MACKINAC FINANCIAL CORP /MI/
Form 10-Q
May 16, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended March 31, 2011

OR

o **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	38-2062816
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

130 SOUTH CEDAR STREET, MANISTIQUE, MI	49854
(Address of principal executive offices)	(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 þ No o

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 o No o

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 o	Accelerated Filer o	Non-accelerated Filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

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

Yes o No þ

As of April 30, 2011, there were outstanding 3,419,736 shares of the registrant s common stock, no par value.

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

	March 31, 2011 (Unaudited)	December 31, 2010	March 31, 2010 (Unaudited)
ASSETS			
Cash and due from banks	**$ 41,715**	$ 22,719	$ 19,359
Federal funds sold	**12,000**	12,000	36,000
Cash and cash equivalents	**53,715**	34,719	55,359
Interest-bearing deposits in other financial institutions	**734**	713	700
Securities available for sale	**37,543**	33,860	36,841
Federal Home Loan Bank stock	**3,423**	3,423	3,794
Loans:			
Commercial	**287,760**	297,047	296,271
Mortgage	**81,404**	80,756	76,996
Consumer	**5,445**	5,283	4,044
Total Loans	**374,609**	383,086	377,311
Allowance for loan losses	**(6,184)**	(6,613)	(4,737)
Net loans	**368,425**	376,473	372,574
Premises and equipment	**9,715**	9,660	10,060
Other real estate held for sale	**5,081**	5,562	7,723
Other assets	**14,154**	14,286	15,376
TOTAL ASSETS	**$ 492,790**	$ 478,696	$ 502,427
LIABILITIES AND SHAREHOLDERS EQUITY			
LIABILITIES:			
Deposits:			
Noninterest bearing deposits	**$ 39,269**	$ 41,264	$ 30,356
NOW, money market, interest checking	**154,420**	134,703	109,374
Savings	**17,691**	17,670	20,675
CDs<$100,000	**104,258**	96,977	75,822
CDs>$100,000	**21,803**	22,698	30,173
Brokered	**63,342**	73,467	138,812

Total deposits	**400,783**	386,779	405,212
Borrowings:			
Federal Home Loan Bank	**35,000**	35,000	35,000
Other	**1,069**	1,069	1,140
Total borrowings	**36,069**	36,069	36,140
Other liabilities	**1,841**	1,966	2,353
Total liabilities	**438,693**	424,814	443,705
SHAREHOLDERS EQUITY:			
Preferred stock No par value:			
Authorized 500,000 shares, 11,000 shares issued and outstanding	**10,757**	10,706	10,562
Common stock and additional paid in capital No par value			
Authorized 18,000,000 shares			
Issued and outstanding **3,419,736 shares**	**43,525**	43,525	43,502
Retained earnings	**(705)**	(961)	3,724
Accumulated other comprehensive income	**520**	612	934
Total shareholders equity	**54,097**	53,882	58,722
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$ 492,790**	$ 478,696	$ 502,427

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 March 31,	
	2011	2010
	(Unaudited)	
INTEREST INCOME:		
Interest and fees on loans:		
Taxable	**$ 5,136**	$ 5,191
Tax-exempt	**42**	52
Interest on securities:		
Taxable	**282**	397
Tax-exempt	**7**	7
Other interest income	**33**	40
Total interest income	**5,500**	5,687
INTEREST EXPENSE:		
Deposits	**1,219**	1,457
Borrowings	**140**	208
Total interest expense	**1,359**	1,665
Net interest income	**4,141**	4,022
Provision for loan losses		900
Net interest income after provision for loan losses	**4,141**	3,122
OTHER INCOME:		
Service fees	**217**	223
Net security gains		215
Income from loans sold	**314**	316
Other	**46**	53
Total other income	**577**	807
OTHER EXPENSE:		
Salaries and employee benefits	**1,824**	1,720
Occupancy	**365**	345
Furniture and equipment	**194**	194
Data processing	**176**	189
Professional service fees	**153**	173
Loan and deposit	**179**	268

ORE writedowns and (gains) losses on sale	**467**	147
FDIC insurance assessment	**285**	222
Telephone	**51**	47
Advertising	**88**	72
Other	**277**	252
Total other expense	**4,059**	3,629
Income before provision for (benefit of) income taxes	**659**	300
Provision for (benefit of) income taxes	**214**	(3,411)
NET INCOME	**445**	3,711
Preferred dividend and accretion of discount	**189**	185
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	**$ 256**	$ 3,526
INCOME PER COMMON SHARE:		
Basic	**$ .07**	$ 1.03
Diluted	**$ .07**	$ 1.03

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 March 31,	
	2011	2010
Balance, beginning of period	**$ 53,882**	$ 55,299
Net income for period	**445**	3,711
Net unrealized gain (loss) on securities available for sale	**(92)**	(159)
Total comprehensive income	**353**	3,552
Dividend on preferred stock	**(189)**	(185)
Stock option compensation		8
Accretion of preferred stock discount	**51**	48
Balance, end of period	**$ 54,097**	$ 58,722

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)

	Three Months Ended March 31,	
	2011	2010
Cash Flows from Operating Activities:		
Net income	**$ 445**	$ 3,711
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	**347**	348
Provision for loan losses		900
Provision for (benefit of) income taxes	**214**	(3,411)
(Gain) loss on sales/calls of securities available for sale		(215)
(Gain) loss on sale of secondary market loans	**(42)**	(46)
Origination of secondary market loans held for sale	**(4,926)**	(2,810)
Proceeds from secondary market loans held for sale	**5,005**	2,873
(Gain) loss on sale of premises, equipment, and other real estate	**15**	20
Writedown of other real estate	**452**	128
Stock option compensation		8
Change in other assets	**(35)**	12,021
Change in other liabilities	**(125)**	(196)
Net cash provided by operating activities	**1,350**	13,331
Cash Flows from Investing Activities:		
Net decrease in loans	**7,213**	2,687
Net increase in interest-bearing deposits in other financial institutions	**(21)**	(22)
Purchase of securities available for sale	**(8,088)**	
Proceeds from maturities, sales, calls or paydowns of securities available for sale	**4,194**	9,560
Capital expenditures	**(330)**	(156)
Proceeds from sale of premises, equipment, and other real estate	**812**	840
Net cash provided by investing activities	**3,780**	12,909
Cash Flows from Financing Activities:		
Net increase (decrease) in deposits	**14,004**	(16,177)
Dividend on preferred stock	**(138)**	(137)
Net cash provided by (used in) financing activities	**13,866**	(16,314)
Net increase in cash and cash equivalents	**18,996**	9,926
Cash and cash equivalents at beginning of period	**34,719**	45,433

Cash and cash equivalents at end of period	**$ 53,715**	$ 55,359
Supplemental Cash Flow Information:		
Cash paid during the year for:		
Interest	**$ 1,315**	$ 1,658
Income taxes	**25**	
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)	**798**	2,907

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 three-month period ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. 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, 2010.

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

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

management believes the collectability of the principal is unlikely. In addition, various regulatory agencies periodically review the 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 split), were made available for grant under these plans. Options under all of the plans are granted at the discretion of a committee of the Corporation s Board of Directors. Options to purchase shares of the Corporation s stock were granted at a price equal to the market price of the stock at the date of grant. The committee determined the vesting of the options when they were granted as established under the plan. All of the option plans have expired.

2. **RECENT ACCOUNTING PRONOUNCEMENTS**

In April 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Updated (ASU) No. 2001-02, Receivables (Topic 310): *A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring.* The ASU will improve financial reporting by creating greater consistency in the way GAAP is applied for various types of debt restructurings. The ASU clarifies which loan modifications constitute troubled debt restructurings. The new guidance is effective for interim and annual periods beginning on or after June 15, 2011, and applies retrospectively to restructurings occurring on or after the beginning of the fiscal year of adoption. The provisions of this guidance are not expected to have a significant impact on our consolidated financial condition, results of operation or liquidity.

In May 2011, the FASB issued ASU No. 2011-03, Transfers and Servicing (Topic 860): *Reconsideration of Effective Control for Repurchase Agreements.* The ASU is intended to improve financial reporting of repurchase agreements (repos) and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments to the Codification in this ASU are intended to improve the accounting for these transactions by removing them from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets. The guidance in the ASU is effective for the first interim or annual period beginning on or after December 15, 2011. The provisions of this guidance are not expected to have a significant impact on the Corporation s consolidated financial condition, results of operation or liquidity.

3. **EARNINGS PER SHARE**

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

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

3. EARNINGS PER SHARE (Continued)

The following shows the computation of basic and diluted earnings per share for the three months ended March 31, 2011 and 2010 (dollars in thousands, except per share data):

	Three Months Ended March 31,	
	2011	2010
(Numerator):		
Net income	**$ 445**	$ 3,711
Preferred stock dividends	**189**	185
Net income available to common shareholders	**$ 256**	$ 3,526
(Denominator):		
Weighted average shares outstanding basic	**3,419,736**	3,419,736
Dilutive effect of stock options (1)		
Dilutive effect of common stock warrants (2)	**90,074**	
Weighted average shares outstanding diluted	**3,509,810**	3,419,736
Income per common share:		
Basic	**$ .07**	$ 1.03
Diluted	**$ .07**	$ 1.03

(1) At March 31, 2011 and 2010, there were 394,072 and 411,057 outstanding stock potions, respectively, which are not included in the computation of diluted earnings per share because they are considered anti-dilutive.

(2) At March 31, 2011 and March 31, 2010, there were 379,310 common stock warrants outstanding at an exercise price of $4.35. The dilutive impact for these shares was negligible for the three month period ended March 31, 2011 and not at all dilutive to the three month period ended March 31, 2010.

4. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities available for sale as of March 31, 2011, December 31, 2010 and March 31, 2010 are as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
March 31, 2011				
US Agencies	**$ 7,742**	**$ 11**	**$**	**$ 7,753**
US Agencies MBS	**22,528**	**739**		**23,267**
Obligations of states and political subdivisions	**1,146**	**41**	**(4)**	**1,183**
Corporate bonds	**5,338**	**2**		**5,340**
Total securities available for sale	**$ 36,754**	**$ 793**	**$ (4)**	**$ 37,543**

December 31, 2010								
US Agencies	$	5,000	$		$	(27)	$	4,973
US Agencies MBS		26,787		923				27,710
Obligations of states and political subdivisions		1,146		35		(4)		1,177
Total securities available for sale	$	32,933	$	958	$	(31)	$	33,860
March 31, 2010								
US Agencies MBS	$	34,220	$	1,326	$		$	35,546
Obligations of states and political subdivisions		1,206		89				1,295
Total securities available for sale	$	35,426	$	1,415	$		$	36,841

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 $12.670 million and $13.222 million, respectively, at March 31, 2011.

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

5. LOANS

The composition of loans at March 31 is as follows (dollars in thousands):

	March 31, 2011	December 31, 2010	March 31, 2010
Commercial real estate	**$ 200,649**	$ 194,859	$ 198,439
Commercial, financial, and agricultural	**63,673**	68,858	69,797
One to four family residential real estate	**75,663**	75,074	70,087
Construction :			
Consumer	**5,741**	5,682	6,909
Commercial	**23,438**	33,330	28,035
Consumer	**5,445**	5,283	4,044
Total loans	**$ 374,609**	$ 383,086	$ 377,311

An analysis of the allowance for loan losses for the three months ended March 31, 2011, the year ended December 31, 2010, and the three months ended March 31, 2010 is as follows (dollars in thousands):

	March 31, 2011	December 31, 2010	March 31, 2010
Balance at beginning of period	**$ 6,613**	$ 5,225	$ 5,225
Recoveries on loans previously charged off	**9**	374	19
Loans charged off	**(438)**	(5,486)	(1,407)
Provision		6,500	900
Balance at end of period	**$ 6,184**	$ 6,613	$ 4,737

In the first quarter of 2011, net charge off activity was $.429 million, or .11% of average loans outstanding compared to net charge-offs of $1.388 million, or .36% of average loans, in the same period in 2010. In the first quarter of 2011, the Corporation recorded no provision for loan loss compared to $.900 million in the first quarter of 2010. The Corporation s allowance for loan loss reserve policy calls for a measurement of the adequacy of the reserve at each quarter end. This process includes an analysis of the loan portfolio to take into account increases in loans outstanding and portfolio composition, historical loss rates, and specific reserve requirements of nonperforming loans.

A breakdown of the allowance for loan losses and recorded balances in loans at March 31, 2011 is as follows (dollars in thousands):

	Commercial real estate	Commercial, financial and agricultural	Commercial construction	One to four family residential real estate	Consumer construction	Consumer	Unallocated	Total

Allowance for loan loss reserve:								
Beginning balance ALLR	$ 3,460	$ 1,018	$ 389	$ 1,622	$	$	$ 124	$ 6,613
Charge-offs	(215)	(25)		(190)		(8)		(438)
Recoveries	3	1				5		9
Provision	(242)	(13)	(128)	356		3	24	
Unallocated assignment								
Ending balance ALLR	$ 3,006	$ 981	$ 261	$ 1,788	$	$	$ 148	$ 6,184
Loans:								
Ending balance	$ 200,649	$ 63,673	$ 23,438	$ 75,663	$ 5,741	$ 5,445	$	$ 374,609
Ending balance ALLR	(3,006)	(981)	(261)	(1,788)			(148)	(6,184)
Net loans	$ 197,643	$ 62,692	$ 23,177	$ 73,875	$ 5,741	$ 5,445	$ (148)	$ 368,425
Ending balance ALLR								
Individually evaluated	1,144	361	39	845				2,389
Collectively evaluated	1,862	620	222	943			148	3,795
Total	$ 3,006	$ 981	$ 261	$ 1,788	$	$	$ 148	$ 6,184

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

5. LOANS (Continued)

As part of the management of the loan portfolio, risk ratings are assigned to all commercial loans. Through the loan review process, ratings are modified as believed to be appropriate to reflect changes in the credit. Our ability to manage credit risk depends in large part on our ability to properly identify and manage problem loans. To do so, we operate a credit risk rating system under which our credit management personnel assign a credit risk rating to each loan at the time of origination and review loans on a regular basis to determine each loan s credit risk rating on a scale of 1 through 8, with higher scores indicating higher risk. The credit risk rating structure used is shown below.

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

Excellent (1)

Borrower is not vulnerable to sudden economic or technological changes and is in a non-seasonal business or industry. These loans generally would be characterized by having good experienced management and a strong liquidity position with minimal leverage.

Good (2)

Borrower shows limited vulnerability to sudden economic change with modest seasonal effect. Borrower has above average financial statements and an acceptable repayment history with minimal leverage and a profitability that exceeds peers.

Average (3)

Generally, a borrower rated as average may be susceptible to unfavorable changes in the economy and somewhat affected by seasonal factors. Some product lines may be affected by technological change. Borrowers in this category exhibit stable earnings, with a satisfactory payment history.

Acceptable (4)

The loan is an otherwise acceptable credit that warrants a higher level of administration due to various underlying weaknesses. These weaknesses, however, have not and may never deteriorate to the point of a Special Mention rating or Classified status. This rating category may include new businesses not yet having established a firm performance record.

Special Mention (5)

The loan is not considered as a Classified status, however may exhibit material weaknesses that, if not corrected, may cause future problems. Borrowers in this category warrant special attention but have not yet reached the point of concern for loss. The borrower may have deteriorated to the point that they would have difficulty refinancing elsewhere. Similarly, purchasers of these businesses would not be eligible for bank financing unless they represent a significantly lessened credit risk.

Substandard (6)

The loan is Classified and exhibits a number of well-defined weaknesses that jeopardize normal repayment. The assets are no longer adequately protected due to declining net worth, lack of earning capacity or insufficient collateral offering the distinct possibility of the loss of a portion of the loan principal. Loans within this category clearly represent troubled and deteriorating credit situations requiring constant supervision and an action plan must be developed and approved by the appropriate officers to mitigate the risk.

Doubtful (7)

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

Charge-off/Loss (8)

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

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

5. LOANS (Continued)

General Reserves:

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

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

Below is a breakdown of loans by risk category as of March 31, 2011 (dollars in thousands):

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	Rating	
	Excellent	Good	Average	Acceptable	Sp. Mention	Substandard	Doubtful	Loss	Unassigned	Total
Commercial real estate	$ 6,418	$ 16,899	$ 42,970	$ 116,110	$ 6,490	$ 9,049	$ 2,582	$	$ 131	$ 200,649
Commercial, financial and agricultural	3,373	3,722	15,524	37,455	230	2,534			835	63,673
Commercial construction	186	563	5,000	11,400	2,237	516			3,536	23,438
One to four family residential real estate	33	3,584	3,118	4,256	1,454	3,786			59,432	75,663
Consumer construction									5,741	5,741
Consumer			92	475					4,878	5,445
Total loans	$ 10,010	$ 24,768	$ 66,704	$ 169,696	$ 10,411	$ 15,885	$ 2,582	$	$ 74,553	$ 374,609

Below is a breakdown of loans by risk category as of December 31, 2010 (dollars in thousands):

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	Rating	
	Excellent	Good	Average	Acceptable	Sp. Mention	Substandard	Doubtful	Unassigned	Total
Commercial real estate	$ 4,745	$ 16,975	$ 44,408	$ 109,911	$ 3,789	$ 10,997	$ 3,956	$ 78	$ 194,859
Commercial, financial and	3,726	5,275	16,466	39,844	259	2,636		652	68,858

agricultural									
Commercial construction		579	4,416	22,280	1,921	568		3,566	33,330
One-to-four family residential real estate	33	3,589	3,146	4,271	1,464	3,941		58,630	75,074
Consumer construction								5,682	5,682
Consumer			34	368				4,881	5,283
Total loans	$ 8,504	$ 26,418	$ 68,470	$ 176,674	$ 7,433	$ 18,142	$ 3,956	$ 73,489	$ 383,086

The breakdown of loans by risk category for the period ended March 31, 2010 is not available. This disclosure was not required on March 31, 2010, and the Corporation no longer has this detail available for historical periods.

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5. LOANS (Continued)

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. The interest income recorded during impairment and that which would have been recognized were $.057 million and $.127 million for the three months ended March 31, 2011. For the three months ended March 31, 2010, the amounts were $.006 million and $.162 million.

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

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

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5. LOANS (Continued)

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

March 31, 2011	Nonaccrual Basis	Accrual Basis	Average Investment	Related Valuation Reserve	Interest Income Recognized During Impairment	Interest Income on Accrual Basis
With no valuation reserve:						
Commercial real estate	**$ 876**	**$**	**$ 5,602**	**$**	**$ 24**	**$ 30**
Commercial, financial and agricultural	**52**		**63**			**1**
Commercial construction	**458**		**458**			**8**
One to four family residential real estate	**942**	**105**	**785**			**11**
Consumer construction			**13**			
Consumer						
With a valuation reserve:						
Commercial real estate	**$ 3,181**	**$**	**$ 1,156**	**$ 770**	**$ 33**	**$ 22**
Commercial, financial and agricultural	**1,069**		**971**	**332**		**20**
Commercial construction						
One to four family residential real estate	**3,281**		**1,633**	**753**		**35**
Consumer construction						
Consumer						
Total:						
Commercial real estate	**$ 4,057**	**$**	**$ 6,758**	**$ 770**	**$ 57**	**$ 52**
Commercial, financial and agricultural	**1,121**		**1,034**	**332**		**21**
Commercial construction	**458**		**458**			**8**
	4,223	**105**	**2,418**	**753**		**46**

One to four family residential real estate						
Consumer construction			**13**			
Consumer						
Total	**$ 9,859**	**$ 105**	**$ 10,681**	**$ 1,855**	**$ 57**	**$ 127**
December 31, 2010						
With no valuation reserve:						
Commercial real estate	$ 960	$	$ 987	$	$	$ 71
Commercial, financial and agricultural	51		13			1
Commercial construction	458		1,186		11	33
One to four family residential real estate	362	105	237		1	13
Consumer construction						
Consumer						
With a valuation reserve:						
Commercial real estate	$ 2,562	$ 4,537	$ 6,531	$ 1,258	$ 117	$ 306
Commercial, financial and agricultural	709		1,660	279		95
Commercial construction						21
One to four family residential real estate	767		730	230	12	39
Consumer construction	52		52	1		4
Consumer						
Total:						
Commercial real estate	$ 3,522	$ 4,537	$ 7,518	$ 1,258	$ 117	$ 377
Commercial, financial and agricultural	760		1,673	279		96
Commercial construction	458		1,186		11	54
One to four family residential real estate	1,129	105	967	230	13	52
Consumer construction	52		52	1		4
Consumer						
Total	$ 5,921	$ 4,642	$ 11,396	$ 1,768	$ 141	$ 583

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5. LOANS (Continued)

March 31, 2010	Nonaccrual Basis	Accrual Basis	Average Investment	Related Valuation Reserve	Interest Income Recognized During Impairment	Interest Income on Accrual Basis
With no valuation reserve:						
Commercial real estate	$ 4,337	$ 869	$ 5,809	$	$ 6	$ 67
Commercial, financial and agricultural	526		804			9
Commercial construction	818		1,622			18
One to four family residential real estate	238		1,156			10
Consumer construction	52		52			1
Consumer						
With a valuation reserve:						
Commercial real estate	$ 1,535	$	$ 1,532	$ 107	$	$ 35
Commercial, financial and agricultural	1,521		1,522	1,512		22
Commercial construction						
One to four family residential real estate						
Consumer construction						
Consumer						
Total:						
Commercial real estate	$ 5,872	$ 869	$ 7,341	$ 107	$ 6	$ 102
Commercial, financial and agricultural	2,047		2,326	1,512		31
Commercial construction	818		1,622			18
One to four family residential real estate	238		1,156			10
Consumer construction	52		52			1
Consumer						
Total	$ 9,027	$ 869	$ 12,497	$ 1,619	$ 6	$ 162

A summary of past due loans at March 31, 2011, December 31, 2010 and March 31, 2010 is as follows (dollars in thousands):

	March 31, 2011			December 31, 2010			March 31, 2010		
	30-89 days Past Due (accruing)	**90+ days Past Due/ Nonaccrual**	**Total**	30-89 days Past Due (accruing)	90+ days Past Due/ Nonaccrual	Total	30-89 days Past Due (accruing)	90+ days Past Due/ Nonaccrual	Total
Commercial real estate	**$ 649**	**$ 4,057**	**$ 4,706**	$ 19	$ 3,522	$ 3,541	$ 675	$ 5,872	$ 6,547
Commercial, financial and agricultural	**1,137**	**1,121**	**2,258**	382	760	1,142	283	2,046	2,329
Commercial construction	**58**	**458**	**516**		458	458	26	818	844
One to four family residential real estate	**600**	**4,223**	**4,823**	923	1,129	2,052	280	238	518
Consumer construction					52	52		52	52
Consumer	**2**		**2**	20		20	5	1	6
Total past due loans	**$ 2,446**	**$ 9,859**	**$ 12,305**	$ 1,344	$ 5,921	$ 7,265	$ 1,269	$ 9,027	$ 10,296

roll-forward of nonaccrual activity for the first three months ended March 31, 2011 (dollars in thousands):

	For the Three Months Ended March 31, 2011						
	Commercial Real Estate	**Commercial, Financial and Agricultural**	**Commercial Construction**	**One to four family residential real estate**	**Consumer Construction**	**Consumer**	**Total**
NONACCRUAL							
Beginning balance	**$ 3,522**	**$ 760**	**$ 458**	**$ 1,129**	**$ 52**	**$**	**$ 5,921**
Principal payments	**(458)**	**(5)**		**(15)**			**(478)**
Charge-offs	**(203)**	**(25)**		**(28)**			**(256)**
Advances							
Class transfers							
Transfers to OREO	**(644)**			**(101)**	**(52)**		**(797)**
Transfers to accruing	**(892)**						**(892)**
Transfers from accruing	**2,724**	**389**		**3,237**			**6,350**
Other	**8**	**2**		**1**			**11**

Ending balance	**$ 4,057**	**$ 1,121**	**$ 458**	**$ 4,223**	**$**	**$**	**$ 9,859**

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MACKINAC FINANCIAL CORPORATION
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5. LOANS (Continued)

A roll-forward of nonaccrual activity for the first three months ended March 31, 2010 (dollars in thousands):

	For the Three Months Ended March 31, 2010						
	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer Construction	Consumer	Total
NONACCRUAL							
Beginning balance	$ 8,290	$ 2,644	$ 1,919	$ 1,461	$ 52	$ 2	$ 14,368
Principal payments	(4,438)	(665)	(83)	(22)		(1)	(5,209)
Charge-offs	(1,119)	(2)	(19)	(1,112)			(2,252)
Advances							
Class transfers							
Transfers to OREO	(466)	(102)	(1,003)	(129)			(1,700)
Transfers to accruing	(55)						(55)
Transfers from accruing	3,638	171		35			3,844
Other	22		4	5			31
Ending balance	$ 5,872	$ 2,046	$ 818	$ 238	$ 52	$ 1	$ 9,027

Insider Loans

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

	March 31, 2011	December 31, 2010	March 31, 2010
Loans outstanding, beginning of period	**$ 9,532**	$ 8,552	$ 8,552
New loans	**705**	5,243	1,087
Net activity on revolving lines of credit	**124**	2,065	1,938
Repayment	**(1,216)**	(6,328)	(2,104)
Loans outstanding, end of period	**$ 9,145**	$ 9,532	$ 9,473

There were no loans to related parties classified substandard as of March 31, 2011, December 31, 2010 or March 31, 2010. In addition to the outstanding balances above, there were unfunded commitments of $.350 million to related parties at March 31, 2011.

6. BORROWINGS

Borrowings consist of the following at March 31, 2011, December 31, 2010 and March 31, 2010 (dollars in thousands):

	March 31, 2011	December 31, 2010	March 31, 2010
Federal Home Loan Bank fixed rate advances at a weighted average rate of 1.73% maturing from December 2011 to January 2016	**$ 35,000**	$ 35,000	$ 35,000
USDA Rural Development, fixed-rate note payable, maturing August 24, 2024, interest payable at 1%	**1,069**	1,069	1,140
	$ 36,069	$ 36,069	$ 36,140

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MACKINAC FINANCIAL CORPORATION
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6. BORROWINGS (Continued)

The Federal Home Loan Bank borrowings are collateralized at March 31, 2011 by the following: a collateral agreement on the Corporation s one to four family residential real estate loans with a book value of approximately $35.892 million; mortgage related and municipal securities with an amortized cost and estimated fair value of $12.303 million and $12.476 million, respectively; and Federal Home Loan Bank stock owned by the Bank totaling $3.423 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 March 31, 2011.

The USDA Rural Development borrowing is collateralized by loans totaling $.253 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 $.925 million, and guaranteed by the Corporation.

7. STOCK OPTION PLANS

A summary of stock option transactions for the three months ended March 31, 2011 and 2010, and the year ended December 31, 2010, is as follows:

	March 31, 2011	December 31, 2010	March 31, 2010
Outstanding shares at beginning of year	**394,072**	411,057	411,057
Granted during the period			
Exercised during the period			
Expired / forfeited during the period		(16,985)	
Outstanding shares at end of period	**394,072**	394,072	411,057
Exercisable shares at end of period	**150,781**	150,781	157,266
Weighted average exercise price per share at end of period	**$ 10.98**	$ 10.98	$ 12.03
Shares available for grant at end of period			

There were no options granted in the first three months of 2011 and 2010.

Following is a summary of the options outstanding and exercisable at March 31, 2011:

Exercise Price	Number Outstanding	Number Exercisable	Unvested Options	Weighted Average Remaining Contractual Life-Years
$ 9.16	5,000	2,000	3,000	4.71
$ 9.75	257,152	120,861	136,291	3.71
$ 10.65	50,000	10,000	40,000	5.71

$ 11.50	40,000	8,000	32,000	4.50
$ 12.00	40,000	8,000	32,000	4.32
$ 156.00	1,920	1,920		.58
	394,072	150,781	243,291	4.09

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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. At March 31, 2010 Management evaluated the valuation allowance. An analysis of the deferred tax asset was made to determine the utilization of those tax benefits based upon projected future taxable income. At that time, based upon management s determination and in accordance with the generally accepted accounting principles, that it was more likely than not that a portion of these benefits would be utilized, a $3.500 million valuation adjustment was made as a credit to income tax expense. Among the criteria that management considered in evaluating the deferred tax asset was taxable income for the three most recent taxable years ending December 31, 2009 which totaled $8.2 million. This taxable income allowed the Corporation to utilize NOL carryforwards.

Management assessed the valuation allowance for the second and third quarters of 2010 and determined that no additional adjustment was deemed appropriate. At December 31, 2010, based upon further analysis, and in recognition of the current period operating loss before taxes, management determined that an adjustment to the valuation was appropriate and increased the valuation allowance by $1.364 million with an increase to current tax expense.

Management evaluated the deferred tax valuation allowance as of March 31, 2011 and determined that no adjustment to the valuation was warranted. The Corporation, as of March 31, 2011 had a net operating loss and tax credit carryforwards for tax purposes of approximately $27.0 million, and $2.1 million, respectively.

The Corporation will continue to evaluate the future benefits from these carryforwards and at such time as it became more likely than not that they would be utilized prior to expiration will recognize the additional benefits as an adjustment to the valuation allowance. 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 $17.0 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 $1.400 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.

9. FAIR VALUE MEASUREMENTS

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

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

Securities - Fair values are based on quoted market prices where available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

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

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

loan.

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.

MACKINAC FINANCIAL CORPORATION
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9. FAIR VALUE MEASUREMENTS (Continued)

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

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

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

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

The following table presents information for financial instruments at March 31, 2011 and December 31, 2010 (dollars in thousands):

	March 31, 2011		December 31, 2010	
	Carrying Amount	**Estimated Fair Value**	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	**$ 53,715**	**$ 53,715**	$ 34,719	$ 34,719
Interest-bearing deposits	**734**	**734**	713	713
Securities available for sale	**37,543**	**37,543**	33,860	33,860
Federal Home Loan Bank stock	**3,423**	**3,423**	3,423	3,423
Net loans	**368,425**	**368,436**	376,473	376,713
Accrued interest receivable	**1,401**	**1,401**	1,155	1,155
Total financial assets	**$ 465,241**	**$ 465,252**	$ 450,343	$ 450,583
Financial liabilities:				
Deposits	**$ 400,783**	**$ 402,311**	$ 386,779	$ 387,885
Borrowings	**36,069**	**35,658**	36,069	36,234
Accrued interest payable	**276**	**276**	232	232
Total financial liabilities	**$ 437,128**	**$ 438,245**	$ 423,080	$ 424,351

***Limitations* -** Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Corporation s entire holdings of a particular financial instrument.

Because no market exists for a significant portion of the Corporation s financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates. Fair value estimates are based on existing on-and off-balance-sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial assets or liabilities include premises and equipment, other assets, and other liabilities. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

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9. FAIR VALUE MEASUREMENTS (Continued)

The following is information about the Corporation s assets and liabilities measured at fair value on a recurring basis at December 31, 2010, and the valuation techniques used by the Corporation to determine those fair values.

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

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

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

The fair value of all investment securities at March 31, 2011 and March 31, 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 March 31, 2011, December 31, 2010 or March 31, 2010.

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

Assets Measured at Fair Value on a Nonrecurring Basis

(dollars in thousands)	Balance at March 31, 2011	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 March 31, 2011
Assets					
Impaired loans	$ 9,964	$	$	$ 9,964	$ 426
Other real estate owned	5,081			5,081	467

					$ 893

Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2010

(dollars in thousands)	Balance at December 31, 2010	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, 2010
Assets					
Impaired loans	$ 10,563	$	$	$ 10,563	$ 1,666
Other real estate owned	5,562			5,562	2,753
					$ 4,419

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

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9. FAIR VALUE MEASUREMENTS (Continued)

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

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 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.

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10. SHAREHOLDERS EQUITY (Continued)

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.

The Corporation is considering whether or not to participate in the U.S. Treasury s Small Business Lending Fund program (SBLF). The Corporation has applied for funding under the SBLF, but has not yet received approval, nor has the Corporation determined if it will participate if approved. This SBLF program would allow the Corporation to pay off the TARP preferred and also requires an injection of capital into the Bank which is dependent upon the amount of the total SBLF funding less the $11 million of TARP preferred.

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):

	March 31, 2011	December 31, 2010	March 31, 2010
Commitments to extend credit:			
Variable rate	**$ 27,814**	$ 18,092	$ 26,629
Fixed rate	**11,325**	13,034	9,853
Standby letters of credit Variable rate	**2,137**	2,192	1,170
Credit card commitments Fixed rate	**2,991**	2,737	2,761
	$ 44,267	$ 36,055	$ 40,413

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management s credit evaluation of the party. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

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

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

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

11. COMMITMENTS, CONTINGENCIES AND CREDIT RISK (Continued)

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 March 31, 2011 represents $58.132 million, or 20.20%, compared to $49.753 million, or 16.79%, of the commercial loan portfolio on March 31, 2010. The remainder of the commercial loan portfolio is diversified in such categories as hospitality and tourism, real estate agents and managers, new car dealers, gaming, petroleum, forestry, agriculture and construction. Due to the diversity of the Bank s locations, the ability of debtors of residential and consumer loans to honor their obligations is not tied to any particular economic sector.

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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, 2010. Throughout this discussion, the term Bank refers to mBank, the principal banking subsidiary of the Corporation.

FINANCIAL OVERVIEW

The Corporation recorded a first quarter 2011 net income available to common shareholders of $.256 million or $0.07 per share compared to net income of $3.526 million, or $1.03 per share for the first quarter of 2010. Operating results for the first quarter of 2010 included the recognition of a $3.500 million deferred tax benefit related to NOL carryforwards. Weighted average shares totaled 3,419,736 for the first quarter in 2011 and 2010.

The first quarter results include no provision for loan losses compared to $.900 million for the same three month period in 2010. Operating results for the three month period in 2011 included $.452 million in OREO write-downs. The net interest margin for the first quarter of 2011 increased to $4.141 million, or 3.92%, compared to $4.022 million, of 3.51% in the first quarter of 2010.

Total assets of the Corporation at March 31, 2011 were $492.790 million, down by $9.637 million, or 1.92% from the $502.427 million in total assets reported at March 31, 2010 and up by $14.094 million, or 2.94%, from total assets of $478.696 million at year-end 2010. Asset totals at March 31, 2011 reflect increased balances of investment securities of approximately $3.683 million from December 31, 2010. The loan portfolio decreased $8.477 million in the first quarter of 2011, from December 31, 2010 balances of $383.086 million. Deposits totaled $400.783 million at March 31, 2011, an increase of $14.004 million from the $386.779 million at December 31, 2010.

FINANCIAL CONDITION

Cash and Cash Equivalents

Cash and cash equivalents increased $18.996 million during the first quarter of 2011. See further discussion of the change in cash and cash equivalents in the Liquidity section.

Investment Securities

Securities available for sale increased $3.683 million, or 10.88%, from December 31, 2010 to March 31, 2011, with the balance on March 31, 2011, totaling $37.543 million. The Corporation purchased $8.1 million of investments during the 2011 first quarter as deposit growth exceeded loan funding demand. Investment securities are utilized in an effort to manage interest rate risk and liquidity. As of March 31, 2011, investment securities with an estimated fair value of $13.222 million were pledged.

Loans

Through the first quarter of 2011, loan balances decreased by $8.477 million, or 2.21%, from December 31, 2010 balances of $383.086 million. During the first three months of 2011, the Bank had total loan production of $16.855 million, which included $4.926 million of secondary market loan production. This loan production, however, was offset loan principal runoff, paydowns and amortization, totaling $16.779 million , along with USDA and SBA loan sales of $2.400 million and nonperforming loans transferred to OREO amounting to $.798 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.

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

Following is a summary of the loan portfolio at March 31, 2011, December 31, 2010 and March 31, 2010 (dollars in thousands):

	March 31, 2011	**Percent of Total**	December 31, 2010	Percent of Total	March 31, 2010	Percent of Total
Commercial real estate	$ 200,649	53.56%	$ 194,859	50.87%	$ 198,439	52.59%
Commercial, financial, and agricultural	63,673	17.00	68,858	17.97	69,797	18.50
One to four family residential real estate	75,663	20.20	75,074	19.60	70,087	18.58
Construction:						
Consumer	5,741	1.53	5,682	1.48	6,909	1.83
Commercial	23,438	6.26	33,330	8.70	28,035	7.43
Consumer	5,445	1.45	5,283	1.38	4,044	1.07
Total loans	$ 374,609	100.00%	$ 383,086	100.00%	$ 377,311	100.00%

Following is a table showing the significant industry types in the commercial loan portfolio as of March 31, 2011, December 31, 2010 and March 31, 2010 (dollars in thousands):

	March 31, 2011			December 31, 2010			March 31, 2010		
	Outstanding Balance	**Percent of Commercial Loans**	**Percent of Shareholders Equity**	Outstanding Balance	Percent of Commercial Loans	Percent of Shareholders Equity	Outstanding Balance	Percent of Commercial Loans	Percent of Shareholders Equity
Real estate operators of nonres bldgs	$ 58,132	20.20%	107.46%	$ 58,114	19.56%	107.85%	$ 49,753	16.79%	84.73%
Hospitality and tourism	35,016	12.17	64.73	37,737	12.70	70.04	44,820	15.13	76.33
Commercial construction	23,438	8.15	43.33	33,330	11.22	61.86	28,035	9.46	47.74
Operators of nonresidential buildings	17,091	5.94	31.59	16,598	5.59	30.80	13,170	4.45	22.43
Real estate agents and managers	15,518	5.39	28.69	15,857	5.34	29.43	21,529	7.27	36.66
Other	138,565	48.15	256.14	135,411	45.59	251.31	138,964	46.90	236.65
Total Commercial Loans	$ 287,760	100.00%		$ 297,047	100.00%		$ 296,271	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 March 31, 2011. 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 March 31, 2011, our residential loan portfolio totaled $75.663 million, or 20.20% of our total outstanding loans.

The Corporation has also extended credit to governmental units, including Native American organizations.

Tax-exempt loans and leases decreased from $2.471 million at the end of December 31, 2010 to $2.412 million at March 31, 2011. The Corporation has elected to reduce its tax-exempt portfolio, since it provides no current tax benefit, due to tax net operating loss carryforwards.

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

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

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 three months ended March 31, 2011 amounted to $.429 million, or .11% of average loans outstanding, compared to $1.388 million, or .36% of average loans outstanding, for the same period in 2010. The current reserve balance is representative of the relevant risk inherent within the Corporation s loan portfolio. Additions or reductions to the reserve in future periods will be dependent upon a combination of future loan growth, nonperforming loan balances and charge-off activity.

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

	March 31, 2011	December 31, 2010	March 31, 2010
Nonperforming Assets:			
Nonaccrual Loans	**$ 9,859**	$ 5,921	$ 9,027
Loans past due 90 days or more			
Restructured loans	**105**	4,642	869
Total nonperforming loans	**9,964**	10,563	9,896
Other real estate owned	**5,081**	5,562	7,723
Total nonperforming assets	**$ 15,045**	$ 16,125	$ 17,619
Nonperforming loans as a % of loans	**2.66**%	2.76%	2.62%
Nonperforming assets as a % of assets	**3.05**%	3.37%	3.51%
Reserve for Loan Losses:			
At period end	**$ 6,184**	$ 6,613	$ 4,737
As a % of loans	**1.65**%	1.73%	1.26%
As a % of nonperforming loans	**62.06**%	62.61%	47.87%
As a % of nonaccrual loans	**62.72**%	111.69%	52.48%
Texas ratio*	**24.96**%	26.66%	27.75%

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

Nonperforming assets at $15.045 million have been reduced in 2011 by $1.080 million from the $16.125 million at 2010 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 first quarter of 2011, there was a significant decrease in balances of restructured loans, approximately $4.537 million. This largely relates to one credit relationship which was reclassified from restructured to nonaccrual during the first quarter of 2011 due to further deterioration.

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

	At Period End		
	March 31, 2011	December 31, 2010	March 31, 2010
Total loans, at period end	**$ 374,609**	$ 386,086	$ 377,311
Average loans for the year	**$ 380,066**	$ 384,347	$ 384,640

	For the Period Ended		
	Three Months Ended March 31, 2011	Twelve Months Ended December 31, 2010	Three Months Ended March 31, 2010
Net charge-offs during the period	**$ 429**	$ 5,112	$ 1,388
Net charge-offs to average loans	**.11%**	1.33%	.36%
Net charge-offs to beginning allowance balance	**6.49%**	97.84%	26.56%

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 2010 provided findings similar to management on the overall adequacy of the reserve. In 2011, the Corporation will again utilize a consultant for loan review.

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

As of March 31, 2011, the allowance for loan losses represented 1.65% of total loans. At March 31, 2011, the allowance included specific reserves in the amount of $2.390 million, as compared to $2.666 million at December 31, 2010 and $2.006 million at March 31, 2010. 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):

	Three Months Ended March 31, 2011	Year Ended December 31, 2010	Three Months Ended March 31, 2010
Balance at beginning of period	**$ 5,562**	$ 5,804	$ 5,804
Other real estate transferred from loans due to foreclosure	**798**	5,373	2,907
Other real estate sold	**(812)**	(2,862)	(839)
OREO write downs	**(452)**	(2,703)	(128)
Loss on sale of other real estate	**(15)**	(50)	(21)
Balance at end of period	**$ 5,081**	$ 5,562	$ 7,723

During the first quarter of 2011, the Corporation received real estate in lieu of loan payments of $.798 million. Other real estate is initially valued at the lower of cost or the fair value less selling costs. After the initial receipt, management periodically re-evaluates the recorded balances and any additional reductions in the fair value result in a write-down of other real estate.

Deposits

The Corporation had an increase in deposits in the first quarter of 2011. Total deposits increased by $14.004 million, or 3.62%, in the first quarter of 2011. The increase in deposits for the first quarter of 2011 is composed of a decrease in noncore deposits of $11.020 million and an increase in core deposits of $25.024 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. 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):

	March 31, 2011	**% of Total**	December 31, 2010	% of Total	March 31, 2010	% of Total
Non-interest-bearing	**$ 39,269**	**9.80%**	$ 41,264	10.67%	$ 30,356	7.49%
NOW, money market, checking	**154,420**	**38.54**	134,703	34.83	109,374	26.99

Savings	**17,691**	**4.41**	17,670	4.57	20,675	5.10
Certificates of Deposit <$100,000	**104,258**	**26.01**	96,977	25.07	75,822	18.71
Total core deposits	**315,638**	**78.76**	290,614	75.14	236,227	58.29
Certificates of Deposit >$100,000	**21,803**	**5.44**	22,698	5.87	30,173	7.45
Brokered CDs	**63,342**	**15.80**	73,467	18.99	138,812	34.26
Total non-core deposits	**85,145**	**21.24**	96,165	24.86	168,985	41.71
Total deposits	**$ 400,783**	**100.00**%	$ 386,779	100.00%	$ 405,212	100.00%

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

Borrowings

The Corporation also uses FHLB borrowings to provide long-term, stable sources of funds. Current FHLB borrowings total $35.000 million with stated maturities ranging through January 2016. 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 $.215 million from December 31, 2010 to March 31, 2011. Contributing to the increase in shareholders equity was net income of $.256 million, a decrease in the market value of securities of $.092 million and the accretion of the discount on preferred stock of $.051 million.

RESULTS OF OPERATIONS

Summary

The Corporation reported net income available to common shareholders of $.256 million, or $.07 per share, in the first quarter of 2011, compared to $3.526 million or $1.03 per share for the first quarter of 2010. Operating results for the first quarter 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 quarter of 2011 there was no provision for loan losses booked in comparison to a provision of $.900 million in the first quarter of 2010. The first quarter of 2011 also includes the preferred dividend and accretion of discount of $.189 million.

Net Interest Income

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

Net interest margin on a fully taxable equivalent basis amounted to $4.166 million, 3.94% of average earning assets, in the first quarter of 2011, compared to $4.052 million, 3.53% of average earning assets, in the first quarter of 2010. In the first quarter of 2011, net interest margin increased to $4.141 million, 3.92% of average earning assets, compared to $4.022 million, 3.51% of average earning assets, for the same period in 2010. Margin improvement in 2011 was primarily due to a reduction in funding costs between periods.

MACKINAC FINANCIAL CORPORATION

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

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.

	Three Months Ended										
								2011-2010			
	Average Balances			**Average Rates**		**Interest**		Income/			Rate/
	March 31,		Increase/	March 31,		March 31,		Expense	Volume	Rate	Volume
(dollars in thousands)	**2011**	2010	(Decrease)	**2011**	2010	**2011**	2010	Variance	Variance	Variance	Variance
Loans (1,2,3)	**$ 380,066**	$ 384,640	$ (4,574)	**5.55%**	5.56%	**$ 5,199**	$ 5,270	$ (71)	$ (63)	$ (8)	$
Taxable securities	**32,271**	37,393	(5,122)	**3.54**	4.31	**282**	397	(115)	(54)	(71)	10
Nontaxable securities (2)	**855**	844	11	**5.22**	4.81	**11**	10	1		1	
Federal funds sold	**11,611**	37,833	(26,222)	**.24**	0.25	**7**	23	(16)	(16)		
Other interest-earning assets	**4,140**	4,470	(330)	**2.55**	1.54	**26**	17	9	(1)	11	(1)
Total earning assets	**428,943**	465,180	(36,237)	**5.22**	4.98	**5,525**	5,717	(192)	(134)	(67)	9
Reserve for loan losses	**(6,687)**	(5,073)	(1,614)								
Cash and due from banks	**27,254**	19,772	7,482								
Fixed Assets	**9,684**	10,131	(447)								
Other Real Estate	**4,921**	5,768	(847)								
Other assets	**14,746**	12,717	2,029								
Total assets	**$ 478,861**	$ 508,495	$ (29,634)								
NOW and money market deposits	**$ 120,034**	$ 87,700	$ 32,334	**.79%**	1.04%	**$ 234**	$ 225	$ 9	$ 83	$ (54)	$ (20)
Interest checking	**23,829**	15,475	8,354	**1.17**	1.73	**69**	66	3	35	(21)	(11)
Savings deposits	**17,741**	18,378	(637)	**.27**	.66	**12**	30	(18)	(1)	(18)	1
CDs <$100,000	**96,735**	66,187	30,548	**1.90**	2.21	**453**	361	92	167	(51)	(24)
CDs >$100,000	**22,122**	33,112	(10,990)	**1.74**	1.71	**95**	140	(45)	(46)	2	(1)
Brokered deposits	**66,380**	159,501	(93,121)	**2.18**	1.61	**356**	635	(279)	(370)	220	(129)
Borrowings	**36,069**	36,140	(71)	**1.57**	2.33	**140**	208	(68)		(68)	
Total interest-bearing liabilities	**382,910**	416,493	(33,583)	**1.44**	1.62	**1,359**	1,665	(306)	(132)	10	(184)
Demand deposits	**39,902**	33,544	6,358								
Other liabilities	**2,179**	3,349	(1,170)								
Shareholders equity	**53,870**	55,109	(1,239)								
Total liabilities and shareholders equity	**$ 478,861**	$ 508,495	$ (29,634)								
Rate spread				**3.78%**	3.36%						

Net interest margin/revenue	**3.94%**	3.53%	**$ 4,166**	$ 4,052	$ 114	$ (2)	$ (77)	$ 193

(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

Throughout 2011 and 2010 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 3.53% in the first quarter of 2010 to 3.94% in the first quarter of 2011.

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 quarter of 2011, the Corporation determined through this analysis that no provision for loan loss was required, compared to a $.900 million provision in the first quarter of 2010. The determination for no additions to the allowance in the first quarter of 2011 included factors such as an overall reduction in loans outstanding and first quarter charge-offs that were specifically reserved for as of December 31, 2010. 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 $.230 million for the three months ended March 31, 2011, compared to the $.807 million in three months ended March 31, 2010 due primarily to the security gains of $.215 million recognized in 2010. In the first quarter of 2011, revenue due to loans produced and sold in the secondary market, along with the sale of SBA guaranteed loans, amounted to $.314 million compared to $.316 million a year ago. We expect to continue to benefit from secondary market activity in future periods. Service fees and other noninterest income decreased slightly between periods largely because of lower NSF fees, which we believe will continue due to customers being more diligent in managing their accounts.

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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 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 months ended March 31, 2011 and 2010 (dollars in thousands):

	Three Months Ended March 31,			
			Increase/(Decrease)	
	2011	2010	**Dollars**	**Percent**
Service fees	**$ 217**	$ 223	$ (6)	(2.69)%
Income from loans sold	**314**	316	(2)	(0.63)
Other noninterest income	**46**	53	(7)	(13.21)
Subtotal	**577**	592	(15)	(2.53)
Net security gain (loss)		215	(215)	
Total noninterest income	**$ 577**	$ 807	$ (230)	(28.50)%

Other Expense

Other expenses increased $.430 million for the quarter ended March 31, 2011, compared to the same period in 2010. The most significant increase in other expense was in costs associated with higher levels of nonperforming assets. During the first quarter of 2011, the Corporation recorded $.452 million in total write-downs and net losses of OREO properties. Salaries and employee benefits increased primarily due to increased benefit costs between periods. 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 months ended March 31, 2011 and 2010 (dollars in thousands):

	Three Months Ended March 31,			
			Increase/(Decrease)	
	2011	2010	**Dollars**	**Percentage**
Salaries and employee benefits	**$ 1,824**	$ 1,720	$ 104	6.05%
Occupancy	**365**	345	20	5.80
Furniture and equipment	**194**	194		
Data processing	**176**	189	(13)	(6.88)
Professional service fees	**153**	173	(20)	(11.56)
Loan and deposit	**179**	268	(89)	(33.21)
OREO writedowns and (gains) losses on sale	**467**	147	320	217.69
FDIC insurance premiums	**285**	222	63	28.38
Telephone	**51**	47	4	8.51
Advertising	**88**	72	16	22.22
Other operating expenses	**277**	252	25	9.92
Total noninterest expense	**$ 4,059**	$ 3,629	$ 430	11.85%

Federal Income Taxes

Current Federal Tax Provision

In the first quarter of 2011, 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, no adjustment to the valuation allowance was deemed necessary.

MACKINAC FINANCIAL CORPORATION

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

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 be realized. As of March 31, 2011, the Corporation had an NOL carryforward of approximately $27.0 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 $17.0 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 March 31, 2011, in deference to the income recorded in the 2011 first 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 $41.715 million in cash and due from balances, $12.000 million in federal funds sold and $24.321 million of unpledged investment securities. The Corporation has also experienced significant deposit inflows during the first three months of 2011. 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 matured. These borrowings were refinanced with the FHLB and now carry a weighted average maturity of three years and a weighted average rate of 1.75%.

During the first quarter of 2011, the Corporation increased cash and cash equivalents by $18.996 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 increase in investment securities of $3.894 million and a net decrease in loans of $7.213 million. Offsetting the net decrease provided by investing activities were uses in financing activities, primarily a net increase in deposits of $14.004 million. The increase in deposits was composed of a decrease in brokered deposits of $10.125 million combined with an increase in bank deposits of $24.129 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 2011, the Corporation will fund anticipated loan production by reducing current balances of liquidity.

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

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.
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 March 31, 2011, the Bank s core deposits in relation to total funding were 72.25% compared to 53.52% at March 31, 2010. These ratios indicated at March 31, 2011, 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 March 31, 2011, the Bank had $15.875 million of unsecured lines available and another $2.500 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 2011 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 2011 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 March 31, 2011, the Corporation and Bank were well capitalized. During the first quarter of 2011, total capitalization increased by $.215 million.

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MACKINAC FINANCIAL CORPORATION

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

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

	March 31, 2011	December 31, 2010	March 31, 2010
Capital Structure			
Shareholders equity	**$ 54,097**	$ 53,882	$ 58,722
Total capitalization	**$ 54,097**	$ 53,882	$ 58,722
Tangible capital	**$ 54,097**	$ 53,882	$ 58,722
Intangible Assets			
Core deposit premium	**$**	$	$
Other identifiable intangibles			
Total intangibles	**$**	$	$
Regulatory capital			
Tier 1 capital:			
Shareholders equity	**$ 54,097**	$ 53,882	$ 58,722
Net unrealized (gains) losses on available for sale securities	**(520)**	(612)	(934)
Less: disallowed deferred tax asset	**(8,000)**	(9,028)	(8,700)
Less: intangibles			
Total Tier 1 capital	**$ 45,577**	$ 44,242	$ 49,088
Tier 2 Capital:			
Allowable reserve for loan losses	**$ 4,891**	$ 4,890	$ 4,737
Qualifying long-term debt			
Total Tier 2 capital	**4,891**	4,890	4,737
Total capital	**$ 50,468**	$ 49,132	$ 53,825
Risk-adjusted assets	**$ 389,967**	$ 389,468	$ 393,226
Capital ratios:			
Tier 1 Capital to average assets	**9.70**%	9.25%	9.85
Tier 1 Capital to risk weighted assets	**11.69**%	11.36%	12.48
Total Capital to risk weighted assets	**12.94**%	12.62%	13.69

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 minumum 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:					
March 31, 2011	**10.98%**	**10.98%**	**9.70%**	**11.69%**	**12.94%**
March 31, 2010	11.69%	11.69%	9.85%	12.48%	13.69%
The Bank:					
March 31, 2011	**10.02%**	**10.02%**	**8.54%**	**10.29%**	**11.54%**
March 31, 2010	10.34%	10.34%	8.43%	10.67%	11.86%

MACKINAC FINANCIAL CORPORATION

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK

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

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

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

The Corporation has established interest rate floors on approximately $161 million, or 76% 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 $65 million of the floor rate loan balances will reprice with a 100 basis point increase on the prime rate, with another $94 million repricing in the next 100 basis point prime rate increase.

The Corporation also has $37.543 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 $211 million of transactional accounts, of which $39 million consists of noninterest bearing demand deposit balances. Transaction account balances have increased significantly in the last year due in part to the Corporation s focus on these low costs accounts by developing new attractive products and increased sales efforts to municipalities, schools and businesses. These transactional account balances provide additional repricing flexibility in changing interest rate environments since they have no scheduled maturities and interest rates can be reset at any time. Other deposit products have a variety of terms ranging from deposits whose interest rates can change on a weekly basis to certificates of deposit with repricing terms of up to five years. Longer term deposits generally include penalty provisions for early withdrawal.

Beyond general efforts to shorten the loan pricing periods and extend deposit maturities, management can manage interest rate risk by 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.

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 March 31, 2011 (dollars in thousands):

	1-90 Days	91 - 365 Days	>1-5 Years	Over 5 Years	Total
Interest-earning assets:					
Loans	$ 266,025	$ 6,195	$ 23,491	$ 78,898	$ 374,609
Securities	134	17,187	19,690	532	37,543
Other (1)	12,734			3,423	16,157
Total interest-earning assets	278,893	23,382	43,181	82,853	428,309
Interest-bearing obligations:					
NOW, money market, savings, interest checking	172,111				172,111
Time deposits	18,653	41,363	65,740	305	126,061
Brokered CDs	20,398	40,216		2,728	63,342
Borrowings		5,000	30,000	1,069	36,069
Total interest-bearing obligations	211,162	86,579	95,740	4,102	397,583
Gap	$ 67,731	$ (63,197)	$ (52,559)	$ 78,751	$ 30,726
Cumulative gap	$ 67,731	$ 4,534	$ (48,025)	$ 30,726	

(1) Includes Federal Home Loan Bank Stock

The above analysis indicates that at March 31, 2011, the Corporation had a cumulative asset sensitivity gap position of $4.534 million within the one-year time frame. The Corporation s cumulative asset sensitive gap suggests that if market interest rates continue to decline in the next twelve months, the Corporation may experience a decrease in 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, 2010, the Corporation had a cumulative liability sensitivity gap position of $1.258 million within the one-year time frame.

The borrowings in the gap analysis include $35.000 million of FHLB advances that were refinanced in late 2010 and early 2011 to fixed rate advances. These borrowings now have a weighted average maturity of 3.0 years with a weighted average rate of 1.75%.

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.

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 March 31, 2011, 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 March 31, 2011.

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 March 31, 2011 that have materially affected, or are reasonably likely to materially affect, the Corporation s internal control over financial reporting.

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: May 16, 2011

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)