	9,280	615,504
September 1, 2015 to September 30, 2015	10,500	\$ 10.45	10,500	505,741
Total Third Quarter 2015	26,780	\$ 10.65	26,780	

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

- | | |
|--------------|--|
| Exhibit 31.1 | Rule 13a-14(a) Certification of Chief Executive Officer. |
| Exhibit 31.2 | Rule 13a-14(a) Certification of Chief Financial Officer. |

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Exhibit 32.1	Section 1350 Certification of Chief Executive Officer.
Exhibit 32.2	Section 1350 Certification of Chief Financial Officer.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

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SIGNATURES

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, thereunto duly authorized.

MACKINAC FINANCIAL CORPORATION
(Registrant)

Date: November 13, 2015

By: /s/ Paul D. Tobias
PAUL D. TOBIAS,
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
(principal executive officer)

By: /s/ Ernie R. Krueger
ERNIE R. KRUEGER
EVP/CHIEF FINANCIAL OFFICER
(principal financial and accounting officer)