

MACKINAC FINANCIAL CORP /MI/

Form 10-Q

November 15, 2010

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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, 2010**

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)

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
(Do not check if a 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 October 31, 2010, there were outstanding 3,419,736 shares of the registrant's common stock, no par value.

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ITEM 1. FINANCIAL STATEMENTS
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands)

	September 30, 2010 (Unaudited)	December 31, 2009	September 30, 2009 (Unaudited)
ASSETS			
Cash and due from banks	\$ 36,561	\$ 18,433	\$ 23,249
Federal funds sold	12,000	27,000	
Cash and cash equivalents	48,561	45,433	23,249
Interest-bearing deposits in other financial institutions	692	678	662
Securities available for sale	37,450	46,513	80,203
Federal Home Loan Bank stock	3,794	3,794	3,794
Loans:			
Commercial	295,262	305,670	306,590
Mortgage	82,312	74,350	73,116
Consumer	5,153	4,290	4,394
Total Loans	382,727	384,310	384,100
Allowance for loan losses	(5,437)	(5,225)	(4,081)
Net loans	377,290	379,085	380,019
Premises and equipment	9,843	10,165	10,281
Other real estate held for sale	5,758	5,804	5,821
Other assets	15,618	23,905	9,151
TOTAL ASSETS	\$ 499,006	\$ 515,377	\$ 513,180
LIABILITIES AND SHAREHOLDERS EQUITY			
LIABILITIES:			
Deposits:			
Noninterest bearing deposits	\$ 44,402	\$ 35,878	\$ 33,254
NOW, money market, checking	127,828	95,790	88,843
Savings	20,265	18,207	18,807
CDs<\$100,000	94,560	59,953	59,637
CDs>\$100,000	22,809	36,385	25,409
Brokered	94,660	175,176	192,631

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Total deposits	404,524	421,389	418,581
Borrowings:			
Federal Home Loan Bank	35,000	35,000	35,000
Other	1,069	1,140	1,140
Total borrowings	36,069	36,140	36,140
Other liabilities	2,426	2,549	2,693
Total liabilities	443,019	460,078	457,414
SHAREHOLDERS EQUITY:			
Preferred stock No par value:			
Authorized 500,000 shares, 11,000 shares issued and outstanding			
	10,658	10,514	10,466
Common stock and additional paid in capital No par value			
Authorized 18,000,000 shares			
Issued and outstanding 3,419,736 shares	43,517	43,493	43,485
Retained earnings	1,131	199	378
Accumulated other comprehensive income	681	1,093	1,437
Total shareholders equity	55,987	55,299	55,766
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 499,006	\$ 515,377	\$ 513,180

See accompanying notes to condensed consolidated financial statements.

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MACKINAC FINANCIAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in Thousands, Except per Share Data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
	(Unaudited)		(Unaudited)	
INTEREST INCOME:				
Interest and fees on loans:				
Taxable	\$ 5,300	\$ 5,106	\$ 15,718	\$ 15,212
Tax-exempt	46	63	145	237
Interest on securities:				
Taxable	324	888	1,077	2,020
Tax-exempt	7	7	21	11
Other interest income	23	28	100	44
Total interest income	5,700	6,092	17,061	17,524
INTEREST EXPENSE:				
Deposits	1,414	1,550	4,309	4,894
Borrowings	222	232	643	774
Total interest expense	1,636	1,782	4,952	5,668
Net interest income	4,064	4,310	12,109	11,856
Provision for loan losses	1,000	700	4,700	1,400
Net interest income after provision for loan losses	3,064	3,610	7,409	10,456
OTHER INCOME:				
Service fees	264	235	737	750
Net security gains	(1)	644	215	644
Net gains on sale of loans	322	247	897	389
Other	63	1,292	199	1,465
Total other income	648	2,418	2,048	3,248
OTHER EXPENSE:				
Salaries and employee benefits	1,779	1,603	5,281	4,761
Occupancy	358	336	1,048	1,069
Furniture and equipment	202	193	594	604
Data processing	193	221	587	665
Professional service fees	168	161	502	458
Loan and deposit	218	162	683	470

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Writedown of other real estate owned	1	36	1,948	36
FDIC insurance assessment	222	203	665	668
Telephone	53	50	145	139
Advertising	77	80	220	238
Other	330	398	887	1,044
Total other expense	3,601	3,443	12,560	10,152
Income (loss) before provision for income taxes	111	2,585	(3,103)	3,552
Provision for (benefit of) income taxes	30	864	(4,593)	1,142
NET INCOME (LOSS)	81	1,721	1,490	2,410
Preferred dividend and accretion of discount	185	185	556	323
NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS	\$ (104)	\$ 1,536	\$ 934	\$ 2,087
INCOME (LOSS) PER COMMON SHARE:				
Basic	\$ (.03)	\$.45	\$.27	\$.61
Diluted	\$ (.03)	\$.45	\$.27	\$.61

See accompanying notes to condensed consolidated financial statements.

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MACKINAC FINANCIAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Dollars in Thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Balance, beginning of period	\$ 56,231	\$ 53,939	\$ 55,299	\$ 41,551
Net income (loss) for period	81	1,721	1,490	2,410
Net unrealized gain (loss) on securities available for sale	(195)	226	(412)	992
Total comprehensive income (loss)	(114)	1,947	1,078	3,402
Dividend on preferred stock	(185)	(185)	(556)	(323)
Stock option compensation	7	17	22	52
Issuance of preferred stock				10,382
Issuance of common stock warrants				618
Accretion of preferred stock discount	48	48	144	84
Balance, end of period	\$ 55,987	\$ 55,766	\$ 55,987	\$ 55,766

See accompanying notes to condensed consolidated financial statements.

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MACKINAC FINANCIAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2010	2009
Cash Flows From Operating Activities:		
Net income	\$ 1,490	\$ 2,410
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,238	1,494
Provision for (benefit of) deferred taxes	(4,593)	1,052
Provision for loan losses	4,700	1,400
(Gain) on sales/calls of securities available for sale	(215)	(644)
Loss on sales of premises, equipment, and other real estate	51	17
Writedown of other real estate	1,948	36
Stock option compensation	22	52
Change in other assets	13,092	(686)
Change in other liabilities	(123)	121
Net cash provided by operating activities	17,610	5,252
Cash Flows From Investing Activities:		
Net (increase) decrease in loans	(7,509)	(19,212)
Net (increase) decrease in interest-bearing deposits in other financial institutions	(14)	(80)
Purchase of securities available for sale	(5,000)	(50,113)
Proceeds from sales, maturities or calls of securities available for sale	13,372	18,976
Capital expenditures	(502)	(540)
Proceeds from sale of premises, equipment, and other real estate	2,663	81
Net cash paid in connection with branch sales		(28,578)
Net cash provided by (used in) investing activities	3,010	(79,466)
Cash Flows From Financing Activities:		
Net increase (decrease) in deposits	(16,865)	76,744
Issuance of Preferred Stock Series A Capital		11,000
Dividend on preferred stock and accretion of discount	(556)	(323)
Principal payments on borrowings	(71)	(70)
Net cash provided by (used in) financing activities	(17,492)	87,351
Net increase in cash and cash equivalents	3,128	13,137
Cash and cash equivalents at beginning of period	45,433	10,112

Cash and cash equivalents at end of period	\$ 48,561	\$ 23,249
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Supplemental Cash Flow Information:

Cash paid during the period for:

Interest	\$ 4,988	\$ 5,836
Income taxes	25	90

Noncash Investing and Financing Activities:

Transfers of foreclosures from loans to other real estate held for sale (net of adjustments made through the allowance for loan losses)	4,604	4,205
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See accompanying notes to condensed consolidated financial statements.

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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, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. 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, 2009.

The preparation of financial statements in conformity with generally accepted accounting principles 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 period. Actual results could differ from those estimates.

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, and the valuation of deferred tax assets and mortgage servicing rights.

Allowance for Loan Losses

The allowance for loan losses includes specific allowances related to commercial loans, which 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 also has 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 probable 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 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.

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MACKINAC FINANCIAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Stock Option Plans**

The Corporation sponsors three stock option plans. One plan was approved during 2000 and applies to officers, employees, and nonemployee directors. This plan was amended as a part of the December 2004 stock offering and recapitalization. The amendment, approved by shareholders, increased the shares available under this plan by 428,587 shares from the original 25,000 (adjusted for the 1:20 reverse stock split), to a total authorized share balance of 453,587. The other two plans, one for officers and employees and the other for nonemployee directors, were approved in 1997. A total of 30,000 shares (adjusted for the 1:20 reverse stock split), were made available for grant under these plans. All three option plans have expired, and therefore no new shares may be granted. Options to purchase shares of the Corporation's stock are granted at a price equal to the market price of the stock at the date of grant. The committee determines the vesting of the options when they are granted as established under the plan.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2010, FASB issued a statement which expands disclosures about credit quality of financing receivables and allowance for credit losses. The standard will require the Corporation to expand disclosures about the credit quality of our loans and the related reserves against them. The extra disclosures will include details on our past due loans, credit quality indicators and modifications of loans. The Corporation will adopt the standard beginning with our December 31, 2010 financial statements.

3. EARNINGS PER SHARE

Earnings per share are based upon the weighted average number of shares outstanding. The issuance of shares as a result of the common stock warrants issued under the TARP Capital Purchase Program would not have a dilutive effect on earnings for the three month period ended September 30, 2010, since they would decrease the loss per share. The common stock warrants would be slightly dilutive for the nine month period ended September 30, 2010. Please refer to the table below for the dilutive impact.

The following shows the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2010 and 2009 (dollars in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income (loss)	\$ 81	\$ 1,721	\$ 1,490	\$ 2,410
Preferred stock dividends	185	185	556	323
Net income (loss) available to common shareholders	\$ (104)	\$ 1,536	\$ 934	\$ 2,087
Weighted average shares outstanding	3,419,736	3,419,736	3,419,736	3,419,736
Effect of dilutive stock options and common stock warrants outstanding			68,734	
Diluted weighted average shares outstanding	3,419,736	3,419,736	3,488,470	3,419,736
Earnings per common share:				
Basic	\$ (.03)	\$.45	\$.27	\$.61
Diluted	\$ (.03)	\$.45	\$.27	\$.61

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MACKINAC FINANCIAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (Unaudited)

4. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities available for sale as of September 30, 2010, December 31, 2009 and September 30, 2009 are as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<i>September 30, 2010</i>				
US Agencies	\$ 5,000	\$ 5	\$	\$ 5,005
US Agencies MBS	30,272	982		31,254
Obligations of states and political subdivisions	1,147	48	(4)	1,191
Total securities available for sale	\$ 36,419	\$ 1,035	\$ (4)	\$ 37,450

December 31, 2009

US Agencies MBS	\$ 43,651	\$ 1,642	\$ (55)	\$ 45,238
Obligations of states and political subdivisions	1,207	68		1,275
Total securities available for sale	\$ 44,858	\$ 1,710	\$ (55)	\$ 46,513

September 30, 2009

US Agencies MBS	\$ 72,623	\$ 2,007	\$ (67)	\$ 74,563
Obligations of states and political subdivisions	1,207	74		1,281
Corporate bonds	4,198	161		4,359
Total securities available for sale	\$ 78,028	\$ 2,242	\$ (67)	\$ 80,203

When gross unrealized losses exist within the portfolio, the Corporation considers them temporary in nature and related to interest rate fluctuations. 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 \$13.688 million and \$14.286 million, respectively, at September 30, 2010.

5. LOANS

The composition of loans at September 30, 2010, December 31, 2009 and September 30, 2009 is as follows (dollars in thousands):

	September 30, 2010	December 31, 2009	September 30, 2009
Commercial real estate	\$ 199,892	\$ 208,895	\$ 211,994
Commercial, financial, and agricultural	69,652	72,184	70,520
One to four family residential real estate	74,829	67,232	66,700
Construction:			
Commercial	25,718	24,591	24,076
Consumer	7,483	7,118	6,416
Consumer	5,153	4,290	4,394
 Total loans	 \$ 382,727	 \$ 384,310	 \$ 384,100

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MACKINAC FINANCIAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (Unaudited)

5. LOANS (Continued)**LOANS Allowance for loan losses**

An analysis of the allowance for loan losses for the nine months ended September 30, 2010, the year ended December 31, 2009, and the nine months ended September 30, 2009 is as follows (dollars in thousands):

	September 30, 2010	December 31, 2009	September 30, 2009
Balance at beginning of period	\$ 5,225	\$ 4,277	\$ 4,277
Recoveries on loans	89	66	50
Loans charged off	(4,577)	(2,818)	(1,646)
Provision for loan losses	4,700	3,700	1,400
Balance at end of period	\$ 5,437	\$ 5,225	\$ 4,081

In the first nine months of 2010, net charge off activity was \$4.488 million, or 1.17% of average loans outstanding compared to net charge offs of \$1.596 million, or .43% of average loans, in the first nine months of 2009. In the first nine months of 2010, the Corporation recorded a provision for loan loss in the amount of \$4.700 million compared to \$1.400 million in the first nine months of 2009, which is discussed in more detail under Management's Discussion and Analysis.

LOANS 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.

Information regarding impaired loans as of September 30, 2010, December 31, 2009 and September 30, 2009 is as follows (dollars in thousands):

	September 30, 2010	December 31, 2009	September 30, 2009	September 30, 2010	December 31, 2009	September 30, 2009
	Valuation Reserve					
Balances, at period end						
Impaired loans with specific valuation reserve	\$ 6,038	\$ 11,348	\$ 6,561	\$ 1,256	\$ 2,705	\$ 1,341
Impaired loans with no specific valuation reserve	5,209	3,889	4,967			

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Total impaired loans	\$	11,247	\$	15,237	\$	11,528	\$	1,256	\$	2,705	\$	1,341
Impaired loans on nonaccrual basis	\$	4,447	\$	14,368	\$	10,655	\$	161	\$	2,705	\$	1,341
Impaired loans on accrual basis		6,800		869		873		1,095				
Total impaired loans	\$	11,247	\$	15,237	\$	11,528	\$	1,256	\$	2,705	\$	1,341

		Nine Months Ended September 30, 2010	Twelve Months Ended December 31, 2009	Nine Months Ended September 30, 2009
Average investment in impaired loans		\$ 11,479	\$ 10,449	\$ 9,809
Interest income recognized during period		7	40	32
Interest income that would have been recognized on an accrual basis		467	700	508
Cash-basis interest income recognized				

Additional discussion on impaired loans is presented in the Management's Discussion and Analysis section of this report.

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MACKINAC FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

5. LOANS (Continued)**LOANS Related parties**

mBank, the Corporation's principal subsidiary (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):

	September 30, 2010	December 31, 2009	September 30, 2009
Loans outstanding beginning of period	\$ 8,552	\$ 6,516	\$ 6,516
New loans	2,665	2,160	2,160
Net activity on revolving lines of credit	2,055	1,189	812
Repayment	(3,857)	(1,610)	(1,205)
Change in related party interest		297	297
Loans outstanding end of period	\$ 9,415	\$ 8,552	\$ 8,580

There were no loans to related parties classified substandard at September 30, 2010, December 31, 2009 or September 30, 2009. In addition to the outstanding balances above, there were unused commitments of \$.395 million to related parties at September 30, 2010.

6. BORROWINGS

Borrowings consist of the following at September 30, 2010, December 31, 2009 and September 30, 2009 (dollars in thousands):

	September 30, 2010	December 31, 2009	September 30, 2009
Federal Home Loan Bank fixed rate advances at rates ranging from 4.98% to 5.16% maturing in December 2010	\$ 15,000	\$ 15,000	\$ 15,000
Federal Home Loan Bank variable rate advances at rates ranging from .455% to .548% maturing in January and February 2011	20,000	20,000	20,000
USDA Rural Development, fixed-rate note payable, maturing August 24, 2024, interest payable at 1%	1,069	1,140	1,140
	\$ 36,069	\$ 36,140	\$ 36,140

The Federal Home Loan Bank borrowings are collateralized at September 30, 2010 by the following: a collateral agreement on the Corporation's one to four family residential real estate loans with a book value of approximately \$33.571 million; mortgage related and municipal securities with an amortized cost and estimated fair value of \$13.105 million and \$13.703 million, respectively; and Federal Home Loan Bank stock owned by the Bank totaling \$3.794 million. Prepayment of the remaining 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, 2010.

The USDA Rural Development borrowing is collateralized by loans totaling \$.260 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 \$.914 million, and guaranteed by the Corporation.

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MACKINAC FINANCIAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

7. STOCK OPTION PLANS

A summary of stock option transactions for the nine months ended September 30, 2010 and 2009, and the year ended December 31, 2009, is as follows:

	September 30, 2010	December 31, 2009	September 30, 2009
Outstanding shares at beginning of year	411,057	446,237	446,237
Granted during the period			
Expired during the period	(16,985)	(35,180)	(35,180)
Outstanding shares at end of period	394,072	411,057	411,057
Weighted average exercise price per share at end of period	\$ 10.98	\$ 12.03	\$ 12.03
Shares available for grant at end of period	0	24,780	24,780

There were no options granted in the first nine months of 2010 and 2009.

Following is a summary of the options outstanding and exercisable at September 30, 2010:

Exercise Price	Number		Remaining Contractual Life-Years	Weighted Average Exercise Price
	Outstanding	Exercisable		
\$ 9.16	5,000	2,000	5.2	\$ 9.16
\$ 9.75	257,152	120,861	4.2	\$ 9.75
\$ 10.65	50,000	10,000	6.2	\$ 10.65
\$ 11.50	40,000	8,000	5.0	\$ 11.50
\$ 12.00	40,000	8,000	4.7	\$ 12.00
\$ 156.00	1,920	1,920	1.1	\$ 156.00
	394,072	150,781	4.6	\$ 10.98

8. 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. During the first quarter of 2010, the Corporation evaluated the valuation allowance against the net deferred tax asset which would require future taxable income in order to be utilized and recorded a \$3.5 million deferred tax benefit related to the utilization of the NOL carryforward. The Corporation, as of September 30, 2010 had a net operating loss and tax credit carryforwards for tax purposes of approximately \$29.5 million, and \$2.1 million, respectively. As of September 30, 2010 the Corporation had total net deferred tax assets of \$12.3 million, with a related valuation allowance of approximately \$2.0 million.

The Corporation recorded the future benefits from these carryforwards at such time as it became more likely than not that they would be utilized prior to expiration. Please refer to further discussion on income taxes contained in Management's Discussion and Analysis. 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, approximately \$18.0 million, 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 \$1.4 million for the NOL and the equivalent value of tax credits, which is approximately \$.477 million. These limitations for use were established in conjunction with the recapitalization of the Corporation in December, 2004.

Subsequent to June 30, 2010, in deference to the loss recorded in the 2010 second quarter, an analysis of the deferred tax asset was performed in order to determine if there was any impairment relative to ultimate utilization during the carryforward period. As a part of this analysis, management reviewed projected levels of taxable income and assessed the probability of attaining these projected levels. Based upon this analysis, it was determined that there was no additional impairment of this net deferred tax asset.

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9. FAIR VALUE MEASUREMENTS

In 2010, the FASB issued authoritative guidance expanding disclosures related to fair value measurements including (i) the amounts of significant transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, (ii) the reasons for transfers of assets or liabilities in or out of Level 3 of the fair value hierarchy, with significant transfers disclosed separately, (iii) the policy for determining when transfers between levels of the fair value hierarchy are recognized and (iv) for recurring fair value measurements of assets and liabilities in Level 3 of the fair value hierarchy, a gross presentation of information about purchases, sales, issuances and settlements. The new guidance further clarifies that (i) fair value measurement disclosures should be provided for each class of assets and liabilities (rather than major category), which would generally be a subset of assets or liabilities within a line item in the statement of financial position and (ii) disclosures should be provided about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for each class of assets and liabilities included in Levels 2 and 3 of the fair value hierarchy. The disclosures related to the gross presentation of purchases, sales issuances and settlements of assets and liabilities included in Level 3 of the fair value hierarchy will be required beginning January 1, 2011. The remaining disclosure requirements and clarifications made by the new guidance became effective on January 1, 2010.

The following table presents information for financial instruments at September 30, 2010 and December 31, 2009 (dollars in thousands):

	September 30, 2010		December 31, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	\$ 48,561	\$ 48,561	\$ 45,433	\$ 45,433
Interest bearing deposits	692	692	678	678
Securities available for sale	37,450	37,450	46,513	46,513
Federal Home Loan Bank stock	3,794	3,794	3,794	3,794
Net loans	377,290	378,190	379,085	382,352
Accrued interest receivable	1,175	1,175	1,413	1,413
Total financial assets	\$ 468,962	\$ 469,862	\$ 476,916	\$ 480,183
Financial liabilities:				
Deposits	\$ 404,524	\$ 405,621	\$ 421,389	\$ 421,124
Borrowings	36,069	36,177	36,140	36,447
Accrued interest payable	289	289	325	325
Total financial liabilities	\$ 440,882	\$ 442,087	\$ 457,854	\$ 457,896

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.

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.

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9. FAIR VALUE MEASUREMENTS (Continued)

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.

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.

Limitations The authoritative accounting guidance for fair value measurements defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

The authoritative accounting guidance requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement costs). Valuation techniques should be consistently applied. Inputs to

valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, the authoritative guidance establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable outputs. The fair value hierarchy is as follows:

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9. FAIR VALUE MEASUREMENTS (Continued)

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 2 investments consist primarily of obligations of U.S. government sponsored enterprises and agencies, obligations of state and municipal subdivisions, corporate bonds and mortgage backed securities.

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.

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.

The fair value of all investment securities at December 31, 2009 and September 30, 2010 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 December 31, 2009 or September 30, 2010.

The Corporation also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These assets include other real estate and loans. 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

	Balance at	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, 2010	Total Losses for Nine Months Ended September 30, 2010
(dollars in thousands)	September 30, 2010	(Level 1)	(Level 2)	(Level 3)	September 30, 2010	September 30, 2010
Assets						
Impaired loans	\$ 7,290	\$	\$	\$ 7,290	\$ 629	\$ 1,609
Other real estate owned	5,758			5,758	7	2,001
					\$ 636	\$ 3,610

Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2009

(dollars in thousands)	Balance at December 31, 2009	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, 2009
Assets					
Impaired loans	\$ 13,621	\$	\$	\$ 13,621	\$ 1,300
Other real estate owned	5,804			5,804	399
					\$ 1,699

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

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9. FAIR VALUE MEASUREMENTS (Continued)

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis, that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

Impaired loans categorized as Level 3 assets consist of non-homogeneous loans that are considered impaired. Impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. 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). For purposes of valuing other real estate owned, the Corporation relies upon third party appraisals and reduces this appraised value by anticipated liquidation costs.

10. SHAREHOLDERS' EQUITY***Participation in the TARP Capital Purchase Program***

On April 24, 2009, the Corporation entered into and closed a Letter Agreement, including the Securities Purchase Agreement-Standard Terms (collectively, the "Securities Purchase Agreement"), related to the TARP Capital Purchase Program ("CPP"). Pursuant to the Securities Purchase Agreement, the Corporation issued and sold to the Treasury (i) 11,000 shares of the Corporation's Series A Preferred Shares, and (ii) the Warrant to purchase 379,310 shares of the Corporation's Common Shares, at an exercise price of \$4.35 per share (subject to certain anti-dilution and other adjustments), for an aggregate purchase price of \$11.000 million in cash. The Warrant has a ten-year term.

As a result of the CPP transaction, the Corporation is required to take certain actions, for so long as the Treasury holds any securities acquired from the Corporation pursuant to the CPP (excluding any period in which the Treasury holds only the Warrant to purchase Common Shares of the Corporation) (the "CPP Period"), to ensure that its executive compensation and benefit plans with respect to Senior Executive Officers (as defined in the relevant agreements) comply with Section 111(b) of Emergency Economic Stabilization Act of 2008 ("EESA"), as implemented by any guidance or regulations issued under Section 111(b) of EESA, and not adopt any benefit plans with respect to, or which cover, the Corporation's Senior Executive Officers that do not comply with EESA, as amended by the American Recovery and Reinvestment Act of 2009 (the "ARRA"), which was passed by Congress and signed by the President on February 17, 2009. The applicable executive compensation standards generally remain in effect during the CPP Period and apply to the Corporation's Senior Executive Officers (which for purposes of the ARRA and the CPP agreements, includes the Corporation's Chief Executive Officer, its Chief Financial Officer, and the next three most highly-compensated executive officers, even though the Corporation's senior executive officers consist of a smaller group of executives for purposes of the other compensation disclosures in the Corporation's annual proxy statement).

Amounts recorded for Preferred Stock and Warrant Common Stock were estimated based on an allocation of the total proceeds from the issuance on the relative fair values of both instruments. Fair value of the Preferred Stock was determined based on assumptions regarding the discount rate (market rate) on the Preferred Stock (estimated 12%). Fair value of the Warrant Common Stock is based on the value of the underlying Preferred Stock based on an estimate for a three year term. The allocation of the proceeds received resulted in the recording of a discount on the Preferred Stock and a premium on the Warrant Common Stock. The discount on the preferred will be accreted on an effective yield basis over a three-year term. The allocated carrying value of the Preferred Stock and Warrant Common Stock on the date of issuance (based on their relative fair values) was \$10.382 million and \$.618 million, respectively. Cumulative dividends on the Preferred Stock are payable at 5% annum for the first five years and at a

rate of 9% per annum thereafter on the liquidation preference of \$1,000 per share. The Company is prohibited from paying any dividend with respect to shares of common stock unless all accrued and unpaid dividends are paid in full on the Preferred Stock for all past dividend periods. The Preferred Stock is non-voting, other than class voting rights on matters that could adversely affect the Preferred Stock. The Preferred Stock may be redeemed at any time with regulatory approval. The Treasury

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10. SHAREHOLDERS EQUITY (Continued)

may also transfer the Preferred Stock to a third party at any time. The preferred stock qualifies as Tier 1 Capital for regulatory purposes at the holding company.

The Corporation has the right to redeem the Series A Preferred Shares at any time after consulting with its primary regulator, in which case the executive compensation standards would no longer apply to the Corporation.

A portion of this capital, \$4.000 million, was used to maintain a strong capital position of the Bank. In addition, the remaining capital will allow the Corporation to consider acquisitions of deposit franchisees that would enhance our funding mix.

11. 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, 2010	December 31, 2009	September 30, 2009
Commitments to extend credit:			
Variable rate	\$ 24,293	\$ 24,839	\$ 37,533
Fixed rate	16,891	6,039	8,653
Standby letters of credit Variable rate	1,363	1,279	1,231
Credit card commitments Fixed rate	2,801	2,714	2,638
	\$ 45,348	\$ 34,871	\$ 50,055

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.

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11. COMMITMENTS, CONTINGENCIES AND CREDIT RISK (Continued)

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

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, 2010 represents \$52.2 million, or 17.68%, compared to \$47.0 million, or 15.33%, of the commercial loan portfolio on September 30, 2009. 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. Additional discussion regarding the concentration of credit risk is presented in the Management's Discussion and Analysis section of this report.

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

FORWARD LOOKING STATEMENTS

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:

The highly regulated environment in which the Corporation operates could adversely affect its ability to carry out its strategic plan due to restrictions on new products, funding opportunities or new market entrances;

General economic conditions, either nationally or in the state(s) in which the Corporation does business;

Legislation or regulatory changes which affect the business in which the Corporation is engaged;

Changes in the level and volatility of interest rates which may negatively affect the Corporation's interest margin;

Changes in securities markets with respect to the market value of financial assets and the level of volatility in certain markets such as foreign exchange;

Significant increases in competition in the banking and financial services industry resulting from industry consolidation, regulatory changes and other factors, as well as action taken by particular competitors;

The ability of borrowers to repay loans;

The effects on liquidity of unusual decreases in deposits;

Changes in consumer spending, borrowing, and saving habits;

Technological changes;

Acquisitions and unanticipated occurrences which delay or reduce the expected benefits of acquisitions;

Difficulties in hiring and retaining qualified management and banking personnel;

The Corporation's ability to increase market share and control expenses;

The effect of compliance with legislation or regulatory changes;

The effect of changes in accounting policies and practices;

The costs and effects of existing and future litigation and of adverse outcomes in such litigation; and

An increase in the Corporation's FDIC insurance premiums, or the collection of special assessments by the FDIC.

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.

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MACKINAC FINANCIAL CORPORATION

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

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, 2009. Throughout this discussion, the term "Bank" refers to mBank, the principal banking subsidiary of the Corporation.

FINANCIAL OVERVIEW

The Corporation recorded a third quarter 2010 loss available to common shareholders of \$.104 million or \$(.03) per share compared to net income of \$1.536 million, or \$.45 per share for the third quarter of 2009. Net income available to common shareholders for the first nine months of 2010 totaled \$.934 million, or \$.27 per share, compared to \$2.087 million, or \$.61 per share, for the same period in 2009. Weighted average shares totaled 3,419,736 year to date and for the third quarter in 2010 and 2009.

The third quarter results include a provision for loan losses of \$1.000 million compared to \$.700 million for the same three month period in 2009. Operating results for the nine month period in 2010 include a \$4.700 million provision, \$1.948 million in OREO write-downs, \$.215 million in security gains and a \$3.500 million deferred tax benefit. The nine month and three month results for 2009 include a \$1.208 million gain from the sale of two branch offices and \$.644 million in security gains.

The loan loss provisions, along with the OREO write-downs through the first nine months of 2010, primarily reflect the continued deterioration of several large credit relationships in Southeast Michigan, two of which emerged in the second quarter, along with others that have been nonperforming assets for some time. The OREO write-down includes a \$1.4 million adjustment on a vacant parcel of land in Southeast Michigan which has decreased in value by more than 80% since the inception of the credit relationship early in 2006.

Total assets of the Corporation at September 30, 2010 were \$499.006 million, down by \$14.174 million, or 2.76% from the \$513.180 million in total assets reported at September 30, 2009 and down by \$16.371 million, or 3.18%, from total assets of \$515.377 million at year-end 2009. Asset totals at September 30, 2010 reflect decreased balances of investment securities of approximately \$9.063 million from December 31, 2009. The loan portfolio decreased \$1.583 million in the first nine months of 2010, from December 31, 2009 balances of \$384.310 million. Deposits totaled \$404.524 million at September 30, 2010, a decrease from the \$421.389 million at December 31, 2009.

FINANCIAL CONDITION**Cash and Cash Equivalents**

Cash and cash equivalents increased \$3.128 million during the first nine months of 2010. See further discussion of the change in cash and cash equivalents in the Liquidity section.

Investment Securities

Securities available for sale decreased \$9.063 million, or 19.48%, from December 31, 2009 to September 30, 2010, with the balance on September 30, 2010, totaling \$37.450 million. The Corporation sold \$8.6 million of investments early in 2010 and recognized a gain of \$.215 million. This sale was in conjunction with the Corporation's strategy to reduce balance sheet leverage and reduce wholesale deposits. Investment securities are utilized in an effort to manage interest rate risk and liquidity. As of September 30, 2010, investment securities with an estimated fair value of \$14.286 million were pledged.

Loans

Through the first nine months of 2010, loan balances decreased by \$1.583 million, or .41%, from December 31, 2009 balances of \$384.310 million. During the first nine months of 2010, the Bank had total loan production of

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MACKINAC FINANCIAL CORPORATION
 ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

\$58.376 million. This loan production, however, was significantly offset by normal loan principal runoff, and amortization, \$38.049 million, and large paydowns and refinancing, which totaled \$17.815 million, along with USDA and SBA loan sales of \$8.9 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, 2010, December 31, 2009 and September 30, 2009 (dollars in thousands):

	September 30, 2010	Percent of Total	December 31, 2009	Percent of Total	September 30, 2009	Percent of Total
Commercial real estate	\$ 199,892	52.23%	\$ 208,895	54.36%	\$ 211,994	55.19%
Commercial, financial, and agricultural	69,652	18.20	72,184	18.78	70,520	18.36
One to four family residential real estate	74,829	19.55	67,232	17.49	66,700	17.37
Consumer	5,153	1.35	4,290	1.12	4,394	1.14
Construction:						
Commercial	25,718	6.72	24,591	6.40	24,076	6.27
Consumer	7,483	1.95	7,118	1.85	6,416	1.67
Total loans	\$ 382,727	100.00%	\$ 384,310	100.00%	\$ 384,100	100.00%

Following is a table showing the significant industry types in the commercial loan portfolio as of September 30, 2010, December 31, 2009 and September 30, 2009 (dollars in thousands):

	September 30, 2010			December 31, 2009			September 30, 2009		
	Percent of Outstanding Balance	Percent of Commercial Loans	Percent of Shareholders' Equity	Percent of Outstanding Balance	Percent of Commercial Loans	Percent of Shareholders' Equity	Percent of Outstanding Balance	Percent of Commercial Loans	Percent of Shareholders' Equity
Real estate operators of nonres bldgs	\$ 52,192	17.68%	93.22%	\$ 48,689	15.93%	88.05%	\$ 47,007	15.33%	84.29%
Hospitality and tourism	39,998	13.55	71.44	45,315	14.82	81.95	45,867	14.96	82.25
Commercial construction	25,718	8.71	45.94	24,591	8.04	44.47	24,076	7.85	43.17
Real estate agents and managers	19,675	6.66	35.14	24,242	7.93	43.84	23,996	7.83	43.03
Other	157,679	53.40	281.64	162,833	53.28	294.46	165,644	54.03	297.03

Total						
Commercial						
Loans	\$ 295,262	100.00%	\$ 305,670	100.00%	\$ 306,590	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, 2010. 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, 2010, our residential loan portfolio totaled \$82.312 million, or 21.51% of our total outstanding loans.

Credit Quality

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, 2010 amounted to \$4.488 million, or 1.17% of average loans outstanding, compared to \$1.596 million, or .43% of average

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MACKINAC FINANCIAL CORPORATION
 ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

loans outstanding, for the same period in 2009. 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 high level of charge-offs thus far in 2010 primarily relate to the deterioration of several credit relationships in Southeast Michigan. These relationships, some of which were unsecured, have been on the Corporation's watchlist of problem credits for sometime; however, the Corporation has exhausted efforts for principal recovery and therefore recorded the charge-off.

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

	September 30, 2010	December 31, 2009	September 30, 2009
Nonperforming Assets:			
Nonaccrual Loans	\$ 4,447	\$ 14,368	\$ 10,625
Loans past due 90 days or more			
Restructured loans	6,800	869	873
Total nonperforming loans	11,247	15,237	11,528
Other real estate owned	5,758	5,804	5,821
Total nonperforming assets	\$ 17,005	\$ 21,041	\$ 17,349
Nonperforming loans as a % of loans	2.94%	3.96%	3.00%
Nonperforming loans as a % of assets	3.41%	4.08%	3.38%
Reserve for Loan Losses:			
At period end	\$ 5,437	\$ 5,225	\$ 4,081
As a % of loans	1.42%	1.36%	1.06%
As a % of nonperforming loans	48.34%	34.29%	35.40%
As a % of nonaccrual loans	122.26%	36.37%	38.30%
Texas rate*	27.68%	34.77%	28.99%

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

Nonperforming assets at \$17.005 million have been reduced in 2010 by \$4.036 million from the \$21.041 million at 2009 year end. This reduction in nonperforming assets reflects management's efforts in the aggressive remediation of problem credits and disposition of OREO properties. In the third quarter of 2010, there was a significant increase in balances of restructured loans, approximately \$6.0 million. This is largely reflective of the current economic times that sometimes require concessions as to interest payments and/or maturity extensions in order to accommodate a borrower. The balance increase during the third quarter includes one restructured customer relationship with balances of approximately \$4.0 million.

The following ratios provide additional information relative to the Corporation's credit quality:

	September 30, 2010	At Period End	
		December 31, 2009	September 30, 2009
Total loans, at period end	\$ 382,727	\$ 384,310	\$ 384,100
Average loans for the year	384,028	374,796	370,952
	Nine Months Ended September 30, 2010	For the Period Ended	
		Twelve Months Ended December 31, 2009	Nine Months Ended September 30, 2009
Net charge-offs during the period	\$ 4,488	\$ 2,752	\$ 1,596
Net charge-offs to average loans	1.17%	.73%	.43%
Net charge-offs to beginning allowance balance	85.89%	64.34%	37.32%

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MACKINAC FINANCIAL CORPORATION
 ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

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 a loan review consultant to perform a review of the loan portfolio. The opinion of this consultant upon completion of the independent review in 2009 provided findings similar to management on the overall adequacy of the reserve. The Corporation engaged this same consultant for loan review, which was completed in August 2010.

Following is the allocation for loan losses as of September 30, 2010, December 31, 2009, and September 30, 2009 (dollars in thousands):

	September 30, 2010	December 31, 2009	September 30, 2009
Commercial, financial and agricultural loans	\$ 4,509	\$ 4,805	\$ 3,564
One to four family residential real estate loans	98	23	47
Consumer loans	2	13	9
Unallocated and general reserves	828	384	461
Totals	\$ 5,437	\$ 5,225	\$ 4,081

As of September 30, 2010, the allowance for loan losses represented 1.42% of total loans. At September 30, 2010, the allowance included specific reserves in the amount of \$1.256 million, as compared to \$2.705 million at December 31, 2009 and \$1.341 million at September 30, 2009. 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, 2010	Year Ended December 31, 2009	September 30, 2009
Balance at beginning of period	\$ 5,804	\$ 2,189	\$ 2,189
Other real estate transferred from loans due to foreclosure	4,604	4,879	4,205
Reclassification of redemption OREO		(475)	(475)
Other real estate sold/written down	(4,597)	(789)	(82)
Loss on sale of other real estate	(53)		(16)
Balance at end of period	\$ 5,758	\$ 5,804	\$ 5,821

During the first nine months of 2010, the Corporation received real estate in lieu of loan payments of \$4.604 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 a decrease in deposits in the first nine months of 2010. Total deposits decreased by \$16.865 million, or 4.00%, in the first nine months of 2010. The decrease in deposits for the first nine months of 2010 is composed of a decrease in noncore deposits of \$94.092 million and an increase in core deposits of \$77.227 million. In 2010, the Corporation continued to strategically emphasize the growth of core deposits. This strategic initiative was supported with an individual incentive plan, along with the introduction of several new deposit products and competitive deposit pricing. The core deposit balance increases are primarily in transactional account deposits, our lowest cost of funds.

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MACKINAC FINANCIAL CORPORATION
 ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

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.

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

	September 30, 2010	% of Total	December 31, 2009	% of Total	September 30, 2009	% of Total
Non-interest-bearing NOW, money market, checking	\$ 44,402	10.98%	\$ 35,878	8.51%	\$ 33,254	7.94%
Savings	127,828	31.60	95,790	22.74	88,843	21.23
Certificates of Deposit <\$100,000	20,265	5.01	18,207	4.32	18,807	4.49
	94,560	23.37	59,953	14.23	59,637	14.25
Total core deposits	287,055	70.96	209,828	49.80	200,541	47.91
Certificates of Deposit >\$100,000	22,809	5.64	36,385	8.63	25,409	6.07
Brokered CDs	94,660	23.40	175,176	41.57	192,631	46.02
Total non-core deposits	117,469	29.04	211,561	50.20	218,040	52.09
Total deposits	\$ 404,524	100.00%	\$ 421,389	100.00%	\$ 418,581	100.00%

Borrowings

The Corporation historically used alternative funding sources to provide long-term, stable sources of funds. Current FHLB borrowings total \$35.000 million with stated maturities ranging through February 2011. FHLB borrowings at quarter end include \$20.000 million with adjustable rates that reprice quarterly based upon the three month LIBOR. The FHLB has the option to convert the remaining \$15.000 million fixed-rate advances to adjustable rate advances on the original call date and quarterly thereafter. The Corporation also has a USDA Rural Development loan held by its wholly owned subsidiary, First Rural Relending that has a fixed interest rate of 1% and matures in August 2024.

Shareholders Equity

Total shareholders' equity increased \$.688 million from December 31, 2009 to September 30, 2010. Contributing to the increase in shareholders' equity was net income of \$.934 million, contributed capital of \$22,000 in recognition of stock option expense, a decrease in the market value of securities of \$.412 million and the accretion of the discount on preferred stock of \$.144 million.

RESULTS OF OPERATIONS**Summary**

The Corporation reported net income available to common shareholders of \$.934 million, or \$.27 per share, in the first nine months of 2010, compared to \$2.087 million or \$.61 per share for the first nine months of 2009. Operating results for the first nine months of 2010 included the recognition of a \$3.500 million deferred tax benefit related to NOL carry-forwards. This deferred tax benefit was recognized in accordance with GAAP accounting which requires the

benefit to be recognized when it is more likely than not that the NOL will be utilized within the carry-forward period. In the first nine months of 2010 a provision for loan losses of \$4.700 million was booked in comparison to a provision of \$1.400 million in the first nine months of 2009. The first nine months of 2010 also includes the preferred dividend and accretion of discount of \$.556 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.

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MACKINAC FINANCIAL CORPORATION
 ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Net interest margin on a fully taxable equivalent basis amounted to \$4.091 million, 3.72% of average earning assets, in the third quarter of 2010, compared to \$4.346 million, 3.69% of average earning assets, in the third quarter of 2009. In the first nine months of 2010, net interest margin increased to \$12.195 million, 3.59% of average earning assets, compared to \$11.983 million, 3.54% of average earning assets, for the same period in 2009. Margin improvement in 2010 was primarily due to a reduction in funding costs between periods as average interest rates on brokered deposits declined more than rates on earning assets.

The following tables present 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											
	Average Balances			Average Rates		Interest		Income/		Rate/		
	September 30, 2010	September 30, 2009	Increase/ (Decrease)	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009	Expense Variance	Volume Variance	Rate Variance	Volume Variance	
Loans (1,2,3)	\$ 385,268	\$ 370,310	\$ 14,958	5.53%	5.57%	\$ 5,369	\$ 5,201	\$ 168	\$ 210	\$ (40)	\$ (2)	
Taxable securities	33,989	91,837	(57,848)	3.78	3.84	324	888	(564)	(559)	(13)	8	
Nontaxable securities (2)	859	1,226	(367)	5.08	3.56	11	11		(3)	5	(2)	
Federal funds sold	12,000		12,000	.26		8		8			8	
Other interest-earning assets	4,472	4,434	38	1.33	2.51	15	28	(13)		(13)		
Total earning assets	436,588	467,807	(31,219)	5.20	5.20	5,727	6,128	(401)	(352)	(61)	12	
Reserve for loan losses	(6,094)	(4,231)	(1,863)									
Cash and due from banks	49,943	24,233	25,710									
Intangible assets		1	(1)									
Other assets	31,898	25,877	6,021									
Total assets	\$ 512,335	\$ 513,687	\$ (1,352)									
NOW and money market deposits	\$ 105,634	\$ 73,236	\$ 32,398	.91%	.96%	\$ 241	\$ 177	\$ 64	\$ 78	\$ (10)	\$ (4)	
Interest checking	20,252	8,853	11,399	1.39	1.88	71	42	29	54	(11)	(14)	
Savings deposits	20,557	21,273	(716)	.44	.73	23	39	(16)	(1)	(15)		
CDs <\$100,000	93,265	66,291	26,974	2.05	2.61	481	436	45	177	(94)	(38)	
CDs >\$100,000	23,376	25,777	(2,401)	1.68	2.31	99	150	(51)	(14)	(41)	4	
Brokered deposits	107,774	191,471	(83,697)	1.84	1.46	499	706	(207)	(309)	181	(79)	

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Borrowings	36,115	36,194	(79)	2.44	2.54	222	232	(10)	(1)	(10)	1
Total interest-bearing liabilities	406,973	423,095	(16,122)	1.59	1.67	1,636	1,782	(146)	(16)		(130)
Demand deposits	45,989	32,201	13,788								
Other liabilities	2,705	3,797	(1,092)								
Shareholders equity	56,668	54,594	2,074								
Total liabilities and shareholders equity	\$ 512,335	\$ 513,687	\$ (1,352)								
Rate spread				3.61%	3.53%						
Net interest margin/revenue				3.72%	3.69%	\$ 4,091	\$ 4,346	\$ (255)	\$ (336)	\$ (61)	\$ 142

- (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

Nine Months Ended

2010-2009

(dollars in thousands)	Average Balances			Average Rates		Interest		Income/ Expense Variance	Volume Variance	Rate/ Volume Variance	Volume Variance
	September 30, 2010	September 30, 2009	Increase/ (Decrease)	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009				
Loans (1,2,3)	\$ 384,028	\$ 370,952	\$ 13,076	5.55%	5.61%	\$ 15,938	\$ 15,570	\$ 368	\$ 549	\$ (175)	\$ (6)
Taxable securities	35,546	72,214	(36,668)	4.05	3.74	1,077	2,020	(943)	(1,026)	168	(85)
Nontaxable securities (2)	849	838	11	5.04	2.70	32	17	15		15	
Federal funds sold	26,619		26,619	.25		50		50			50
Other interest-earning assets	4,477	4,400	77	1.49	1.34	50	44	6	1	5	
Total earning assets	451,519	448,404	3,115	5.08	5.26	17,147	17,651	(504)	(476)	13	(41)
Reserve for loan losses	(5,446)	(4,494)	(952)								
Cash and due from banks	30,714	18,469	12,245								
Intangible assets		17	(17)								
Other assets	31,151	24,364	6,787								
Total assets	\$ 507,938	\$ 486,760	\$ 21,178								

NOW and money market deposits	\$ 96,866	\$ 70,214	\$ 26,652	1.00%	.85%	\$ 722	\$ 448	\$ 274	\$ 170	\$ 75	\$ 30
Interest checking	17,880	6,380	11,500	1.56	1.93	209	92	117	166	(17)	(32)
Savings deposits	19,676	20,791	(1,115)	.56	.73	83	113	(30)	(6)	(25)	1
CDs <\$100,000	80,997	69,838	11,159	2.11	2.87	1,277	1,497	(220)	239	(396)	(63)
CDs >\$100,000	27,494	25,823	1,671	1.69	2.48	348	479	(131)	31	(152)	(10)
Brokered deposits	130,344	173,600	(43,256)	1.71	1.74	1,671	2,265	(594)	(564)	(39)	9
Borrowings	36,132	36,404	(272)	2.38	2.84	642	774	(132)	(6)	(127)	1
Total interest-bearing liabilities	409,389	403,050	6,339	1.62	1.88	4,952	5,668	(716)	30	(682)	(64)
Demand deposits	38,818	31,285	7,533								
Other liabilities	3,170	3,624	(454)								
Shareholders equity	56,561	48,801	7,760								
Total liabilities and shareholders equity	\$ 507,938	\$ 486,760	\$ 21,178								
Rate spread				3.46%	3.38%						
Net interest margin/revenue				3.61%	3.57%	\$ 12,195	\$ 11,983	\$ 212	\$ (506)	\$ 695	\$ 23

- (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

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MACKINAC FINANCIAL CORPORATION
 ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Throughout 2010 and 2009 there have been no changes to the prime rate. The Corporation, during this period, 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, from 3.57% in the first nine months of 2009 to 3.61% in the first nine months of 2010.

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.

Provision for Loan Losses

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 2010, the Corporation recorded a \$4.700 million provision for loan loss, compared to a \$1.400 million provision in the first nine months of 2009. The large provision for the first nine months of 2010 is composed of a number of factors including a portion to re-establish the reserve for net charge-offs incurred during the period, which totaled \$4.488 million, increases attributable to specific reserves on deteriorating credit relationships, and increases due to the changing economic and experience factors used in the computation for adequacy of the overall reserve for loan losses. In future periods, loan loss provisions will be required if there is further market deterioration that impacts the credit quality on the existing portfolio and to provide for loan growth.

Other Income

Other income decreased by \$1.200 million for the nine months ended September 30, 2010, compared to the nine months ended September 30, 2009. The 2009 nine month period includes a net gain of \$1.208 million on the sale of two branch offices. In 2010, revenue due to loans produced and sold in the secondary market, along with the sale of SBA guaranteed loans, amounted to \$.897 million compared to \$.389 million a year ago. We expect to continue to benefit from secondary market activity in future periods. Service fees decreased \$.013 million in the first nine months of 2010, while other noninterest income decreased \$.058 million.

During the third quarter of 2010, the Corporation recognized \$.648 million in other income, compared to \$2.418 million for the third quarter of 2009. The 2009 third quarter includes a net gain of \$1.208 million on the sale of two branch offices. The decrease between periods was attributed largely to gains recognized on the sale of branches and investment securities in the third quarter of 2009. Service fees increased for the third quarter of 2010 by \$.029 million to \$.264 million when compared to \$.235 million in the third quarter of 2009. 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, 2010 and 2009 (dollars in thousands):

	Three Months Ended		% Increase (Decrease)	Nine Months Ended		% Increase (Decrease)
	September 30, 2010	2009	2010-2009	September 30, 2010	2009	2010-2009
Service fees	\$ 264	\$ 235	12.34	\$ 737	\$ 750	(1.73)
Net gains on sale of loans	322	247	30.36	897	389	130.59
Net gain on sale of branches		1,208	(100.00)		1,208	(100.00)
Other noninterest income	63	84	(25.00)	199	257	(22.57)
Subtotal	649	1,774	(63.42)	1,833	2,604	(29.61)

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Net security gain (loss)	(1)	644	(100.16)	215	644	(66.61)
Total noninterest income	\$ 648	\$ 2,418	(73.20)	\$ 2,048	\$ 3,248	(36.95)

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MACKINAC FINANCIAL CORPORATION
 ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Other Expense

Other expenses increased \$2.408 million for the nine months ended September 30, 2010, compared to the same period in 2009. Salaries and employee benefits also increased between periods, largely reflective of annual salary increases along with increased incentive pay related to compensation plans in place for 2010 that incent employees for core deposit growth. The most significant increase in other expense was in the loan and deposit expense category from costs associated with higher levels of nonperforming assets. During the first nine months of 2010, the Corporation recorded \$1.948 million in total write-downs of OREO properties and incurred other costs associated with nonperforming assets of \$.615 million. Management continually reviews all areas of other expense for cost reduction opportunities that will not impact service quality and employee morale.

The following table details other expense for the three and nine months ended September 30, 2010 and September 30, 2009 (dollars in thousands):

	Three Months Ended September 30,		% Increase (Decrease)	Nine Months Ended September 30,		% Increase (Decrease)
	2010	2009	2010-2009	2010	2009	2010-2009
Salaries and employee benefits	\$ 1,779	\$ 1,603	10.98	\$ 5,281	\$ 4,761	10.92
Occupancy	358	336	6.55	1,048	1,069	(1.96)
Furniture and equipment	202	193	4.66	594	604	(1.66)
Data processing	193	221	(12.67)	587	665	(11.73)
Professional service fees	168	161	4.35	502	458	9.61
Loan and deposit:						
FDIC insurance premiums	222	203	9.36	665	668	(0.45)
Other loan and deposit	219	198	10.61	2,631	506	419.96
Telephone	53	50	6.00	145	139	4.32
Advertising	77	80	(3.75)	220	238	(7.56)
Other	330	398	(17.09)	887	1,044	(15.04)
Total noninterest expense	\$ 3,601	\$ 3,443	4.59	\$ 12,560	\$ 10,152	23.72

Federal Income Taxes*Current Federal Tax Provision*

In the first nine months of 2010, management evaluated the deferred tax benefits associated with the net operating loss and tax credit carryforwards based upon the Corporation's foreseen ability to utilize the benefits of these carryforwards prior to their expiration. As a part of this analysis, management considered, among other things, current asset levels and projected loan and deposit growth, current interest rate spreads and projected net interest income levels, and other income and expense, along with management's ability to control expenses and the potential for increasing contributions of noninterest income. Management also considered the impact of nonperforming assets and future period charge-off activity relative to projected provisions. Based upon the analysis of projected taxable income and the probability of achieving these projected taxable income levels, a portion, \$3.500 million of the remaining deferred tax benefit was recognized. This \$3.500 million deferred tax benefit, along with taxes on current net operating results, income before taxes resulted in a total net benefit in the first nine months of \$4.593 million compared to the \$1.142 million tax expense recorded in the first nine months of 2009.

Deferred Tax Benefit

The Corporation recognized a federal deferred tax benefit of \$7.500 million in the third quarter of 2007. The recognition of this deferred tax benefit relates to the generally accepted accounting principles applicable to the probability of utilizing the NOL and tax credit carryforwards of the Corporation. The Corporation, based upon current profitability trends largely supported by expansion of the net interest margin and controlled expenses, determined that the utilization of the NOL carryforward was probable. This tax benefit was recorded by reducing the valuation allowance that was recorded against the deferred tax assets of the Corporation. In 2006, the Corporation recognized a portion of this benefit, \$.500 million, based upon the then current probabilities. The \$7.500 million recognition is based upon assumptions of a sustained level of taxable income within the NOL carryforward period and takes into account Section 382, establishing annual limitations. A valuation allowance is provided against deferred tax assets when it is more likely than not that some or all of the deferred tax assets will not

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MACKINAC FINANCIAL CORPORATION

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

be realized. As of September 30, 2010, the Corporation had an NOL carryforward of approximately \$29.5 million along with various credit carryforwards of \$2.1 million. This NOL and credit carryforward benefit is dependent upon the future profitability of the Corporation. A portion of the NOL, approximately \$18.0 million, and all of the tax credit carryforwards are also subject to the use limitations of Section 382 of the Internal Revenue Code since they originated prior to the December 2004 recapitalization of the Corporation. The Corporation intends to further evaluate the utilization of the NOL and credit carryforwards in subsequent periods to determine if any further adjustment to the valuation allowance is necessary. The determination criteria for recognition of deferred tax benefits will include the assumption of future period taxable income based upon the projected profitability of the Corporation.

Subsequent to September 30, 2010, in deference to the loss recorded in the 2010 third quarter, an analysis of the deferred tax asset was performed in order to determine if there was any impairment relative to ultimate utilization during the carryforward period. As a part of this analysis, management reviewed projected levels of taxable income and assessed the probability of attaining these projected levels. Based upon this analysis, it was determined that there was no additional impairment of this deferred tax asset.

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 \$36.561 million in cash and due from balances, \$12.000 million in federal funds sold and \$23.164 million of unpledged investment securities. The overall balance sheet liquidity results from the late 2009 and early 2010 sale of approximately \$40 million of investment securities. The Corporation has also experienced significant deposit inflows during the first nine months of 2010. Management anticipates reducing liquidity levels in future periods through payments of maturing brokered deposits and funding loan growth.

Late in 2010 and early in 2011, the \$35.000 million of FHLB borrowings will mature. Management expects to refinance these matured borrowings with the FHLB into a 4-6 year instrument which would be secured with the same assets used to pledge against current balances.

During the first nine months of 2010, the Corporation increased cash and cash equivalents by \$3.128 million. As shown on the Corporation's condensed consolidated statement of cash flows, liquidity was impacted by cash provided by investing activities, with a net decrease in investment securities of \$8.372 million and a net increase in loans of \$7.509 million. Offsetting the increases provided by investing activities were uses in financing activities, with a net decrease in deposits of \$16.865 million. The decrease in deposits was composed of a decrease in brokered deposits of \$80.516 million combined with an increase in bank deposits of \$63.651 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.

It is anticipated that during the remainder of 2010, the Corporation will fund anticipated loan production by reducing current balances of liquidity.

The Corporation's primary source of liquidity on a stand-alone basis is dividends from the Bank. The Bank is currently prohibited from paying dividends because of a deficit in retained earnings. The Bank, in order to pay dividends in future periods, will need to completely eliminate the negative balance of retained earnings through future profits.

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.

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MACKINAC FINANCIAL CORPORATION

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

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, 2010, the Bank's core deposits in relation to total funding were 65.15% compared to 44.10% at September 30, 2009. These ratios indicated at September 30, 2010, that the Bank has decreased 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, 2010, the Bank had \$15.875 million of unsecured lines available and another \$2.5 million 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 operating plan for 2010 includes strategies to increase core deposits in the Corporation's local markets. New deposit products and strategic advertising is expected to aid in efforts of management in growing core deposits which will then reduce the dependency on noncore deposits. The Corporation's operating plan for 2010 calls for augmenting local deposit growth efforts with wholesale CD funding, to the extent necessary.

CAPITAL AND REGULATORY

As a bank holding company, the Corporation is required to maintain certain levels of capital under government regulation. There are several measurements of regulatory capital and the Corporation is required to meet minimum requirements under each measurement. The federal banking regulators have also established capital classifications beyond the minimum requirements in order to risk-rate deposit insurance premiums and to provide trigger points for prompt corrective action in the event an institution becomes financially troubled. As of September 30, 2010, the Corporation and Bank were well capitalized. During the first nine months of 2010, total capitalization increased by \$.688 million.

The following table details sources of capital for the periods indicated (dollars in thousands):

	September 30, 2010	December 31, 2009	September 30, 2009
Capital Structure			
Shareholders' equity	\$ 55,987	\$ 55,299	\$ 55,766
Total capitalization	\$ 55,987	\$ 55,299	\$ 55,766
Tangible capital	\$ 55,987	\$ 55,299	\$ 55,766
Intangible Assets			
Core deposit premium	\$	\$	\$
Other identifiable intangibles			
Total intangibles	\$	\$	\$

Regulatory capital

Tier 1 capital:

Shareholders equity	\$	55,987	\$	55,299	\$	55,766
Net unrealized (gains) losses on available for sale securities		(681)		(1,093)		(1,437)
Less: disallowed deferred tax asset		(9,000)		(4,800)		(5,000)
Less: intangibles						

Total Tier 1 capital	\$	46,306	\$	49,406	\$	49,329
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Tier 2 Capital:

Allowable reserve for loan losses	\$	4,941	\$	5,181	\$	4,081
Qualifying long-term debt						

Total Tier 2 capital		4,941		5,181		4,081
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Total capital	\$	51,247	\$	54,587	\$	53,410
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Risk-adjusted assets	\$	39,780	\$	414,440	\$	404,883
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Capital ratios:

Tier 1 Capital to average assets		9.22%		9.75%		9.74%
Tier 1 Capital to risk weighted assets		11.73%		11.92%		12.18%
Total Capital to risk weighted assets		12.98%		13.17%		13.19%

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MACKINAC FINANCIAL CORPORATION
 ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

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.

Presented below is a summary of the capital position in comparison to generally applicable regulatory requirements:

	Shareholders Equity to Quarter-end Assets	Tangible Equity to Quarter-end Assets	Tier 1 Capital to Average Assets	Tier 1 Capital to Risk-Weighted Assets	Total Capital to Risk-Weighted Assets
Regulatory minimum for capital adequacy purposes	N/A	N/A	4.00%	4.00%	8.00%
Regulatory defined well capitalized guideline	N/A	N/A	5.00%	6.00%	10.00%
The Corporation:					
September 30, 2010	11.22%	11.22%	9.22%	11.73%	12.98%
September 30, 2009	10.87%	10.87%	9.74%	12.18%	13.19%
The Bank:					
September 30, 2010	10.16%	10.16%	8.10%	10.30%	11.55%
September 30, 2009	9.46%	9.46%	8.32%	10.40%	11.40%

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MACKINAC FINANCIAL CORPORATION

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKINTEREST 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.

The Corporation has established interest rate floors on approximately \$155 million, or 72% 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 \$64 million of the floor rate loan balances will reprice with a 100 basis point increase on the prime rate, with another \$88 million repricing in the next 100 basis point prime rate increase.

The Corporation also has \$37.450 million of securities providing for scheduled monthly principal and interest payments as well as unanticipated prepayments of principal. 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.

The Corporation has \$192 million of transactional accounts, of which \$44 million consists of non interest 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 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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MACKINAC FINANCIAL CORPORATION

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (Continued)

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 opportunities at September 30, 2010 (dollars in thousands):

	1-90 Days	91 - 365 Days	>1-5 Years	Over 5 Years	Total
Interest-earning assets:					
Loans	\$ 276,160	\$ 13,853	\$ 24,493	\$ 68,221	\$ 382,727
Securities	548	22,632	13,734	536	37,450
Other (1)	12,692			3,794	16,486
Total interest-earning assets	289,400	36,485	38,227	72,551	436,663
Interest-bearing obligations:					
NOW, money market, savings, interest checking	148,093				148,093
Time deposits	21,169	54,370	41,471	359	117,369
Brokered CDs	21,193	70,739		2,728	94,660
Borrowings	35,000			1,069	36,069
Total interest-bearing obligations	225,455	125,109	41,471	4,156	396,191
Gap	\$ 63,945	\$ (88,624)	\$ (3,244)	\$ 68,395	\$ 40,472
Cumulative gap	\$ 63,945	\$ (24,679)	\$ (27,923)	\$ 40,472	

(1) Includes Federal Home Loan Bank Stock

The above analysis indicates that at September 30, 2010, the Corporation had a cumulative liability sensitivity gap position of \$24.679 million within the one-year time frame. The Corporation's cumulative liability sensitive gap suggests that if market interest rates continue to decline in the next twelve months, the Corporation has the potential to increase net interest income. 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.

At December 31, 2009, the Corporation had a cumulative liability sensitivity gap position of \$17.977 million within the one-year time frame.

The borrowings in the gap analysis include \$15.000 million of the FHLB advances as fixed-rate advances. These advances give the FHLB the option to convert from a fixed-rate advance to an adjustable rate advance with quarterly repricing at three-month LIBOR Flat. The exercise of this conversion feature by the FHLB would impact the repricing dates currently assumed in the analysis.

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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MACKINAC FINANCIAL CORPORATION

ITEM 3. **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (Continued)**

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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MACKINAC FINANCIAL CORPORATION
ITEM 4 CONTROLS AND PROCEDURES

As of September 30, 2010, 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, 2010.

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, 2010 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 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.

Exhibit 32.1 Section 1350 Certification of Chief Executive Officer.

Exhibit 32.2 Section 1350 Certification of Chief Financial Officer.

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MACKINAC FINANCIAL CORPORATION
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 15, 2010

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)

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