MACKINAC FINANCIAL CORP /MI/
Form 10-Q
May 15, 2015
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2015

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 (State or other jurisdiction of incorporation or organization)	**38-2062816** (I.R.S. Employer Identification No.)
130 SOUTH CEDAR STREET, MANISTIQUE, MI (Address of principal executive offices)	**49854** (Zip Code)

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

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

Yes x 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 x 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 Smaller reporting company x

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

Yes o No x

As of April 30, 2015, there were outstanding 6,246,450 shares of the registrant s common stock, no par value.

Table of Contents

MACKINAC FINANCIAL CORPORATION

INDEX

Table of Contents

MACKINAC FINANCIAL CORPORATION

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)

	March 31, 2015 (Unaudited)	December 31, 2014	March 31, 2014 (Unaudited)
ASSETS			
Cash and due from banks	**$ 24,242**	$ 21,947	$ 24,748
Federal funds sold	**4**		3
Cash and cash equivalents	**24,246**	21,947	24,751
Interest-bearing deposits in other financial institutions	**5,832**	5,797	10
Securities available for sale	**63,313**	65,832	47,411
Federal Home Loan Bank stock	**2,973**	2,973	3,060
Loans:			
Commercial	**428,439**	433,566	361,299
Mortgage	**152,016**	148,984	110,759
Consumer	**17,276**	18,385	13,804
Total Loans	**597,731**	600,935	485,862
Allowance for loan losses	**(5,527)**	(5,140)	(4,883)
Net loans	**592,204**	595,795	480,979
Premises and equipment	**12,614**	12,658	9,800
Other real estate held for sale	**2,632**	3,010	2,166
Deferred tax asset	**10,332**	11,498	9,533
Deposit based intangibles	**1,167**	1,196	
Goodwill	**3,805**	3,805	
Other assets	**9,726**	19,274	5,882
TOTAL ASSETS	**$ 728,844**	$ 743,785	$ 583,592
LIABILITIES AND SHAREHOLDERS EQUITY			
LIABILITIES:			
Deposits:			
Noninterest bearing deposits	**$ 104,689**	$ 95,498	$ 68,027
NOW, money market, interest checking	**206,824**	212,565	148,023
Savings	**29,470**	28,015	14,425
CDs<$100,000	**127,639**	134,951	154,371
CDs>$100,000	**29,434**	30,316	23,317

Brokered		**99,857**		105,628		67,547
Total deposits		**597,913**		606,973		475,710
Borrowings		**49,839**		49,846		38,852
Other liabilities		**6,054**		12,970		3,300
Total liabilities		**653,806**		669,789		517,862
SHAREHOLDERS EQUITY:						
Preferred stock - No par value:						
Authorized 500,000 shares, None issued and outstanding						
Common stock and additional paid in capital - No par value						
Authorized - 18,000,000 shares						
Issued and outstanding - **6,257,450;** 6,266,756; and 5,527,690 shares respectively		**61,558**		61,679		53,590
Retained earnings		**12,706**		11,804		11,796
Accumulated other comprehensive income		**774**		513		344
Total shareholders equity		**75,038**		73,996		65,730
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$**	**728,844**	$	743,785	$	583,592

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in Thousands, Except per Share Data)

	Three Months Ended March 31, 2015	2014
	(Unaudited)	
INTEREST INCOME:		
Interest and fees on loans:		
Taxable	**$ 8,225**	$ 6,281
Tax-exempt	**3**	23
Interest on securities:		
Taxable	**302**	237
Tax-exempt	**41**	13
Other interest income	**62**	48
Total interest income	**8,633**	6,602
INTEREST EXPENSE:		
Deposits	**823**	822
Borrowings	**290**	187
Total interest expense	**1,113**	1,009
Net interest income	**7,520**	5,593
Provision for loan losses	**305**	183
Net interest income after provision for loan losses	**7,215**	5,410
OTHER INCOME:		
Deposit service fees	**184**	157
Income from loans sold on the secondary market	**167**	103
SBA/USDA loan sale gains	**118**	382
Mortgage servicing income	**31**	13
Net security gains	**10**	
Other	**114**	36
Total other income	**624**	691
OTHER EXPENSE:		
Salaries and employee benefits	**3,047**	2,541
Occupancy	**576**	538
Furniture and equipment	**399**	319
Data processing	**355**	286
Advertising	**126**	107
Professional service fees	**301**	331
Loan and deposit	**138**	79
Writedowns and losses on other real estate held for sale	**17**	
FDIC insurance assessment	**108**	85
Telephone	**132**	82
Other	**557**	739
Total other expenses	**5,756**	5,107
Income before provision for income taxes	**2,083**	994
Provision for income taxes	**712**	334

NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	**$**	**1,371**	$	660
INCOME PER COMMON SHARE:				
Basic	**$**	**.22**	$	.12
Diluted	**$**	**.22**	$	.12

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS COMPREHENSIVE INCOME

(Dollars in Thousands)

(Unaudited)

	Three Months Ended March 31, 2015		2014	
Net income	**$**	**1,371**	$	660
Other comprehensive income				
Change in securities available for sale:				
Unrealized gains arising during the period		**533**		193
Reclassification adjustment for securities gains included in net income		**(10)**		
Tax effect		**(262)**		(65)
Unrealized gains on available for sale securities		**261**		128
Total comprehensive income	**$**	**1,632**	$	788

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(Dollars in Thousands)

(Unaudited)

Three Months Ended March 31, 2015	Shares of Common Stock	Common Stock and Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance, beginning of period	**6,266,756**	**$ 61,679**	**$ 11,804**	**$ 513**	**$ 73,996**
Net income for period			**1,371**		**1,371**
Other comprehensive income					
Net unrealized gain on securities available for sale				**261**	**261**
Actuarial loss on defined benefit pension obligation					
Total comprehensive income			**1,371**	**261**	**1,632**
Stock compensation		**144**			**144**
Issuance of common stock:					
Restricted stock award vesting	**13,194**				
Repurchase of common stock	**(22,500)**	**(265)**			**(265)**
Dividend on common stock			**(469)**		**(469)**
Balance, end of period	**6,257,450**	**$ 61,558**	**$ 12,706**	**$ 774**	**$ 75,038**

Three Months Ended March 31, 2014	Shares of Common Stock	Common Stock and Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance, beginning of period	5,541,390	$ 53,621	$ 11,412	$ 216	$ 65,249
Net income for period			660		660
Other comprehensive income					
Net unrealized gain on securities available for sale				128	128
Actuarial loss on defined benefit pension obligation					
Total comprehensive income			660	128	788
Stock compensation		112			112
Issuance of common stock:					
Restricted stock award vesting					
Repurchase of common stock	(13,700)	(143)			(143)
Dividend on common stock			(276)		(276)

Balance, end of period	5,527,690	$	53,590	$	11,796	$	344	$	65,730

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands)

(Unaudited)

	Three Months Ended March 31, 2015		Three Months Ended March 31, 2014	
Cash Flows from Operating Activities:				
Net income	**$**	**1,371**	$	660
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization		**414**		391
Provision for loan losses		**305**		183
Deferred income taxes, net		**712**		334
(Gain) on sale of securities		**(10)**		
(Gain) on sale of loans sold in the secondary market		**(135)**		(81)
Origination of loans held for sale in secondary market		**(8,576)**		(4,987)
Proceeds from sale of loans in the secondary market		**8,711**		5,068
Loss on sale of premises, equipment, and other real estate held for sale		**14**		29
Writedowns of other real estate held for sale		**3**		
Stock compensation		**144**		112
Change in other assets		**9,578**		43
Change in other liabilities		**(6,916)**		(100)
Net cash provided by operating activities		**5,615**		1,652
Cash Flows from Investing Activities:				
Net decrease (increase) in loans		**3,445**		(2,272)
Net (increase) in interest bearing deposits in other financial institutions		**(35)**		
Purchase of securities available for sale		**(151)**		(3,027)
Proceeds from maturities, sales, calls or paydowns of securities available for sale		**3,127**		149
Capital expenditures		**(324)**		(499)
Proceeds from sale of premises, equipment, and other real estate		**423**		537
Net cash provided by (used in) investing activities		**6,485**		(5,112)
Cash Flows from Financing Activities:				
Net (decrease) increase in deposits		**(9,060)**		9,411
Net activity on line of credit		**93**		1,000
Net (decrease) increase in borrowings		**(100)**		
Repurchase of common stock		**(265)**		(143)
Dividend on common stock		**(469)**		(276)
Net cash (used in) provided by financing activities		**(9,801)**		9,992
Net increase in cash and cash equivalents		**2,299**		6,532
Cash and cash equivalents at beginning of period		**21,947**		18,219
Cash and cash equivalents at end of period	**$**	**24,246**	$	24,751
Supplemental Cash Flow Information:				
Cash paid during the year for:				
Interest	**$**	**1,091**	$	1,001

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)	**63**	282

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. The unaudited consolidated financial statements and footnotes thereto should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Corporation s Annual Report on Form 10-K for the year ended December 31, 2014.

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

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of investment securities, the valuation of foreclosed real estate, deferred tax assets, and mortgage servicing rights.

Acquired Loans

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

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

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

See accompanying notes to condensed consolidated financial statements.

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses

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

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

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

Stock Compensation Plans

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

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

2. EARNINGS PER SHARE

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

The following shows the computation of basic and diluted earnings per share for the three months ended March 31, 2015 and 2014 (dollars in thousands, except per share data):

	Three Months Ended March 31, 2015		2014	
(Numerator):				
Net income available to common shareholders	**$**	**1,371**	$	660
(Denominator):				
Weighted average shares outstanding - basic		**6,256,475**		5,530,908
Effect of dilutive stock options and vesting of restricted stock units		**12,267**		20,901
Weighted average shares outstanding - diluted		**6,268,742**		5,551,809
Income per common share:				
Basic	**$**	**.22**	$	.12
Diluted	**$**	**.22**	$	.12

3. INVESTMENT SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
March 31, 2015				
US Treasury	**$ 4,301**	**$ 57**	**$**	**$ 4,358**
US Agencies	**21,173**	**338**	**(2)**	**21,509**

Corporate Bonds		**12,496**		**115**				**12,611**
US Agencies - MBS		**12,815**		**278**		**(3)**		**13,090**
Obligations of states and political subdivisions		**11,066**		**819**		**(140)**		**11,745**
Total securities available for sale	**$**	**61,851**	**$**	**1,607**	**$**	**(145)**	**$**	**63,313**
December 31, 2014								
US Treasury	$	5,287	$	3	$	(10)	$	5,280
US Agencies		22,667		144		(94)		22,717
Corporate Bonds		12,558		116				12,674
US Agencies - MBS		13,461		262		(35)		13,688
Obligations of states and political subdivisions		10,930		685		(142)		11,473
Total securities available for sale	$	64,903	$	1,210	$	(281)	$	65,832
March 31, 2014								
US Agencies	$	17,745	$	40	$	(287)	$	17,498
Corporate Bonds		15,776		201				15,977
US Agencies - MBS		6,938		278				7,216
Obligations of states and political subdivisions		6,431		292		(3)		6,720
Total securities available for sale	$	46,890	$	811	$	(290)	$	47,411

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. **INVESTMENT SECURITIES** (CONTINUED)

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

The amortized cost and estimated fair value of investment securities pledged to secure FHLB borrowings and customer relationships were $3.891 million and $4.126 million, respectively, at March 31, 2015.

4. **LOANS**

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

	March 31, 2015	**December 31, 2014**	**March 31, 2014**
Commercial real estate	**$ 310,924**	$ 315,387	$ 267,153
Commercial, financial, and agricultural	**99,496**	101,895	83,461
One to four family residential real estate	**142,283**	139,553	104,376
Construction :			
Consumer	**9,733**	9,431	6,383
Commerical	**18,019**	16,284	10,685
Consumer	**17,276**	18,385	13,804
Total loans	**$ 597,731**	$ 600,935	$ 485,862

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

The table below details the acquired portfolio at March 31, 2015 (dollars in thousands):

	Acquired Impaired	Acquired Non-impaired	Acquired Total
Loans acquired - contractual payments	$ 12,711	$ 53,849	$ 66,560
Nonaccretable difference	(1,857)		(1,857)
Expected cash flows	10,854	53,849	64,703
Accretable yield	(619)	(1,867)	(2,486)
Carrying balance at March 31, 2015	$ 10,235	$ 51,982	$ 62,217

The table below presents a rollforward of the accretable yield on acquired loans for the three months ended March 31, 2015 (dollars in thousands):

	Acquired Impaired	Acquired Non-impaired	Acquired Total
Balance, December 31, 2014	$ 744	$ 2,042	$ 2,611
Accretion	(429)	(175)	(440)
Reclassification from nonaccretable difference	304		315
Balance at March 31, 2015	$ 619	$ 1,867	$ 2,486

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS (Continued)

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

	March 31, 2015	December 31, 2014	March 31, 2014
Balance at beginning of period	**$ 5,140**	$ 4,661	$ 4,661
Recoveries on loans previously charged off	**93**	325	121
Loans charged off	**(11)**	(1,046)	(82)
Provision	**305**	1,200	183
Balance at end of period	**$ 5,527**	$ 5,140	$ 4,883

In the first quarter of 2015 the Corporation recorded net recoveries of $83,000, compared to net recoveries of $39,000 in the same period in 2014. In the first quarter of 2015, the Corporation recorded a provision for loan loss of $.305 million, compared to $.183 million in the first quarter of 2014. The Corporation s allowance for loan loss reserve policy calls for a measurement of the adequacy of the reserve at each quarter end. This process includes an analysis of the loan portfolio to take into account increases in loans outstanding and portfolio composition, historical loss rates, and specific reserve requirements of nonperforming loans.

A breakdown of the allowance for loan losses and recorded balances in loans at March 31, 2015 is as follows (dollars in thousands):

	Commercial real estate	Commercial, financial and agricultural	Commercial construction	One to four family residential real estate	Consumer construction	Consumer	Unallocated	Total
Allowance for loan loss reserve:								
Beginning balance ALLR	**$ 2,813**	**$ 1,539**	**$ 142**	**$ 285**	**$ 6**	**$ 13**	**$ 342**	**$ 5,140**
Charge-offs						**(11)**		**(11)**
Recoveries	**81**				**1**	**11**		**93**
Provision	**(124)**	**814**	**2**	**(41)**	**(1)**	**6**	**(351)**	**305**
Ending balance ALLR	**$ 2,770**	**$ 2,353**	**$ 144**	**$ 244**	**$ 6**	**$ 19**	**$ (9)**	**$ 5,527**
Loans:								
Ending balance	**$ 310,924**	**$ 99,496**	**$ 18,019**	**$ 142,283**	**$ 9,733**	**$ 17,276**		**$ 597,731**
Ending balance ALLR	**(2,770)**	**(2,353)**	**(144)**	**(244)**	**(6)**	**(19)**	**(9)**	**(5,527)**

Net loans	**$ 308,154**	**$ 97,143**	**$ 17,875**	**$ 142,039**	**$ 9,727**	**$ 17,257**	**$ (9)**	**$ 592,204**
Ending balance ALLR:								
Individually evaluated	**$ 792**	**$ 1,380**	**$**	**$ 21**	**$**	**$ 10**	**$**	**$ 2,203**
Collectively evaluated	**1,978**	**973**	**144**	**223**	**6**	**9**	**(9)**	**3,324**
Acquired with deteriorated credit quality								
Total	**$ 2,770**	**$ 2,353**	**$ 144**	**$ 244**	**$ 6**	**$ 19**	**$ (9)**	**$ 5,527**
Ending balance Loans:								
Individually evaluated	**$ 2,334**	**$ 6,793**	**$**	**$ 271**	**$**	**$ 37**	**$**	**$ 9,435**
Collectively evaluated	**303,256**	**92,342**	**17,613**	**137,883**	**9,733**	**17,234**		**578,061**
Acquired with deteriorated credit quality	**5,334**	**361**	**406**	**4,129**		**5**		**10,235**
Total	**$ 310,924**	**$ 99,496**	**$ 18,019**	**$ 142,283**	**$ 9,733**	**$ 17,276**	**$**	**$ 597,731**

Impaired loans, by definition, are individually evaluated.

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS (Continued)

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

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

Impaired loans, by definition, are individually evaluated.

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

	Commercial real estate	Commercial, financial and agricultural	Commercial construction	One to four family residential real estate	Consumer construction	Consumer	Unallocated	Total
Allowance for loan loss reserve:								
Beginning balance ALLR	$ 1,849	$ 1,378	$ 80	$ 516	$ 25	$ 148	$ 665	$ 4,661
Charge-offs	(1)	(62)		(3)		(16)		(82)
Recoveries	54	44	3	6		14		121
Provision	(146)	212	(42)	(128)	(9)	(32)	328	183
Ending balance ALLR	$ 1,756	$ 1,572	$ 41	$ 391	$ 16	$ 114	$ 993	$ 4,883
Loans:								
Ending balance	$ 267,153	$ 83,461	$ 10,685	$ 104,376	$ 6,383	$ 13,804	$	$ 485,862
Ending balance ALLR	(1,756)	(1,572)	(41)	(391)	(16)	(114)	(993)	(4,883)
Net loans	$ 265,397	$ 81,889	$ 10,644	$ 103,985	$ 6,367	$ 13,690	$ (993)	$ 480,979
Ending balance ALLR:								
Individually evaluated	$ 189	$ 1,111	$	$ 98	$	$ 8	$	$ 1,406
Collectively evaluated	1,567	461	41	293	16	106	993	3,477
Total	$ 1,756	$ 1,572	$ 41	$ 391	$ 16	$ 114	$ 993	$ 4,883
Ending balance Loans:								
Individually evaluated	$ 610	$ 1,748	$	$ 513	$	$ 25	$	$ 2,896
Collectively evaluated	266,543	81,713	10,685	103,863	6,383	13,779		482,966
Total	$ 267,153	$ 83,461	$ 10,685	$ 104,376	$ 6,383	$ 13,804	$	$ 485,862

Impaired loans, by definition, are individually evaluated.

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.

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS (Continued)

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

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

Strong (1)

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

Good (2)

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

Average (3)

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

Acceptable/Acceptable Watch (4)

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

Special Mention (5)

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

Substandard (6)

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

Doubtful (7)

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. **LOANS** (Continued)

Charge-off/Loss (8)

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

General Reserves:

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

Using a historical average loss by loan type as a base, each loan graded as higher risk is assigned a specific percentage. 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.

Commercial construction loans in the amount of $2.761 million, $3.251 million and $3.323 million for the periods ended March 31, 2015, December 31, 2014 and March 31, 2014, respectively did not receive a specific risk rating. These amounts represent loans made for land development and unimproved land purchases. Below is a breakdown of loans by risk category as of March 31, 2015 (dollars in thousands):

	(1) Strong	(2) Good	(3) Average	(4) Acceptable/ Acceptable Watch	(5) Sp. Mention	(6) Substandard	(7) Doubtful	Rating Unassigned	Total
Commercial real estate	**$ 2,610**	**$ 27,471**	**$ 128,172**	**$ 144,634**	**$**	**$ 8,037**	**$**	**$**	**$ 310,924**
	4,711	**4,047**	**34,255**	**53,492**		**2,991**			**99,496**

Commercial, financial and agricultural									
Commercial construction	**110**	**425**	**2,618**	**11,212**		**893**		**2,761**	**18,019**
One to four family residential real estate	**415**	**1,049**	**3,983**	**4,078**		**5,449**		**127,309**	**142,283**
Consumer construction								**9,733**	**9,733**
Consumer	**45**	**23**		**6**		**5**		**17,197**	**17,276**
Total loans	**$ 7,891**	**$ 33,015**	**$ 169,028**	**$ 213,422**	**$**	**$ 17,375**	**$**	**$ 157,000**	**$ 597,731**

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

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS (Continued)

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

	(1) Strong	(2) Good	(3) Average	(4) Acceptable/ Acceptable Watch	(5) Sp. Mention	(6) Substandard	(7) Doubtful	Rating Unassigned	Total
Commercial real estate	**$ 3,039**	**$ 24,678**	**$ 117,113**	**$ 120,167**	**$**	**$ 2,156**	**$**	**$**	**$ 267,153**
Commercial, financial and agricultural	**3,634**	**3,388**	**28,004**	**45,309**		**3,126**			**83,461**
Commercial construction	**30**	**463**	**3,513**	**2,954**		**402**		**3,323**	**10,685**
One to four family residential real estate		**3,360**	**1,246**	**4,339**				**95,431**	**104,376**
Consumer construction								**6,383**	**6,383**
Consumer				**25**				**13,779**	**13,804**
Total loans	**$ 6,703**	**$ 31,889**	**$ 149,876**	**$ 172,794**	**$**	**$ 5,684**	**$**	**$ 118,916**	**$ 485,862**

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. There was no interest income recorded during impairment for the three months ended March 31, 2015. Interest income that would have been recognized during this period was $.072 million. For the three months ended March 31, 2014, the income that would have been recorded was $.024 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.

Purchased loans acquired in a business combination are recorded at estimated fair value on their purchase date with no carryover of the related allowance for loan losses. In determining the estimated fair value of purchased loans, management considers a number of factors including the remaining life of the acquired loans, estimated prepayments, estimated loss ratios, estimated value of the underlying collateral, net present value of cash flows expected to be received, among others. Purchased loans are accounted for in accordance with guidance for certain loans acquired in a transfer (ASC 310-30), when the loans have evidence of credit deterioration since origination and it is probable at the date of acquisition that the acquirer will not collect all contractually required principal and interest payments. The difference between contractually required payments and the cash flows expected to be collected at acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in expected cash flows will result in a reversal of the provision for loan losses to the extent of prior charges and then an adjustment to accretable yield, which would have a positive impact on interest income. The ASC 310-30 mark on impaired loans totaled $2.978 million. The accretable yield in this impaired loans was estimated at $.619 million. The Corporation recorded $.429 million due to the positive resolution of one large acquired nonperforming commercial loan relationship in the first quarter of 2015 and no accretable yield of the loan mark in 2014.

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS (Continued)

The following table reflects the contractually required payments receivable, cash flows expected to be collected, and fair value of the credit impaired Peninsula loans at March 31, 2015:

Contractually required payments including interest	$	12,711
Less: nonaccretable difference		(1,857)
Cash flows expected to be collected		10,854
Less: accretable yield		(619)
Fair value of credit impaired loans acquired	$	10,235

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

	Nonaccrual Basis	Accrual Basis	Average Investment	Related Valuation Reserve	Interest Income Recognized During Impairment	Interest Income on Accrual Basis
March 31, 2015						
With no valuation reserve:						
Commercial real estate	**$ 2,248**	**$ 3,537**	**$ 4,888**	**$**	**$**	**$ 16**
Commercial, financial and agricultural	**72**	**128**	**200**			**1**
Commercial construction	**266**	**110**	**367**			**4**
One to four family residential real estate	**1,950**	**2,727**	**4,635**			**25**
Consumer construction	**23**		**24**			
Consumer	**29**	**5**				
With a valuation reserve:						
Commercial real estate	**$ 170**	**$**	**$ 379**	**$ 570**	**$**	**$ 5**
Commercial, financial and agricultural	**6,926**		**2,327**	**1,517**		**19**
Commercial construction						
One to four family residential real estate	**117**		**15**	**11**		**2**

Consumer construction						
Consumer				**9**		
Total:						
Commercial real estate	**$ 2,418**	**$ 3,537**	**$ 5,267**	**$ 570**	**$**	**$ 21**
Commercial, financial and agricultural	**6,998**	**128**	**2,527**	**1,517**		**20**
Commercial construction	**266**	**110**	**367**			**4**
One to four family residential real estate	**2,067**	**2,727**	**4,650**	**11**		**27**
Consumer construction	**23**		**24**			
Consumer	**29**	**5**		**9**		
Total	**$ 11,801**	**$ 6,507**	**$ 12,835**	**$ 2,107**	**$**	**$ 72**

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS (Continued)

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

	Interest Income	Interest Income

	Nonaccrual Basis	Accrual Basis	Average Investment	Related Valuation Reserve	Recognized During Impairment	on Accrual Basis
March 31, 2014						
With no valuation reserve:						
Commercial real estate	$ 279	$	$ 322	$	$	$ 4
Commercial, financial and agricultural	142		183			2
Commercial construction						
One to four family residential real estate	67		235			3
Consumer construction						
Consumer			9			
With a valuation reserve:						
Commercial real estate	$ 176	$	$ 176	$ 104	$	$ 4
Commercial, financial and agricultural	588		597	271		7
Commercial construction						
One to four family residential real estate	232		215	44		4
Consumer construction						
Consumer	7		8	1		
Total:						
Commercial real estate	$ 455	$	$ 498	$ 104	$	$ 8
Commercial, financial and agricultural	730		780	271		9
Commercial construction						
One to four family residential real estate	299		450	44		7
Consumer construction						
Consumer	7		17	1		
Total	$ 1,491	$	$ 1,745	$ 420	$	$ 24

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS (Continued)

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

	March 31, 2015			December 31, 2014			March 31, 2014		
	30-89 days Past Due (accruing)	90+ days Past Due/ Nonaccrual	Total	30-89 days Past Due (accruing)	90+ days Past Due/ Nonaccrual	Total	30-89 days Past Due (accruing)	90+ days Past Due/ Nonaccrual	Total
Commercial real estate	**$ 746**	**$ 2,418**	**$ 3,164**	$ 1,857	$ 859	$ 2,716	$ 729	$ 455	$ 1,184
Commercial, financial and agricultural	**25**	**6,998**	**7,023**	104	848	952	18	730	748
Commercial construction		**266**	**266**						
One to four family residential real estate	**1,075**	**2,116**	**3,191**	1,412	1,958	3,370	471	299	770
Consumer construction	**273**	**23**	**296**	38	274	312			
Consumer	**29**	**29**	**58**	88		88	18	7	25
Total past due loans	**$ 2,148**	**$ 11,850**	**$ 13,998**	$ 3,499	$ 3,939	$ 7,438	$ 1,236	$ 1,491	$ 2,727

A roll-forward of nonaccrual activity for the three months ended March 31, 2015 (dollars in thousands):

	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer Construction	Consumer	Total
NONACCRUAL							
Beginning balance	**$ 859**	**$ 848**	**$**	**$ 1,958**	**$ 274**	**$**	**$ 3,939**
Principal payments	**(75)**	**(3)**		**(21)**			**(99)**
Charge-offs							
Advances							
Class transfers			**250**		**(250)**		
Transfers to OREO				**(79)**			**(79)**

	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer Construction	Consumer	Total
Transfers to accruing	**(419)**			**(60)**			**(479)**
Transfers from accruing	**2,030**	**6,153**		**263**		**29**	**8,475**
Other	**23**		**16**	**6**	**(1)**		**44**
Ending balance	**$ 2,418**	**$ 6,998**	**$ 266**	**$ 2,067**	**$ 23**	**$ 29**	**$ 11,801**

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

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS (Continued)

A roll-forward of nonaccrual activity for the three months ended March 31, 2014 (dollars in thousands):

	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer Construction	Consumer	Total
NONACCRUAL							
Beginning balance	$ 572	$ 811	$	$ 611	$	$ 30	$ 2,024
Principal payments	(99)	(18)		(7)		(4)	(128)
Charge-offs		(53)		(3)		(19)	(75)
Advances							
Class transfers							
Transfers to OREO	(26)			(257)			(283)
Transfers to accruing		(10)		(127)			(137)
Transfers from accruing				82			82
Other	8						8
Ending balance	$ 455	$ 730	$	$ 299	$	$ 7	$ 1,491

Loans accounted for under ASC 310-30 accrue interest as any nonpayment of contractual principal or interest is considered in the periodic re-estimation of expected cash flows and is included in the resulting recognition of current period loan loss provision or prospective yield adjustments.

Troubled Debt Restructuring

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

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

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

	Three Months Ended March 31, 2015		**Year Ended December 31, 2014**		**Three Months Ended March 31, 2014**	
	Number of Modifications	**Recorded Investment**	**Number of Modifications**	**Recorded Investment**	**Number of Modifications**	**Recorded Investment**
Commercial real estate	**3**	**$ 1,216**		$		$
Commercial, financial and agricultural	**3**	**268**				
Commercial construction	**4**	**266**				
One to four family residential real estate	**20**	**1,538**				
Consumer construction						
Consumer						
Total troubled debt restructurings	**30**	**$ 3,288**		$		$

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS (Continued)

A roll-forward of troubled debt restructuring during the period ended March 31, 2015 (dollars in thousands):

	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer and Consumer Construction	Total
ACCRUING						
Beginning balance	$ 1,007	$ 1,186	$ 852	$ 60	$	$ 3,105
Principal payments			(3)			(3)
Charge-offs						
Advances						
New restructured	647	268		1,243		2,158
Transferred out of TDR						
Transfer from nonaccrual						
Transfers to nonaccrual						
Ending Balance	$ 1,654	$ 1,454	$ 849	$ 1,303	$	$ 5,260
NONACCRUAL						
Beginning balance	$	$	$	$	$	$
Principal payments						
Charge-offs						
Advances						
New restructured	569		266	295		1,130
Transfer to accruing						
Transfers from accruing						
Ending Balance	$ 569	$	$ 266	$ 295	$	$ 1,130
TOTALS						
Beginning balance	$ 1,007	$ 1,186	$ 852	$ 60	$	$ 3,105
Principal payments			(3)			(3)
Charge-offs						
Advances						

New restructured		**1,216**		**268**		**266**		**1,538**		**3,288**
Transfers out of TDRs										
Tansfers from nonaccrual										
Transfers to accruing										
Ending Balance	**$**	**2,223**	**$**	**1,454**	**$**	**1,115**	**$**	**1,598**	**$**	**$ 6,390**

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS (Continued)

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

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

Transfers out of TDRs				91		91
Tansfers to nonaccrual				(89)		(89)
Transfers to foreclosed properties				(143)		(143)
Transfers from accruing				89		89
Ending Balance	$ 1,007	$ 1,186	$ 852	$ 60	$	$ 3,105

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS (Continued)

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

	Commercial Real Estate	Commercial, Financial and Agricultural	Commercial Construction	One to four family residential real estate	Consumer and Consumer Construction	Total
ACCRUING						
Beginning balance	$ 3,520	$ 1,186	$ 858	$ 99	$	$ 5,663
Principal payments	(2,511)			(3)		(2,514)
Charge-offs						
Advances						
New restructured						
Transferred out of TDR						
Transfer from nonaccrual				91		91
Transfers to nonaccrual						
Ending Balance	$ 1,009	$ 1,186	$ 858	$ 187	$	$ 3,240
NONACCRUAL						
Beginning balance	$	$ 523	$	$ 91	$	$ 614
Principal payments		(15)				(15)
Charge-offs						
Advances						
New restructured						
Transfer to accruing				(91)		(91)
Transfers from accruing						
Ending Balance	$	$ 508	$	$	$	$ 508
TOTALS						
Beginning balance	$ 3,520	$ 1,709	$ 858	$ 190	$	$ 6,277
Principal payments	(2,511)	(15)		(3)		(2,529)
Charge-offs						
Advances						
New restructured						

Transfers out of TDRs						
Tansfers from nonaccrual				91		91
Transfers to accruing				(91)		(91)
Ending Balance	$ 1,009	$ 1,694	$ 858	$ 187	$	$ 3,748

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

Loans were recorded at fair value in accordance with FASB ASC 805, Business Combinations. No allowance for loan losses related to the acquired loans is recorded on the acquisition date as the fair value of the loans acquired incorporates assumptions regarding credit. Loans acquired are recorded at fair value in accordance with the fair value methodology prescribed in FASB ASC 820. The fair value estimated associated with the loans include estimates related to expected prepayments and the amount and timing of undiscounted expected principal, interest and other cash flows.

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

4. LOANS (Continued)

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, 2015	**December 31, 2014**	**March 31, 2014**
Loans outstanding, beginning of period	**$ 8,789**	$ 9,043	$ 9,043
New loans		33	
Net activity on revolving lines of credit	**117**	1,390	760
Repayment	**(2,412)**	(1,677)	(1,436)
Loans outstanding, end of period	**$ 6,494**	$ 8,789	$ 8,367

There were no loans to related parties classified substandard as of March 31, 2015, December 31, 2014 or March 31, 2014. In addition to the outstanding balances above, there were unfunded commitments of $.255 million to related parties at March 31, 2015.

5. GOODWILL AND OTHER INTANGIBLE ASSETS

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

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

The deposit based intangible is reported net of accumulated amortization at $1.167 million at March 31, 2015. Amortization expense in the first quarter of 2015 is $.029 million. Amortization expense for the next five years is expected to be at $.121 million per year.

6. SERVICING RIGHTS

Mortgage Loans

Mortgage servicing rights (MSRs) are recorded when loans are sold in the secondary market with servicing retained. As of March 31, 2015, the Corporation had obligations to service approximately $223 million of residential first mortgage loans. The valuation is based upon the net present value of the projected revenues over the expected life of the loans being serviced, as reduced by estimated internal costs to service these loans. The fair value of the capitalized servicing rights approximates the carrying value. The key economic assumptions used in determining the fair value of the mortgage servicing rights include an annual constant prepayment speed of 10.75% and a discount rate of 8.90% for March 31, 2015.

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

6. SERVICING RIGHTS (CONTINUED)

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

	Three Months Ended March 31, 2015	Year Ended December 31, 2014	Three Months Ended March 31, 2014
Balance at beginning of period	**$ 1,994**	$ 1,129	$ 1,129
Additions from loans sold with servicing retained	**100**	636	
MSRs acquired in Peninsula transaction		539	
Amortization	**(214)**	(310)	(72)
Balance at end of period	**$ 1,880**	$ 1,994	$ 1,057

Commercial Loans

The Corporation also retains the servicing on commercial loans that have been sold. These loans were originated and underwritten under the SBA and USDA government guarantee programs, in which the guaranteed portion of the loan was sold to a third party with servicing retained. The balance of these sold loans with servicing retained at March 31, 2015 and March 31, 2014 was approximately $46 million and $48 million. The Corporation valued these servicing rights at $.190 million as of March 31, 2015 and $.193 million at March 31, 2014. This valuation was established in consideration of the discounted cash flow of expected servicing income over the life of the loans.

7. BORROWINGS

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

	March 31,	December 31,	March 31,

	2015	2014	2014
Federal Home Loan Bank fixed rate advances at March 31, 2015 with a weighted average rate of 1.68% maturing in 2016, 2018 and 2019	**$ 35,000**	$ 35,000	$ 35,000
Correspondent bank line of credit - holding company	**8,500**	8,000	
Bank line of credit - wholly owned asset based lending subsidiary	**2,961**	3,367	
Correspondent bank term note, current floor rate of 4%, maturing December 28, 2017	**2,600**	2,700	3,000
USDA Rural Development, fixed-rate note payable, maturing August 24, 2024, interest payable at 1%	**778**	779	852
	$ 49,839	$ 49,846	$ 38,852

The Federal Home Loan Bank borrowings are collateralized at March 31, 2015 by the following: a collateral agreement on the Corporation s one to four family residential real estate loans with a book value of approximately $41.759 million; mortgage related and municipal securities with an amortized cost and estimated fair value of $3.891 million and $4.126 million, respectively; and Federal Home Loan Bank stock owned by the Bank totaling $2.973 million. Prepayment of the advances is subject to the provisions and conditions of the credit policy of the Federal Home Loan Bank of Indianapolis in effect as of March 31, 2015.

The USDA Rural Development borrowing is collateralized by loans totaling $.119 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 $.727 million, and guaranteed by the Corporation.

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

8. DEFINED BENEFIT PENSION PLAN

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

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

At March 31, 2015, the plan s assets had a fair value of $2.107 million and the Corporation had a net liability of $1.183 million. The accumulated benefit obligation was $3.290 million.

Assumptions in the actuarial valuation are:

	2015
Weighted average discount rate	3.98%
Rate of increase in future compensation levels	N/A
Expected long-term rate of return on plan assets	8.00%

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

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

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

9. STOCK COMPENSATION PLANS

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

Restricted Stock Awards

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

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

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

	Number Outstanding	Weighted Average Grant Date Fair Value
Nonvested balance at January 1, 2015	127,024	$ 10.07
Granted during the period	37,730	11.15
Vested during the period	(13,194)	12.95
Nonvested balance at March 31, 2015	151,560	$ 10.09

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

	March 31, 2015	December 31, 2014	March 31, 2014
Outstanding shares at beginning of year	**20,000**	237,152	237,152
Granted during the period			
Exercised during the period		(70,502)	
Expired / forfeited during the period		(146,650)	
Outstanding shares at end of period	**20,000**	20,000	237,152
Exercisable shares at end of period	**4,000**	4,000	124,861
Weighted average exercise price per share at end of period	**$ 11.33**	$ 11.33	$ 9.88
Shares available for grant at end of period			

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

9. STOCK COMPENSATION PLANS (Continued)

Following is a summary of the options outstanding and exercisable at March 31, 2015:

Exercise Price		Outstanding	Number Exercisable	Unvested Options	Weighted Average Remaining Contractual Life-Years
$	10.65	10,000	2,000	8,000	.29
$	12.00	10,000	2,000	8,000	.71
		20,000	4,000	16,000	.50

10. INCOME TAXES

A valuation allowance is provided against deferred tax assets when it is more likely than not that some or all of the deferred tax asset will not be realized. The Corporation, as of March 31, 2015 had a net operating loss and tax credit carryforwards for tax purposes of approximately $14.8 million, and $2.7 million, respectively. The net operating loss carryforwards expire twenty years from the date they originated. These carryforwards, if not utilized, will begin to expire in the year 2023. A portion of the NOL and all of the credit carryforwards are subject to the limitations for utilization as set forth in Section 382 of the Internal Revenue Code. The annual limitation is $1.400 million for the NOL and the equivalent value of tax credits, which is approximately $.476 million. These limitations for use were established in conjunction with the recapitalization of the Corporation in December 2004.

The Corporation has reported deferred tax assets of $10.332 million at March 31, 2015, which is net of a valuation allowance of $.760 million. Management evaluated the deferred tax valuation allowance as of March 31, 2015 and determined that no adjustment to the valuation was warranted. The remaining valuation allowance pertains to the existing tax credit carryovers, which will only be utilized after all net operating loss carryforwards. Since a portion of these tax credits may expire before that occurs, a valuation allowance for these has been established. The Corporation will continue to evaluate the future benefits from these carryforwards in order to determine if any adjustment to the deferred tax asset is warranted.

11. FAIR VALUE MEASUREMENTS

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

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

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

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

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

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.

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

11. FAIR VALUE MEASUREMENTS (Continued)

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

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

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

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

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

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

		March 31, 2015		**December 31, 2014**		**March 31, 2014**	
	Level in Fair Value Hierarchy	**Carrying Amount**	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**
Financial assets:							
Cash and cash equivalents	Level 1	**$ 24,246**	**$ 24,246**	$ 21,947	$ 21,947	$ 24,751	$ 24,751
	Level 2	**5,832**	**5,832**	5,797	5,797	10	10

Interest-bearing deposits							
Securities available for sale	Level 2	**63,313**	**63,313**	65,832	65,832	47,411	47,411
Federal Home Loan Bank stock	Level 2	**2,973**	**2,973**	2,973	2,973	3,060	3,060
Net loans	Level 3	**592,204**	**593,121**	595,795	596,429	480,979	481,101
Accrued interest receivable	Level 3	**1,758**	**1,758**	1,680	1,680	1,468	1,468
Total financial assets		**$ 690,326**	**$ 691,243**	$ 694,024	$ 694,658	$ 557,679	$ 557,801
Financial liabilities:							
Deposits	Level 2	**$ 597,913**	**$ 598,184**	$ 606,973	$ 606,534	$ 475,710	$ 474,958
Borrowings	Level 2	**49,839**	**50,685**	49,846	50,280	38,852	38,604
Accrued interest payable	Level 3	**227**	**227**	205	205	190	190
Total financial liabilties		**$ 647,979**	**$ 649,096**	$ 657,024	$ 657,019	$ 514,752	$ 513,752

***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.

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

11. FAIR VALUE MEASUREMENTS (Continued)

The following is information about the Corporation s assets and liabilities measured at fair value on a recurring basis at March 31, 2015, and the valuation techniques used by the Corporation to determine those fair values.

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

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

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

The fair value of all investment securities at March 31, 2015 and March 31, 2014 were based on level 2 inputs. There are no other assets or liabilities measured on a recurring basis at fair value. For additional information regarding investment securities, please refer to Note 3 Investment Securities.

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

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

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 at March 31, 2015

(dollars in thousands)	Balance at March 31, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses for Three Months Ended March 31, 2015
Assets					
Impaired loans	**$ 18,308**	**$**	**$**	**$ 18,308**	**$**
Other real estate owned	**2,632**			**2,632**	**17**
					$ 17

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

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

11. FAIR VALUE MEASUREMENTS (Continued)

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

(dollars in thousands)	Balance at March 31, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses for Three Months Ended March 31, 2014
Assets					
Impaired loans	$ 1,491	$	$	$ 1,491	$ 77
Other real estate owned	2,166			2,166	
					$ 77

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

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

12. SHAREHOLDERS EQUITY

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

The Corporation currently has a share repurchase program. The program is conducted under authorizations from time to time by the Board of Directors. The Corporation repurchased 22,500 shares thus far in 2015, 13,700 shares in 2014 and 55,594 shares in 2013. The share repurchases were conducted under Board authorizations made and publically announced of $600,000 on February 27, 2013, increased this amount by an additional $600,000 on December 17, 2013, and further increased this amount by an additional $750,000 on April 28, 2015. None of these authorizations has an expiration date.

13. 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.

Table of Contents

MACKINAC FINANCIAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

13. COMMITMENTS, CONTINGENCIES AND CREDIT RISK (Continued)

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, 2015	December 31, 2014	March 31, 2014
Commitments to extend credit:			
Variable rate	**$ 42,690**	$ 44,134	$ 40,704
Fixed rate	**21,713**	24,191	14,377
Standby letters of credit - Variable rate	**6,310**	6,072	5,396
Credit card commitments - Fixed rate	**3,367**	3,267	3,279
	$ 74,080	$ 77,664	$ 63,756

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

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

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

Legal Proceedings and Contingencies

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

Concentration of Credit Risk

The Bank grants commercial, residential, agricultural, and consumer loans throughout Michigan. The Bank s most prominent concentration in the loan portfolio relates to commercial real estate loans to operators of nonresidential buildings. This concentration at March 31, 2015 represents $106.286 million, or 24.81% compared to $97.153 million, or 26.89%, of the commercial loan portfolio on March 31, 2014. The remainder of the commercial loan portfolio is diversified in such categories as hospitality and tourism, real estate agents and managers, new car dealers, gaming, petroleum, forestry, agriculture and construction. Due to the diversity of the Bank s locations, the ability of debtors of residential and consumer loans to honor their obligations is not tied to any particular economic sector.

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Forward Looking Statements/Risk Factors

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:

RISK FACTORS

Risks Related to our Lending and Credit Activities

• *Our business may be adversely affected by conditions in the financial markets and economic conditions generally, as our borrowers ability to repay loans and the value of the collateral securing our loans decline.*

• *Weakness in the markets for residential or commercial real estate, including the secondary residential mortgage loan markets, could reduce our net income and profitability.*

• *As a community banking organization, the Corporation s success depends upon local and regional economic conditions and has different lending risks than larger banks.*

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

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

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

Risks Related to Our Operations

- *We are subject to interest rate risk.*

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

- *Changes in our accounting policies or in accounting standards could materially affect how we report our financial results and condition.*

- *Our controls and procedures may fail or be circumvented.*

- *Impairment of deferred income tax assets could require charges to earnings, which could result in an adverse impact on our results of operations.*

In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that some allowance requires management to evaluate all available evidence, both negative and positive. Positive evidence necessary to overcome the negative evidence includes whether future taxable income in sufficient amounts and character within the carry back and carry forward periods is available under the tax law, including the use of tax planning strategies. When negative evidence (e.g. cumulative losses in recent years, history of operating loss or tax credit carry forwards expiring unused) exists, more positive evidence than negative evidence will be necessary. If

Table of Contents

a valuation allowance becomes necessary with respect to such balance, it could have a material adverse effect on our business, results of operations and financial condition.

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

Risks Related to Legal and Regulatory Compliance

- *We operate in a highly regulated environment, which could increase our cost structure or have other negative impacts on our operations.*

- *The full impact of the recently enacted Dodd-Frank Act is currently unknown given that many of the details and substance of the new laws will be implemented through agency rulemaking.*

Strategic Risks

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

Reputation Risks

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

Liquidity Risks

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

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

Risks Related to an Investment in Our Common Stock

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

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

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

MACKINAC FINANCIAL CORPORATION

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

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

FINANCIAL OVERVIEW

The Corporation recorded a first quarter 2015 net income available to common shareholders of $1.371 million or $.22 per share compared to net income of $.660 million, or $.12 per share for the first quarter of 2014. Operating results for the first quarter of 2015 included a provision for loan losses of $.305 million compared to $.183 million for the same period of 2014.

Weighted average shares outstanding totaled 6,256,475 for the first quarter of 2015 and 5,527,690 for the same period in 2014.

The net interest margin for the first quarter of 2015 increased to $7.520 million, or 4.53%, compared to $5.593 million, or 4.25% in the first quarter of 2014.

Total assets of the Corporation at March 31, 2015 were $728.844 million, up by $145.252 million, or 24.89% from the $583.592 million in total assets reported at March 31, 2014 and down by $14.941 million, or 2.01%, from total assets of $743.785 million at year-end 2014.

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

FINANCIAL CONDITION

Cash and Cash Equivalents

Cash and cash equivalents increased $2.299 million during the first quarter of 2015. See further discussion of the change in cash and cash equivalents in the Liquidity section.

Investment Securities

Securities available for sale decreased $2.519 million, or 3.83%, from December 31, 2014 to March 31, 2015, with the balance on March 31, 2015, totaling $63.313 million. Investment securities are utilized in an effort to manage interest rate risk and liquidity. As of March 31, 2015, investment securities with an estimated fair value of $4.126 million were pledged.

Loans

Through the first quarter of 2015, loan balances decreased slightly from December 31, 2014 balances of $600.935 million. During the first three months of 2015, the Bank had total loan production of $31.4 million, which included $8.576 million of secondary market loan production. This loan production, however, was offset by loan principal runoff, paydowns and amortization.

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.

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	March 31, 2015	Percent of Total	December 31, 2014	Percent of Total	March 31, 2014	Percent of Total
Commercial real estate	$ **310,924**	**52.02**%	$ 315,387	52.48%	$ 267,153	54.99%
Commercial, financial, and agricultural	**99,496**	**16.65**	101,895	16.96	83,461	17.18
One to four family residential real estate	**142,283**	**23.80**	139,553	23.22	104,376	21.48
Construction:						
Consumer	**9,733**	**1.63**	9,431	1.57	6,383	1.31
Commercial	**18,019**	**3.01**	16,284	2.71	10,685	2.20
Consumer	**17,276**	**2.89**	18,385	3.06	13,804	2.84
Total loans	$ **597,731**	**100.00**%	$ 600,935	100.00%	$ 485,862	100.00%

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

	March 31, 2015			December 31, 2014			March 31, 2014		
	Outstanding Balance	Percent of Loans	Percent of Capital	Outstanding Balance	Percent of Loans	Percent of Capital	Outstanding Balance	Percent of Loans	Percent of Capital
Real estate - operators of nonres bldgs	$ **106,286**	**24.81%**	**141.64%**	$ 106,644	24.60%	144.12%	$ 97,153	26.89%	147.81%
Hospitality and tourism	**45,995**	**10.73**	**61.30**	46,211	10.66	62.45	44,243	12.25	67.31
Lessors of nonresidential buildings	**21,545**	**5.03**	**28.71**	19,776	4.56	26.73	13,649	3.78	20.77
Commercial construction	**18,019**	**4.21**	**24.01**	16,284	3.76	22.01	10,685	2.96	16.26
Gasoline stations and convenience stores	**13,965**	**3.26**	**18.61**	13,841	3.19	18.71	11,980	3.32	18.23
Real estate agents and managers	**9,717**	**2.27**	**12.95**	9,454	2.18	12.78	10,115	2.80	15.39
Other	**212,912**	**49.69**	**283.74**	221,356	51.05	299.15	173,474	48.01	263.92
Total Commercial Loans	$ **428,439**	**100.00%**		$ 433,566	100.00%		$ 361,299	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, 2015. The current concentration of real estate related loans represents a broad customer base comprised 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, 2015, our residential loan portfolio totaled $152.016 million, or 25.43% of our total outstanding loans.

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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 recoveries for the three months ended March 31, 2015 amounted to $83,000, compared to $39,000 for the same period in 2014. The current reserve balance is representative of the relevant risk inherent within the Corporation s loan portfolio. Additions or reductions to the reserve in future periods will be dependent upon a combination of future loan growth, nonperforming loan balances and charge-off activity.

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

	March 31, 2015	December 31, 2014	March 31, 2014
Nonperforming Assets:			
Nonaccrual Loans	**$ 10,671**	$ 3,939	$ 983
Loans past due 90 days or more	**49**		
Restructured loans	**1,130**		508
Total nonperforming loans	**11,850**	3,939	1,491
Other real estate owned	**2,632**	3,010	2,166
Total nonperforming assets	**$ 14,482**	$ 6,949	$ 3,657
Nonperforming loans as a % of loans	**1.98**%	.66%	.31%
Nonperforming assets as a % of assets	**1.99**%	.93%	.63%
Reserve for Loan Losses:			
At period end	**$ 5,527**	$ 5,140	$ 4,883
As a % of loans	**.92**%	.86%	1.01%
As a % of nonperforming loans	**46.64**%	130.49%	327.50%
As a % of nonaccrual loans	**46.84**%	130.49%	497.74%
Texas ratio*	**19.16**%	9.37%	5.18%

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

Nonperforming assets at $14.482 million have increased in 2015 by $7.533 million from the $6.949 million at 2014 year end. This increase in nonperforming assets is due almost entirely to one large credit, an approximate $7.5 million local loan relationship, which the bank entered into in 2011 as a chapter 11 bankruptcy reorganization. This relationship was established in conjunction with several other state and federal government lending parties who provided various loan guarantees, in order to preserve a long standing paper mill in our headquarters market and save over 150 jobs.

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

	At Period End March 31, 2015	December 31, 2014	At Period End March 31, 2014

Total loans, at period end	**$**	**597,731**	$	600,935	$	485,862
Average loans for the period	**$**	**600,052**	$	509,749	$	486,354

	For the Period Ended Three Months Ended March 31, 2015		Twelve Months Ended December 31, 2014		For the Period Ended Three Months Ended March 31, 2015	
Net charge-offs (recoveries) during the period	**$**	**(83)**	$	721	$	(39)
Net charge-offs to average loans		**N/M%**		.14%		N/M%
Net charge-offs to beginning allowance balance		**N/M%**		15.47%		N/M%

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

As of March 31, 2015, the allowance for loan losses represented .92% of total loans. At March 31, 2015, the allowance included specific reserves in the amount of $2.203 million, as compared to $1.216 million at December 31, 2014 and $1.406 million at March 31, 2014. In management s opinion, the allowance for loan losses is adequate to cover probable losses related to specifically identified loans, as well as probable losses inherent in the balance of the loan portfolio.

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

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

	Three Months Ended March 31, 2015	Year Ended December 31, 2014	Three Months Ended March 31, 2014
Balance at beginning of period	**$ 3,010**	$ 1,884	$ 1,884
Other real estate acquired, net of purchase accounting		1,193	
Other real estate transferred from loans due to foreclosure	**63**	588	282
Other real estate sold	**(424)**	(375)	
Writedowns on other real estate held for sale	**(3)**	(228)	
Loss on sale of other real estate held for sale	**(14)**	(52)	
Balance at end of period	**$ 2,632**	$ 3,010	$ 2,166

During the first quarter of 2015, the Corporation received real estate in lieu of loan payments of $.063 million. Other real estate is initially valued at the lower of cost or the fair value less selling costs. After the initial receipt, management periodically re-evaluates the recorded balances and any additional reductions in the fair value result in a write-down of other real estate.

Deposits

The Corporation had a decrease in deposits in the first quarter of 2015. Total deposits decreased by $9.060 million, or 1.49%, in the first quarter of 2015. The decrease in deposits for the first quarter of 2015 is composed of a decrease in noncore deposits of $6.653 million and a decrease in core deposits of $2.407 million. In recent years, the Corporation strategically emphasized the growth of core deposits. This strategic initiative is supported with an individual incentive plan, along with the introduction of several new deposit products and competitive deposit pricing. The core deposit balances increased primarily in transactional account deposits, our lowest cost of funds. Most recently, we have experienced some declines in core deposits. A portion of these decreases can be attributed to individual customer deposit reductions due to various business related needs. In an effort to stem some runoff from core deposit CDs, management recently increased some offering rates on CD products.

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, 2015	% of Total	December 31, 2014	% of Total	March 31, 2014	% of Total
Noninterest bearing	**$ 104,689**	**17.51%**	$ 95,498	15.73%	$ 68,027	14.30%
NOW, money market, checking	**206,824**	**34.59**	212,565	35.02	148,023	31.12
Savings	**29,470**	**4.93**	28,015	4.62	14,425	3.03
Certificates of Deposit <$100,000	**127,639**	**21.35**	134,951	22.23	154,371	32.45
Total core deposits	**468,622**	**78.38**	471,029	77.60	384,846	80.90
Certificates of Deposit >$100,000	**29,434**	**4.92**	30,316	4.99	23,317	4.90
Brokered CDs	**99,857**	**16.70**	105,628	17.39	67,547	14.20
Total non-core deposits	**129,291**	**21.62**	135,944	22.40	90,864	19.10
Total deposits	**$ 597,913**	**100.00%**	$ 606,973	100.00%	$ 475,710	100.00%

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Borrowings

The Corporation also utilizes FHLB borrowings as a source of funding. At March 31, 2015, this source of funding totaled $35 million and the Corporation secured this funding by pledging loans and investments. The $35 million of FHLB borrowings has a weighted average maturity of 1.18 years and a weighted average rate of 1.68% at March 31, 2015. The Corporation also has a USDA Rural Development loan held by its wholly owned subsidiary, First Rural Relending that has an outstanding balance of $.779 million, with a fixed interest rate of 1% that matures in August 2024.

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

Shareholders   Equity

Total shareholders   equity increased $1.042 million from December 31, 2014 to March 31, 2015. Contributing to the increase in shareholders equity was net income available to common shareholders of $1.371 million, a reduction for dividends on common stock of $.469 million, increases due to stock compensation of $.144 million, an increase in the market value of securities of $.261 million and a decrease due to the repurchase of common stock of $.265 million.

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

RESULTS OF OPERATIONS

Summary

The Corporation recorded a first quarter 2015 net income available to common shareholders of $1.371 million or $.22 per share compared to net income of $.660 million, or $.12 per share for the first quarter of 2014. Operating results for the first quarter of 2015 included a provision for loan losses of $.305 million compared to $.183 million for the same period of 2014.

Net Interest Income

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

Net interest margin on a fully taxable equivalent basis amounted to $7.543 million, 4.53% of average earning assets, in the first quarter of 2015, compared to $5.608 million, and 4.26% of average earning assets, in the first quarter of 2014. Net interest income in the first quarter of 2015 increased to $7.520 million, 4.53%, compared to $5.593 million, or 4.25%, in the first quarter of 2014. The increase in net interest income was largely due to the PFC acquisition as we increased earning assets by approximately $90 million. We also had increased net interest contribution due to the accretive attributes associated with the purchase accounting adjustments related to PFC loan marks under GAAP.

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	Three Months Ended								2015-2014		
	Average Balances			**Average Rates**		**Interest**		**Income/**			**Rate/**
	March 31,		**Increase/**	**March 31,**		**March 31,**		**Expense**	**Volume**	**Rate**	**Volume**
(dollars in thousands)	**2015**	**2014**	**(Decrease)**	**2015**	**2014**	**2015**	**2014**	**Variance**	**Variance**	**Variance**	**Variance**
Loans (1),(2),(3)	**$ 600,052**	$ 486,354	$ 113,698	**5.56%**	5.27%	**$ 8,231**	$ 6,315	$ 1,916	$ 1,477	$ 356	$ 83
Taxable securities	**61,742**	43,257	18,485	**1.98**	2.22	**302**	237	65	101	(25)	(11)
Nontaxable securities (2)	**2,450**	1,505	945	**10.10**	4.85	**61**	18	43	11	19	13
Federal funds sold	**2**	3	(1)								
Other interest-earning assets	**8,475**	3,070	5,405	**2.94**	6.21	**62**	47	15	83	(25)	(43)
Total earning assets	**672,721**	534,189	138,532	**5.22**	5.02	**8,656**	6,617	2,039	1,672	325	42
Reserve for loan losses	**(5,201)**	(4,852)	(349)								
Cash and due from banks	**19,568**	23,847	(4,279)								
Fixed Assets	**12,690**	10,288	2,402								
Other Real Estate	**2,731**	2,058	673								
Other assets	**34,987**	15,186	19,801								
Total assets	**$ 737,496**	$ 580,716	$ 156,780								
NOW and money market deposits	**$ 166,280**	$ 116,847	$ 49,433	**.28%**	.21%	**$ 116**	$ 61	$ 55	$ 26	$ 21	$ 8
Interest checking	**51,015**	33,090	17,925	**.19**	.18	**24**	15	9	8	1	
Savings deposits	**28,485**	13,569	14,916	**.07**	.09	**5**	3	2	3	(1)	(1)
CDs <$100,000	**131,122**	151,317	(20,195)	**1.11**	1.23	**358**	460	(102)	(61)	(47)	6
CDs >$100,000	**29,656**	23,205	6,451	**1.07**	1.40	**78**	80	(2)	22	(19)	(5)
Brokered deposits	**99,595**	67,557	32,038	**.99**	1.22	**242**	203	39	95	(38)	(17)
Borrowings	**54,605**	38,808	15,797	**2.15**	1.95	**290**	187	103	76	19	8
Total interest-bearing liabilities	**560,758**	444,393	116,365	**.92**	.92	**1,113**	1,009	104	169	(64)	(1)
Demand deposits	**95,230**	68,366	26,864								
Other liabilities	**7,731**	2,495	5,236								
Shareholders equity	**73,777**	65,462	8,315								
Total liabilities and shareholders equity	**$ 737,496**	$ 580,716	$ 156,780								
Rate spread				**4.30%**	4.10%						
Net interest margin/revenue				**4.53%**	4.26%	**$ 7,543**	$ 5,608	$ 1,935	$ 1,503	$ 389	$ 43

(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 euivalent basis, using a 34% tax rate

(3) Interest income on loans includes fees

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

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

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 2015, the Corporation determined through this analysis that a $.305 million provision for loan loss was required, compared to $.183 required in the first quarter of 2014. There were net recoveries of $83,000 in the first quarter of 2015 and $39,000 in the same period of 2014.

Other Income

Other income decreased by $.067 million for the three months ended March 31, 2015, compared to the three months ended March 31, 2014. Included in first quarter of 2015 is income from loans sold on the secondary market of $.167 million and income from SBA/USDA loan sales of $.118 million, compared to $.103 million for secondary market loans and $.382 million from SBA/USDA loans sales in the first quarter of 2014.

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.

See accompanying notes to condensed consolidated financial statements.

Table of Contents

The following table details other income for the three months ended March 31, 2015 and 2014 (dollars in thousands):

Noninterest Income

	Three Months Ended March 31,		Increase/(Decrease)	
	2015	**2014**	**Dollars**	**Percent**
Deposit service fees	**$ 184**	$ 157	$ 27	17.20%
Income from secondary market loans sold	**167**	103	64	62.14
SBA/USDA loan sale gains	**118**	382	(264)	100.00
Mortgage servicing income	**31**	13	18	138.46
Net security gains	**10**		10	100.00
Other noninterest income	**114**	36	78	216.67
Total other income	**$ 624**	$ 691	$ (67)	(9.70)%

Other Expense

For the first quarter of 2015, the Corporation recorded other expense of $5.756 million compared to $5.107 million in 2014, an increase of $.649 million. Included in other expense for the quarter is an increase in salaries and employee benefits of $.506 million, largely attributable to the PFC acquisition in December 2014.

The following table details other expense for the three months ended March 31, 2015 and 2014 (dollars in thousands):

	Three Months Ended March 31,		Increase/(Decrease)	
	2015	**2014**	**Dollars**	**Percentage**
Salaries and employee benefits	**$ 3,047**	$ 2,541	$ 506	19.91%
Occupancy	**576**	538	38	7.06
Furniture and equipment	**399**	319	80	25.08
Data processing	**355**	286	69	24.13
Advertising	**126**	107	19	17.76
Professional service fees	**301**	331	(30)	(9.06)
Loan and deposit	**138**	79	59	74.68
Writedowns and losses on other real estate held for sale	**17**		17	100.00%
FDIC insurance premiums	**108**	85	23	27.06
Telephone	**132**	82	50	60.98

Other		**557**		739		(182)	(24.63)
Total other expense	**$**	**5,756**	$	5,107	$	649	12.71%

Federal Income Taxes

A valuation allowance is provided against deferred tax assets when it is more likely than not that some or all of the deferred tax asset will not be realized. The Corporation, as of March 31, 2015 had a net operating loss and tax credit carryforwards for tax purposes of approximately $14.8 million, and $2.7 million, respectively. The net operating loss carryforwards expire twenty years from the date they originated. These carryforwards, if not utilized, will begin to expire in the year 2023. A portion of the NOL and all of the credit carryforwards are subject to the limitations for utilization as set forth in Section 382 of the Internal Revenue Code. The annual limitation is $1.400 million for the NOL and the equivalent value of tax credits, which is approximately $.476 million. These limitations for use were established in conjunction with the recapitalization of the Corporation in December 2004.

The Corporation has reported deferred tax assets of $10.332 million at March 31, 2015, which is net of a valuation allowance of $.760 million. Management evaluated the deferred tax valuation allowance as of March 31, 2015 and determined that no adjustment to the valuation was warranted. The remaining valuation allowance pertains to the existing tax credit carryovers, which will only be utilized after all net operating loss carryforwards. Since a portion of these tax credits may expire before that occurs, a valuation allowance for these has been established. The Corporation will continue to evaluate the future benefits from these carryforwards in order to determine if any adjustment to the deferred tax asset is warranted.

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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 $24.242 million in cash and due from balances, negligible federal funds sold and $59.187 million of unpledged investment securities. Although current liquidity is deemed adequate, management will increase on hand liquidity in the near term by issuing brokered CDs in order to fund anticipated loan growth.

During the first quarter of 2015, the Corporation increased cash and cash equivalents by $2.299 million. As shown on the Corporation s condensed consolidated statement of cash flows, liquidity was impacted by cash provided by investing activities, with a net decrease in investment securities of $2.976 million and a net decrease in loans of $3.445 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.

The Corporation s primary source of liquidity on a stand-alone basis is dividends from the Bank. At this time, the Corporation does not have any definitive plans for payments of dividends by the Bank however may consider doing so in future periods.

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, 2015, the Bank s core deposits in relation to total funding were 72.35% compared to 74.79% at March 31, 2014. These ratios indicated at March 31, 2015, that the Bank has increased its reliance on noncore deposits and borrowings to fund the Bank s long-term assets, namely loans and investments. The bank believes that by maintaining adequate volumes of short-term investments and implementing competitive pricing strategies on deposits, it can ensure adequate liquidity to support future growth. The Bank also has correspondent lines of credit available to meet unanticipated short-term liquidity needs. As of March 31, 2015, the Bank had $28.375 million of unsecured lines available and additional funding sources available if secured. The bank believes that its liquidity position remains strong to meet both present and future financial obligations and commitments, events or uncertainties that have resulted or are reasonably likely to result in material changes with respect to the Bank s liquidity.

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

See accompanying notes to condensed consolidated financial statements.

Table of Contents

CAPITAL AND REGULATORY

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

Quantitative measures established by regulation to ensure capital adequacy require the Corporation to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. Management has determined that, as of March 31, 2015, the Corporation is well capitalized.

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

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

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

The Corporation s and the Bank s actual capital and ratios compared to generally applicable regulatory requirements as of March 31, 2015 are as follows (dollars in thousands):

	Actual		Adequacy Purposes		Well-Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk weighted assets:						
Consolidated	**$ 69,519**	**11.7%**	**≥ $ 47,562**	**≥ 8.0%**	**≥ $ 59,452**	**10.0%**
mBank	**$ 73,252**	**12.5%**	**≥ $ 46,828**	**≥ 8.0%**	**≥ $ 58,535**	**10.0%**

Tier 1 capital to risk weighted assets:								
Consolidated	**$**	**63,992**	**10.8%**	**≥ $**	**35,671**	**≥ 6.0%**	**≥ $**	**47,561**	**8.0%**
mBank	**$**	**73,252**	**11.6%**	**≥ $**	**35,121**	**≥ 6.0%**	**≥ $**	**46,828**	**8.0%**
Tier 1 capital to average assets:									
Consolidated	**$**	**63,992**	**8.8%**	**≥ $**	**29,046**	**≥ 4.0%**	**≥ $**	**36,307**	**5.0%**
mBank	**$**	**67,904**	**9.5%**	**≥ $**	**28,647**	**≥ 4.0%**	**≥ $**	**35,809**	**5.0%**

See accompanying notes to condensed consolidated financial statements.

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 $152.521 million of its variable rate commercial loans. These interest rate floors will result in a lag on the repricing of these variable rate loans when and if interest rates increase in future periods. Approximately $117.038 million of the floor rate loan balances will reprice with a 100 basis point increase on the prime rate, with another $33.711 million repricing in the next 100 basis point prime rate increase.

The Corporation also has $63.313 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 $340.983 million of transactional accounts, of which $104.689 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.

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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, 2015 (dollars in thousands):

	1-90 Days	91 - 365 Days	>1-5 Years	Over 5 Years	Total
Interest-earning assets:					
Loans	**$ 216,018**	**$ 168,485**	**$ 211,734**	**$ 1,494**	**$ 597,731**
Securities	**5,952**	**8,380**	**32,685**	**16,296**	**63,313**
Other (1)	**4,256**	**2,079**	**2,474**		**8,809**
Total interest-earning assets	**226,226**	**178,944**	**246,893**	**17,790**	**669,853**
Interest-bearing obligations:					
NOW, money market, savings, interest checking	**236,294**				**236,294**
Time deposits	**19,389**	**75,028**	**62,536**	**120**	**157,073**
Brokered CDs	**18,060**	**24,140**	**57,657**		**99,857**
Borrowings	**100**	**10,374**	**39,040**	**325**	**49,839**
Total interest-bearing obligations	**273,843**	**109,542**	**159,233**	**445**	**543,063**
Gap	**$ (47,617)**	**$ 69,402**	**$ 87,660**	**$ 17,345**	**$ 126,790**
Cumulative gap	**$ (47,617)**	**$ 21,785**	**$ 109,445**	**$ 126,790**	

(1) Includes Federal Home Loan Bank Stock

The above analysis indicates that at March 31, 2015, the Corporation had a cumulative asset sensitivity gap position of $21.785 million within the one-year time frame. The Corporation s cumulative asset sensitive gap suggests that if market interest rates were to increase in the next twelve months, the Corporation has the potential to earn more net interest income. Since more assets would reprice at higher rates than liabilities. Conversely, if market interest rates decrease in the next twelve months, the above gap position suggests the Corporation s net interest income would decrease. 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, 2014, the Corporation had a cumulative liability sensitivity gap position of $8.027 million within the one-year time frame.

The borrowings in the gap analysis include $35.000 million of FHLB advances that have a weighted average maturity of 1.51 years and a weighted average rate of 1.68%.

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

Table of Contents

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.

Table of Contents

MACKINAC FINANCIAL CORPORATION

ITEM 4 CONTROLS AND PROCEDURES

As of March 31, 2015, we carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934. Our management, which includes our principal executive officer and our principal financial officer, does not expect that our disclosure controls and procedures will prevent all errors and all fraud.

A control system, no matter how well conceived and operated, can provide only reasonable, but not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints; additionally, the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Corporation have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is also based, in part, upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate due to changes in conditions; also the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Our principal executive officer and principal accounting officer have concluded, based on our evaluation of our disclosure controls and procedures, that our disclosure controls and procedures, as defined, under Rule 13a-15 of the Securities Exchange Act of 1934 are effective as of March 31, 2015.

Changes in Internal Control Over Financial Reporting

There were no changes in the Corporation s internal control over financial reporting that occurred during the quarter ended March 31, 2015 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 2. Unregistered Sales of Equity Securities and Use of Proceeds

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

Issuer purchase of Equity Securities

Period of purchases	Total number of shares purchased		Average price paid per share	Total number of shares purchased as part of a publically announced plan or program		Maximum dollars yet to be used for stock purchases*
January 1, 2015 to January 31, 2015	10,000	$	11.90	10,000	$	428,368
February 1, 2015 to February 28, 2015	10,000	$	11.73	10,000		311,106
March 1, 2015 to March 31, 2015	2,500	$	11.65	2,500		281,975
Total First Quarter 2015	22,500	$	11.79	22,500		

* Data does not include the April 2015 authorization of $750,000.

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.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

Table of Contents

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 15, 2015	By:	/s/ Paul D. Tobias	
				PAUL D. TOBIAS, CHAIRMAN AND CHIEF EXECUTIVE OFFICER (principal executive officer)
			By:	/s/ Ernie R. Krueger ERNIE R. KRUEGER EVP/CHIEF FINANCIAL OFFICER (principal financial and accounting officer)