MACKINAC FINANCIAL CORP /MI/
Form 10-K
March 31, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2014

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 0-20167

Mackinac Financial Corporation

(Exact name of registrant as specified in its charter)

Michigan	**38-2062816**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

130 South Cedar Street

Manistique, Michigan 49854

(888) 343-8147

(Address, including ZIP Code, and telephone number, including area code, of registrant s principal executive offices)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, no par value	The NASDAQ Stock Market, LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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 period 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	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

The aggregate market value of the common stock held by non-affiliates of the Registrant, based on a per share price of $12.90 as of June 30, 2014, was $29.127 million. As of March 27, 2015, there were outstanding 6,257,450 shares of the Corporation s Common Stock (no par value).

Documents incorporated by reference:

Certain portions, as expressly described in this report, of the registrant s Proxy Statement for the 2015 Annual Meeting of Shareholders to be filed subsequently are incorporated by reference into this report.

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PART I

Item 1. Business

Mackinac Financial Corporation (the   Corporation) was incorporated under the laws of the state of Michigan on December 16, 1974. The Corporation changed its name from   First Manistique Corporation   to   North Country Financial Corporation   on April 14, 1998. On December 16, 2004, the Corporation changed its name from North Country Financial Corporation to Mackinac Financial Corporation. The Corporation is headquartered and located in Manistique, Michigan. The mailing address of the Corporation is 130 South Cedar Street, Manistique, Michigan 49854.

In December of 2004, the Corporation was recapitalized with the net proceeds, approximately $26.2 million, from the issuance of $30 million of common stock in a private placement. Commensurate with this recapitalization, the Corporation changed its name from North Country Financial Corporation to Mackinac Financial Corporation with the Bank adopting the   mBank   identity early in 2005.

On December 5, 2014, the Corporation completed its acquisition of Peninsula Financial Corporation (PFC) and its wholly owned subsidiary, The Peninsula Bank. PFC had six branch offices and $126 million in assets as of the acquisition date. The results of operations due to the merger have been included in the Corporation s results since the acquisition date. The merger was effected by a combination of cash payments and the issuance of shares of the Corporation s common stock to PFC shareholders. Each share of PFC s 288,000 shares of common stock was converted into the right to receive, at the shareholder s election and subject to certain limitations (i) approximately 3.64 shares of the Corporation s common stock, with cash paid in lieu of fractional shares, or (ii) cash at $46.13 per share of common stock. The conversion of PFC s shares resulted in the issuance of 695,361 shares of the Corporation s common stock and payment of $4.484 million in cash to the former PFC shareholders.

The Corporation owns all of the outstanding stock of its banking subsidiary, mBank (the   Bank). The Bank currently has 13 branch offices located in the Upper Peninsula of Michigan and 4 branch offices located in Michigan s Lower Peninsula. The Bank maintains offices in Chippewa, Grand Traverse, Luce, Manistee, Marquette, Menominee, Oakland, Otsego, and Schoolcraft Counties. The Bank provides drive-in convenience at 12 branch locations and has 20 automated teller machines. The Bank has no foreign offices.

The Corporation also owns four non-bank subsidiaries: First Manistique Agency, presently inactive; First Rural Relending Company, a relending company for nonprofit organizations; and North Country Capital Trust, a statutory business trust which was formed solely for the issuance of trust preferred securities and Mackinac Commercial Credit, LLC, an asset based lending subsidiary located in Southeast Michigan. The Bank represents the principal asset of the Corporation. The Bank has one wholly owned subsidiary, mBank Title Insurance Agency, LLC, which provided title insurance services throughout Michigan, as of 2014 years end, this subsidiary was inactive. The Corporation and its subsidiary Bank are engaged in a single industry segment, commercial banking, broadly defined to include commercial and retail banking activities, along with other permitted activities closely related to banking.

Operations

The principal business the Corporation is engaged in, through the Bank, is the general commercial banking business, providing a full range of loan and deposit products. These banking services include customary retail and commercial banking services, including checking and savings accounts, time deposits, interest bearing transaction accounts, safe deposit facilities, real estate mortgage lending, commercial lending, commercial and governmental lease financing, and direct and indirect consumer financing. Funds for the Bank s operation are also provided by brokered deposits and through borrowings from the Federal Home Loan Bank (FHLB) system, proceeds from the sale of loans and mortgage-backed and other securities, funds from repayment of outstanding loans and earnings from operations. Earnings depend primarily upon the difference between (i) revenues from loans, investments, and other interest-bearing assets and (ii) expenses incurred in payment of interest on deposit accounts and borrowings, maintaining an adequate allowance for loan losses, and general operating expenses.

Competition

Banking is a highly competitive business. The Bank competes for loans and deposits with other banks, savings and loan associations, credit unions, mortgage bankers, and investment firms in the scope and type of services offered,

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pricing of loans, interest rates paid on deposits, and number and location of branches, among other things. The Bank also faces competition for investors funds from mutual funds and corporate and government securities.

The Bank competes for loans principally through interest rates and loan fees, the range and quality of the services it provides and the locations of its branches. In addition, the Bank actively solicits deposit-related clients and competes for deposits by offering depositors a variety of savings accounts, checking accounts, and other services.

Employees

As of December 31, 2014, the Corporation and its subsidiaries employed, in the aggregate, 171 employees equating to 160 full-time equivalents. The Corporation provides its employees with comprehensive medical and dental benefit plans, a life insurance plan, and a 401(k) plan. None of the Corporation s employees are covered by a collective bargaining agreement with the Corporation. Management believes its relationship with its employees to be good.

Business

The Bank makes mortgage, commercial, and installment loans to customers throughout Michigan. Fees may be charged for these services. The Bank s most prominent concentration in the loan portfolio relates to commercial loans to entities within the real estate operators of nonresidential buildings industry. This concentration represented $106.644million or 24.60% of the commercial loan portfolio at December 31, 2014. The Bank also supports the service industry, with its hospitality and related businesses, as well as gaming, forestry, restaurants, farming, fishing, and many other activities important to growth in Michigan. The economy of the Bank s market areas is affected by summer and winter tourism activities.

The Bank has become a premier SBA/USDA lender in the State of Michigan. Many of these SBA/USDA guaranteed loans are sold at a premium on the secondary market, with the Bank retaining the servicing. The Bank does not sell the loan guarantees on every credit, rather only those where acceptable market rates are above par.

The Bank also offers various consumer loan products including installment, mortgages and home equity loans. In addition to making consumer portfolio loans, the Bank engages in the business of making residential mortgage loans for sale to the secondary market.

On December 5, 2014, upon the consummation of the merger of Peninsula with and into the Corporation, the Corporation consolidated Peninsula Bank with the Bank. The acquisition nearly doubled the bank s presence in the Upper Peninsula to 13 total branches and increased the total number of branches in Michigan from 11 to 17.

In late 2013, the Corporation launched Mackinac Commercial Credit, LLC (MCC), a wholly owned subsidiary of the Corporation. MCC is a specialty finance company engaged in asset based lending and factoring of accounts receivable.

The Corporation may pursue new lease opportunities through unrelated entities, where the credit quality and rate of return on the transactions for its current business strategies. The Bank accounts for lease transactions as loans.

The Bank s primary source for lending, investments, and other general business purposes is deposits. The Bank offers a wide range of interest bearing and non-interest bearing accounts, including commercial and retail checking accounts, negotiable order of withdrawal (NOW) accounts, money market accounts with limited transactions, individual retirement accounts, regular interest-bearing statement savings accounts, certificates of deposit with a range of maturity date options, and accessibility to a customer s deposit relationship through online banking. The sources of deposits are residents, businesses and employees of businesses within the Bank s market areas, obtained through the personal solicitation of the Bank s officers and directors, direct mail solicitation and limited advertisements published in the local media. The Bank also utilizes the wholesale deposit market for any shortfalls in loan funding. No material portions of the Bank s deposits have been received from a single person, industry, group, or geographical location.

The Bank is a member of the FHLB. The FHLB provides an additional source of liquidity and long-term funds. Membership in the FHLB has provided access to attractive rate advances, as well as advantageous lending programs. The Community Investment Program makes advances to be used for funding community-oriented mortgage lending, and the Affordable Housing Program grants advances to fund lending for long-term low and moderate income owner occupied and affordable rental housing at subsidized interest rates.

The Bank has secondary borrowing lines of credit available to respond to deposit fluctuations and temporary loan demands. The unsecured lines totaled $28.375 million at December 31, 2014, with additional amounts available if collateralized.

As of December 31, 2014, the Bank had no material risks relative to foreign sources. See the Interest Rate Risk and Foreign Exchange Risk sections in Management s Discussion and Analysis of Financial Condition and Results of Operations under Item 7 below, for details on the Corporation s foreign account activity.

Compliance with federal, state, and local statutes and/or ordinances relating to the protection of the environment is not expected to have a material effect upon the Bank s capital expenditures, earnings, or competitive position.

Supervision and Regulation

As a registered bank holding company, the Corporation is subject to regulation and examination by the Board of Governors of the Federal Reserve System (the Federal Reserve Board) under the Bank Holding Company Act, as amended (the BHCA). The Bank is subject to regulation and examination by the Michigan Department of Financial and Insurance Services (the DIFS) and the Federal Deposit Insurance Corporation (the FDIC).

Under the BHCA, the Corporation is subject to periodic examination by the Federal Reserve Board, and is required to file with the Federal Reserve Board periodic reports of its operations and such additional information as the Federal Reserve Board may require. In accordance with Federal Reserve Board policy, the Corporation is expected to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances where the Corporation might not do so absent such policy. In addition, there are numerous federal and state laws and regulations which regulate the activities of the Corporation, the Bank and the non-bank subsidiaries, including requirements and limitations relating to capital and reserve requirements, permissible investments and lines of business, transactions with affiliates, loan limits, mergers and acquisitions, issuances of securities, dividend payments, inter-affiliate liabilities, extensions of credit and branch banking.

Federal banking regulatory agencies have established risk-based capital guidelines for banks and bank holding companies that are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies. The resulting capital ratios represent qualifying capital as a percentage of total risk-weighted assets and off-balance sheet items. The guidelines are minimums, and the federal regulators have noted that banks and bank holding companies contemplating expansion programs should not allow expansion to diminish their capital ratios and should maintain all ratios well in excess of the minimums. The current guidelines require all bank holding companies and federally-regulated banks to maintain a minimum risk-based total capital ratio equal to 8%, of which at least 4% must be Tier 1 capital. Tier 1 capital includes common shareholders equity, qualifying perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, but excludes goodwill and most other intangibles and excludes the allowance for loan and lease losses. Tier 2 includes the excess of any preferred stock not included in Tier 1 capital, mandatory convertible securities, hybrid capital instruments, subordinated debt and intermediate term-preferred stock, and general reserves for loan and lease losses up to 1.25% of risk-weighted assets.

The Federal Deposit Insurance Corporation Improvement Act contains prompt corrective action provisions pursuant to which banks are to be classified into one of five categories based upon capital adequacy, ranging from well capitalized to critically undercapitalized and which require (subject to certain exceptions) the appropriate federal banking agency to take prompt corrective action with respect to an institution which becomes significantly undercapitalized or critically undercapitalized .

In general, the regulations define the five capital categories as follows: (i) an institution is well capitalized if it has a total risk-based capital ratio of 10% or greater, has a Tier 1 risk-based capital ratio of 6% or greater, has a leverage ratio of 5% or greater and is not subject to any written capital order or directive to meet and maintain a specific capital level for any capital measures; (ii) an institution is adequately capitalized if it has a total risk-based capital ratio of 8% or greater, has Tier 1 risk-based capital ratio of 4% or greater, and has a leverage ratio of 4% or greater; (iii) an institution is undercapitalized if it has a total risk-based capital ratio of less than 8%, has a Tier 1 risk-based capital ratio that is less than 4% or has a leverage ratio that is less than 4%; (iv) an institution is significantly undercapitalized if it has a total risk-based capital ratio that is less than 6%, a Tier I risk-based capital ratio that is

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less than 3% or a leverage ratio that is less than 3%; (v) an institution is critically undercapitalized if its tangible equity is equal to or less than 2% of its total assets. The FDIC also, after an opportunity for a hearing, has authority to downgrade an institution from well capitalized to adequately capitalized or to subject an adequately capitalized or undercapitalized institution to the supervisory actions applicable to the next lower category, for supervisory concerns. These regulatory ratios are subject to further review and adjustment as described under Basel III below.

Information pertaining to the Corporation s capital is contained in Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 below.

Current federal law provides that adequately capitalized and managed bank holding companies from any state may acquire banks and bank holding companies located in any other state, subject to certain conditions.

In 1999, Congress enacted the Gramm-Leach-Bliley Act (GLBA), which eliminated certain barriers to and restrictions on affiliations between banks and securities firms, insurance companies and other financial service organizations. Among other things, GLBA repealed certain Glass-Steagall Act restrictions on affiliations between banks and securities firms, and amended the BHCA to permit bank holding companies that qualify as financial holding companies to engage in a broad list of financial activities, and any non-financial activity that the Federal Reserve Board, in consultation with the Secretary of the Treasury, determines is complementary to a financial activity and poses no substantial risk to the safety and soundness of depository institutions or the financial system. GLBA treats lending, insurance underwriting, insurance company portfolio investment, financial advisory, securities underwriting, dealing and market-making, and merchant banking activities as financial in nature for this purpose.

Under GLBA, a bank holding company may become certified as a financial holding company by filing a notice with the Federal Reserve Board, together with a certification that the bank holding company meets certain criteria, including capital, management, and Community Reinvestment Act requirements. The Corporation is not currently required to qualify as a financial holding company.

Privacy Restrictions

GLBA, in addition to the previous described changes in permissible non-banking activities permitted to banks, bank holding companies and financial holding companies, also requires financial institutions in the U.S. to provide certain privacy disclosures to customers and consumers, to comply with certain restrictions on sharing and usage of personally identifiable information, and to implement and maintain commercially reasonable customer information safeguarding standards. The Corporation believes that it complies with all provisions of GLBA and all implementing regulations, and the Bank has developed appropriate policies and procedures to meet its responsibilities in connection with the privacy provisions of GLBA.

The USA PATRIOT Act

In 2001, Congress enacted the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the USA PATRIOT Act). The USA PATRIOT Act is designed to deny terrorists and criminals the ability to obtain access to the United States financial system, and has significant implications for depository institutions, brokers, dealers and other businesses involved in the transfer of money. The USA PATRIOT Act mandates financial services companies to implement additional policies and procedures with respect to, or additional measures designed to address, any or all of the following matters, among others: money laundering, terrorist financing, identifying and reporting suspicious activities and currency transactions, and currency crimes.

Sarbanes-Oxley Act

On July 30, 2002, President Bush signed into law The Sarbanes-Oxley Act of 2002. This legislation addresses accounting oversight and corporate governance matters, including:

- The creation of a five-member oversight board that will set standards for accountants and have investigative and disciplinary powers;
- The prohibition of accounting firms from providing various types of consulting services to public clients and requiring accounting firms to rotate partners among public client assignments every five years;

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- Increased penalties for financial crimes;
- Expanded disclosure of corporate operations and internal controls and certification of financial statements;
- Enhanced controls on, and reporting of, insider training; and
- Prohibition on lending to officers and directors of public companies, although the Bank may continue to make these loans within the constraints of existing banking regulations.

Among other provisions, Section 302(a) of the Sarbanes-Oxley Act requires that our Chief Executive Officer and Chief Financial Officer certify that our quarterly and annual reports do not contain any untrue statement or omission of a material fact. Specific requirements of the certifications include having these officers confirm that they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our disclosure controls and procedures; they have made certain disclosures to our auditors and Audit Committee about our internal controls; and they have included information in our quarterly and annual reports about their evaluation and whether there have been significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to their evaluation.

In addition, Section 404 of the Sarbanes-Oxley Act and the SEC s rules and regulations thereunder require our management to evaluate, with the participation of our principal executive and principal financial officers, the effectiveness, as of the end of each fiscal year, of our internal control over financial reporting. Our management must then provide a report of management on our internal over financial reporting that contains, among other things, a statement of their responsibility for establishing and maintaining adequate internal control over financial reporting, and a statement identifying the framework they used to evaluate the effectiveness of our internal control over financial reporting.

Extraordinary Government Programs

Troubled Asset Relief Program. On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (EESA) was enacted, which, among other things, provided the United States Department of the Treasury (Treasury) access to up to $700 billion to stabilize the U.S. banking system. On October 14, 2008, Treasury announced its intention to inject capital into nine large U.S. financial institutions under the Capital Purchase Program (the CPP) as part of the Troubled Asset Relief Program (TARP) implementing the EESA, and since has injected capital into many other financial institutions.

Under the CPP, the Corporation issued previously authorized preferred stock with a 5% annual dividend rate to the Department of Treasury (Treasury). The Corporation also, as a required part of this transaction, issued 379,093 common stock warrants with an exercise price of $4.35 per share. The preferred stock and common stock warrants were issued on the closing date, April 24, 2009. In 2012, the Treasury auctioned the Corporation s preferred stock and the stock was sold to several individual and private investors. The Corporation repurchased its common stock warrants from the Treasury in December 2012 at a cost of $1.3 million. In 2013, the Corporation redeemed the entire $11.0 million in Series A Preferred Stock.

Additional information pertaining to Supervision and Regulation is contained in Management s Discussion and Analysis of Financial Condition and Results of Operations under Item 7 below.

Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act) into law. The Dodd-Frank Act resulted in sweeping changes in the regulation of financial institutions aimed at strengthening safety and soundness for the financial services sector. A summary of certain provisions of the Dodd-Frank Act is set forth below:

- *Increased Capital Standards and Enhanced Supervision.*

The federal banking agencies are required to establish minimum leverage and risk-based capital requirements for banks and bank holding companies. These new standards will be no lower than current regulatory capital and leverage standards applicable to insured depository institutions and may, in fact, be higher when established by the agencies. The Dodd-Frank Act also increased regulatory oversight, supervision and examination of banks, bank holding companies and their respective subsidiaries by the appropriate regulatory agency.

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- *Federal Deposit Insurance.*

The Dodd-Frank Act made permanent the $250,000 deposit insurance limit for insured deposits and provided unlimited federal deposit insurance on noninterest bearing transaction accounts at all insured depository institutions through December 31, 2012. Subsequent to 2012, these amounts reverted from unlimited insurance to $250,000 coverage per separately insured depositor. The Dodd-Frank Act also changed the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible equity, eliminated the ceiling on the size of the Deposit Insurance Fund (the DIF) and increased the floor on the size of the DIF.

- *The Consumer Financial* Protection *Bureau (CFPB).*

The Dodd-Frank Act centralized responsibility for consumer financial protection by creating a new agency, the CFPB, responsible for implementing, examining and, for large financial institutions of $10 billion or more in total assets, enforcing compliance with federal consumer financial laws. Because we have under $10 billion in total assets, however, the Federal Reserve Bank of Chicago (Reserve Bank) will still continue to examine us at the federal level for compliance with such laws.

- *Interest on Demand Deposit Accounts.*

The Dodd-Frank Act repealed the prohibition on the payment of interest on demand deposit accounts effective July 21, 2011, thereby permitting depository institutions to now pay interest on business checking and other accounts.

- *Mortgage Reform.*

The Dodd-Frank Act provided for mortgage reform addressing a customer s ability to repay, restricted variable-rate lending by requiring the ability to repay to be determined for variable rate loans by using the maximum rate that will apply during the first five years of a variable-rate loan term, and made more loans subject to requirement for higher-cost loans, new disclosures and certain other restrictions.

- *Interstate Branching.*

The Dodd-Frank Act allows banks to engage in de novo interstate branching, a practice that was previously significantly limited.

- *Interchange Fee Limitations.*

The Dodd-Frank Act gave the Federal Reserve Board the authority to establish rules regarding interchange fees charged for electronic debit transactions by a payment card issuer that, together with its affiliates, has assets of $10 billion or more and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer. The Federal Reserve Board has rules under this provision that limit the swipe fees that a debit card issuer can charge a merchant for a transaction to the sum of 21 cents and five basis points times the value of the transaction, plus up to one cent for fraud prevention costs. While we are not directly subject to such regulations since our total assets do not exceed $10 billion, these regulations may impact our ability to compete with larger institutions who are subject to the restrictions.

We expect that many of the requirements called for in the Dodd-Frank Act will be implemented over time, and most will be subject to implementing regulations over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on financial institutions operations is unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements.

Basel III

On July 2, 2013, the Federal Reserve and OCC approved a final rule to establish a new comprehensive regulatory capital framework for all US banking organizations, with an effective date of January 1, 2015. The Regulatory Capital Framework (Basel III) implements several changes to the US regulatory capital framework required by the Dodd-Frank Act. The new US capital framework imposes higher minimum capital requirements, additional capital buffers above those minimum requirements, a more restrictive definition of capital, and higher risk weights for

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various enumerated classifications of assets, the combined impact of which effectively results in substantially more demanding capital standards for US banking organizations.

The Basel III final rule establishes a new common equity Tier 1 capital (CET1) requirement, an increase in the Tier 1 capital requirement from 4.0% to 6.0% and maintains the current 8.0% total capital requirement. The new CET1 and minimum Tier 1 capital requirements are effective January 1, 2015. In addition to these minimum risk-based capital ratios, the Basel III final rule requires that all banking organizations maintain a capital conservation buffer consisting of CET1 in an amount equal to 2.5% of risk-weighted assets in order to avoid restrictions on their ability to make capital distributions and to pay certain discretionary bonus payments to executive officers. In order to avoid those restrictions, the capital conservation buffer effectively increases the minimum CET1 capital, Tier 1 capital and total capital ratios for US banking organizations to 7.0%, 8.5% and 10.5%, respectively. Banking organizations with capital levels that fall within the buffer will be required to limit dividends, shares repurchases or redemptions (unless replaced within the same calendar quarter by capital instruments of equal or higher quality), and discretionary bonus payments. The capital conservation buffer is phased in over a 5-year period, beginning January 1, 2016.

	Adequately Capitalized Requirement, effective January 1, 2015	**Well-Capitalized Requirement, effective January 1, 2015**	**Well-Capitalized with Buffer, fully phased in 2019**
Leverage	4.0%	5.0%	5.0%
CET1	4.5%	6.5%	7.0%
Tier 1	6.0%	8.0%	8.5%
Total Capital	8.0%	10.0%	10.5%

As required by Dodd-Frank, the Basel III final rule requires that capital instruments such as trust preferred securities and cumulative preferred shares be phased out of Tier 1 capital by January 1, 2016, for banking organizations that had $15 billion or more in total consolidated assets as of December 31, 2009 and permanently grandfathers as Tier 1 capital such instruments issued by these smaller entities prior to May 19, 2010 (provided they do not exceed 25% of Tier 1 capital).

The Basel III final rule provides banking organizations under $250 billion in total consolidated assets or under $10 billion in foreign exposures with a one-time opt-out right to continue excluding Accumulated Other Comprehensive income from CET1 capital. The election to opt-out must be made on the banking organization s first Call Report filed after January 1, 2015. The Corporation intends to elect to opt-out to continue excluding Accumulated Other Comprehensive Income from its regulatory capital.

The Basel III final rule requires that goodwill and other intangible assets (other than mortgage servicing assets), net of associated deferred tax liabilities, be deducted from CET1 capital. Additionally, deferred tax assets that arise from net operating loss and tax credit carryforwards, net of associated deferred tax liabilities and valuation allowances, are fully deducted from CET1 capital. However, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks, along with mortgage servicing assets and significant (defined as greater than 10% of the issued and outstanding common stock of the unconsolidated financial institution) investments in the common stock of unconsolidated financial institutions are partially includible in CET1 capital, subject to deductions defined in the final rule. Our preliminary calculations indicate we will meet or exceed the new requirements to continue to be classified as well-capitalized under Basel III as of January 1, 2015.

Monetary Policy

The earnings and business of the Corporation and the Bank depends on interest rate differentials. In general, the difference between the interest rates paid by the Bank to obtain its deposits and other borrowings, and the interest rates received by the Bank on loans extended to its customers and on securities held in the Bank s portfolio, comprises the major portion of the Bank s earnings. These rates are highly sensitive to many factors that are beyond the control of the Bank, and accordingly, its earnings and growth will be subject to the influence of economic conditions, generally, both domestic and foreign, including inflation, recession, unemployment, and the monetary policies of the Federal Reserve Board. The Federal Reserve Board implements national monetary policies designed to curb inflation, combat recession, and promote growth through, among other means, its open-market dealings in US government securities, by adjusting the required level of reserves for financial institutions subject to reserve requirements, through adjustments to the discount rate applicable to borrowings by banks that are members of the

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Federal Reserve System, and by adjusting the Federal Funds Rate, the rate charged in the interbank market for purchase of excess reserve balances. In addition, legislative and economic factors can be expected to have an ongoing impact on the competitive environment within the financial services industry. The nature and timing of any future changes in such policies and their impact on the Bank cannot be predicted with certainty.

Selected Statistical Information

I. Distribution of Assets, Obligations, and Shareholders Equity; Interest Rates and Interest Differential

The key components of net interest income, the daily average balance sheet for each year including the components of earning assets and supporting obligations the related interest income on a fully tax equivalent basis and interest expense, as well as the average rates earned and paid on these assets and obligations is contained under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations under Item 7 below.

An analysis of the changes in net interest income from period-to-period and the relative effect of the changes in interest income and expense due to changes in the average balances of earning assets and interest-bearing obligations and changes in interest rates is contained under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations under Item 7 below.

II. Investment Portfolio

A. Investment Portfolio Composition

The following table presents the carrying value of investment securities available for sale as of December 31 of the years set forth below (dollars in thousands):

	2014	2013	2012
US Treasuries	**$ 5,280**	$	$
Corporate	**12,674**	16,079	18,977
US Agencies	**22,717**	14,855	10,404
US Agencies - MBS	**13,688**	7,359	8,374
State and political subdivisions	**11,473**	6,095	6,044
Total	**$ 65,832**	$ 44,388	$ 43,799

B. Relative Maturities and Weighted Average Interest Rates

The following table presents the maturity schedule of securities held and the weighted average yield of those securities, as of December 31, 2014 (fully taxable equivalent, dollars in thousands):

	In one year or less	After one, but within five years	After five, but within ten years	Over ten years	Total	Weighted Average Yield (1)
US Treasuries	$	$ 5,280	$	$	$ 5,280	1.47%
US Agencies		16,782	5,137	798	22,717	1.69%
US Agencies - MBS		2,463	3,694	7,531	13,688	2.49%
Corporate	8,176	4,498			12,674	1.72%
State and politicial subdivisions	704	2,264	5,224	3,281	11,473	4.17%
Total	$ 8,880	$ 31,287	$ 14,055	$ 11,610	$ 65,832	
Weighted average yield (1)	1.59%	1.88%	3.14%	2.84%	2.27%	

(1) Weighted average yield includes the effect of tax-equivalent adjustments using a 34% tax rate.

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III. Loan Portfolio

A. Type of Loans

The following table sets forth the major categories of loans outstanding for each category at December 31 (dollars in thousands):

	2014	2013	2012	2011	2010
Commercial real estate	**$ 315,387**	$ 268,809	$ 244,966	$ 199,201	$ 194,859
Commercial, financial and agricultural	**101,895**	79,655	80,646	92,269	68,858
One to four family residential real estate	**139,553**	103,768	87,948	77,332	75,074
Construction	**25,715**	17,799	24,694	25,519	39,012
Consumer	**18,385**	13,801	10,923	6,925	5,283
Total	**$ 600,935**	$ 483,832	$ 449,177	$ 401,246	$ 383,086

B. Maturities and Sensitivities of Loans to Changes in Interest Rates

The following table presents the remaining maturity of total loans outstanding for the categories shown at December 31, 2014, based on scheduled principal repayments (dollars in thousands):

	Commercial Real Estate	Commercial, Financial, and Agricultural	1-4 Family Residential Real Estate	Consumer	Construction	Total
In one year or less:						
Variable interest rates	$ 143,942	$ 69,587	$ 106,871	$ 558	$ 12,051	$ 333,009
Fixed interest rates	2,820	1,563	2,603	1,434	9,387	17,807
After one year but within five years:						
Variable interest rates						
Fixed interest rates	165,792	27,253	14,419	15,913	4,089	227,466
After five years:						
Variable interest rates						
Fixed interest rates	2,833	3,492	15,660	480	188	22,653
Total	$ 315,387	$ 101,895	$ 139,553	$ 18,385	$ 25,715	$ 600,935

C. Risk Elements

The following table presents a summary of nonperforming assets and problem loans as of December 31 (dollars in thousands):

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	2014	2013	2012	2011	2010
Nonaccrual loans	**$ 3,939**	$ 1,406	$ 4,687	$ 5,490	$ 5,921
Interest income that would have been recorded for nonaccrual loans under original terms	**130**	228	313	363	583
Interest income recorded during period for nonaccrual loans			54	118	141
Accruing loans past due 90 days or more					
Restructured loans not included above	**3,105**	618		2,503	4,642

IV. Summary of Loan Loss Experience

A. Analysis of the Allowance for Loan Losses

Changes in the allowance for loan losses arise from loans charged off, recoveries on loans previously charged off by loan category, and additions to the allowance for loan losses through provisions charged to expense. Factors which influence management s judgment in determining the provision for loan losses include establishing specified loss allowances for selected loans (including large loans, nonaccrual loans, and problem and delinquent loans) and consideration of historical loss information and local economic conditions.

The following table presents information relative to the allowance for loan losses for the years ended December 31 (dollars in thousands):

	2014	2013	2012	2011	2010
Balance of allowance for loan losses at beginning of period	**$ 4,661**	$ 5,218	$ 5,251	$ 6,613	$ 5,225
Loans charged off:					
Commercial	**682**	2,171	775	3,258	5,027
One to four family residential real estate	**290**	141	399	490	410
Consumer	**74**	120	82	52	48
Total loans charged off	**1,046**	2,432	1,256	3,800	5,485
Recoveries of loans previously charged off:					
Commercial	**259**	150	253	128	346
One to four family residential real estate	**22**	26	7	1	11
Consumer	**44**	24	18	9	16
Total recoveries	**325**	200	278	138	373
Net loans charged off	**721**	2,232	978	3,662	5,112
Provisions charged to expense	**1,200**	1,675	945	2,300	6,500

Balance at end of period	**$ 5,140**	$ 4,661	$ 5,218	$ 5,251	$ 6,613
Average loans outstanding	**509,749**	462,500	422,440	388,115	384,347
Ratio of net charge-offs	**.14**%	.48%	.23%	.94%	1.33%

B. Allocation of Allowance for Loan Losses

The allocation of the allowance for loan losses for the years ended December 31, is shown on the following table. The percentages shown represent the percent of each loan category to total loans (dollars in thousands):

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	2014 Amount	2014 %	2013 Amount	2013 %	2012 Amount	2012 %	2011 Amount	2011 %	2010 Amount	2010 %
Commercial real estate	**$ 2,813**	**54.73%**	$ 1,849	39.67%	$ 3,267	62.61%	$ 2,973	56.62%	$ 3,460	52.32%
Commercial, financial, and agricultural	**1,539**	**29.94%**	1,378	29.56%	692	13.26%	1,079	20.55%	1,018	15.39%
Commercial construction	**142**	**2.76%**	80	1.72%	125	2.40%	207	3.94%	389	5.88%
1-4 family residential real estate	**285**	**5.54%**	516	11.07%	980	18.78%	1,114	21.22%	1,622	24.53%
Consumer construction	**6**	**.12%**	25	.54%		.00%		.00%		.00%
Consumer	**13**	**.25%**	148	3.18%		.00%		.00%		.00%
Unallocated general reserves	**342**	**6.66%**	665	14.26%	154	2.95%	(122)	-2.33%	124	1.88%
Total	**$ 5,140**	**100.00%**	$ 4,661	100.00%	$ 5,218	100.00%	$ 5,251	100.00%	$ 6,613	100.00%

V. Deposits

Deposit information is contained in Note 7 to the Corporation s Consolidated Financial Statements in Item 8 of this Form 10-K below.

VI. Return on Equity and Assets

See Item 6 of this Form 10-K, Selected Financial Data

VII. Financial Instruments with Off-Balance Sheet Risk

Information relative to commitments, contingencies, and credit risk are discussed in Note 19 to the Corporation s Consolidated Financial Statements contained in Item 8 of this Form 10-K.

Item 1B. Unresolved Staff Comments

None.

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Item 2. Properties

The Corporation s headquarters are located at 130 South Cedar Street, Manistique, Michigan 49854. The headquarters location is owned by the Corporation and not subject to any mortgage.

All of the branch locations are designed for use and operation as a bank, are well maintained, and are suitable for current operations. Of the 17 branch locations 10 are owned and 7 are leased. The Corporation has additional office space to house and administrative operational support. The Corporation also leases one office that supports our commercial lending. Below is a comprehensive listing of our branch locations:

Birmingham	260 E. Brown Street, Suite 300	Birmingham, MI	Leased
Escanaba	2224 N. Lincoln Road	Escanaba, MI	Owned
Gaylord	1955 S. Otsego Avenue	Gaylord, MI	Owned
Ishpeming - Downtown	100 S. Main Street	Ishpeming, MI	Owned
Ishpeming - Jubilee	900 US 41 West	Ishpeming, MI	Leased
Ishpeming - West	US West & 170 N. Daisy Street	Ishpeming, MI	Leased
Kaleva	14429 Wuoksi Avenue	Kaleva, MI	Owned
Manistique	130 South Cedar Street	Manistique, MI	Owned
Manistique - Jack s	735 E. Lakeshore Drive	Manistique, MI	Leased
Marquette	857 W. Washington Street	Marquette, MI	Leased
Marquette - McClellan	175 S. McClellan Avenue	Marquette, MI	Owned
Marquette - Medical Center	1414 W. Fair Avenue, Suite 140	Marquette, MI	Leased
Negaunee	440 US 41 East	Negaunee, MI	Leased
Newberry	414 Newberry Avenue	Newberry, MI	Owned
Sault Ste. Marie	138 Ridge Street	Sault Ste. Marie, MI	Owned
Stephenson	S216 Menominee Street	Stephenson, MI	Owned
Traverse City	3530 North Country Drive	Traverse City, MI	Owned

Item 3. Legal Proceedings

There are no pending material legal proceedings to which the Corporation is a party or to which any of its property was subject, except for proceedings which arise in the ordinary course of business. In the opinion of management, pending legal proceedings will not have a material effect on the consolidated financial position or results of operations of the Corporation.

Item 4. Mine Safety Disclosures

Not applicable.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

MARKET INFORMATION

(Unaudited)

The Corporation s common stock is traded on the NASDAQ Capital Market under the symbol MFNC. The following table sets forth the range of high and low trading prices of the Corporation s common stock from January 1, 2013 through December 31, 2014, as reported by NASDAQ.

	For the Quarter Ended			
	March 31	**June 30**	**September 30**	**December 31**
2014				
High	**$ 15.06**	**$ 14.19**	**$ 13.70**	**$ 12.10**
Low	**9.86**	**11.35**	**10.28**	**9.95**
Close	**12.54**	**12.90**	**11.30**	**11.85**
Dividends declared per share	**.050**	**.050**	**.050**	**.075**
Book value	**11.89**	**12.03**	**12.06**	**11.81**
2013				
High	$ 9.25	$ 9.25	$ 10.09	$ 10.14
Low	7.09	8.25	8.61	8.38
Close	9.04	8.88	9.05	9.90
Dividends delcared per share	.04	.04	.04	.05
Book value	11.16	11.26	11.30	11.77

The Corporation had approximately 1,600 shareholders of record as of March 30, 2015.

Dividends

The holders of the Corporation s common stock are entitled to dividends when, and if declared by the Board of Directors of the Corporation, out of funds legally available for that purpose. In determining dividends, the Board of Directors considers the earnings, capital requirements and financial condition of the Corporation and its subsidiary bank, along with other relevant factors. The Corporation s principal source of funds for cash dividends is the dividends paid by the Bank. The ability of the Corporation and the Bank to pay dividends is subject to regulatory restrictions and requirements.

The Bank paid a $3.0 million dividend in 2013 and 2014. The Corporation declared a $.075 dividend per share on its common stock in the fourth quarter of 2014. There were no sales of unregistered securities in 2014. In 2013, the Corporation approved a stock buyback program. In 2014, the Corporation repurchased 13,700 shares of its common stock at a total purchase price of $143,298. During 2013, the Corporation repurchased 55,594 shares of its common stock at a total purchase price of $509,334.

The holders of the Corporation s common stock are entitled to dividends when, and if declared by the Board of Directors of the Corporation out of funds legally available for that purpose. In determining dividends, the Board of Directors considers the earnings, capital requirements and financial condition of the Corporation and its subsidiary bank, along with other relevant factors. The Corporation s principal source of funds for cash dividends is the dividends paid by the Bank. The ability of the Corporation and the Bank to pay dividends is subject to regulatory restrictions and requirements. There were no dividends declared or paid by the Bank in 2012. The Bank paid a dividend of $3.0 million to the Corporation in 2013 and 2014, respectively. The Corporation declared cash dividends per common share of $.04 in 2004, $.17 in 2014 and $.225 in 2014.

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Issuer Purchases of Equity Securities

The Corporation currently has a share repurchase program. The program is conducted under authorizations from time to time by the Board of Directors. Shares repurchased to date are covered by Board authorizations made and publically announced for $600,000 on February 27, 2013 and an additional $600,000 on December 17, 2013. Neither of these authorizations has an expiration date. The Corporation purchased 55,594 shares for $509,334 in 2013 and 13,700 shares of its common stock for $143,298 in 2014. As of December 31, 2014 the Corporation had $547,367 remaining of the previously authorized buyback amount. There was no common stock purchased by the Corporation in the fourth quarter of 2014.

For information regarding securities authorized for issuance under equity compensation plans, see Item 12 of this Form 10-K.

Performance Graph

Shown below is a line graph comparing the yearly percentage change in the cumulative total shareholder return on the Corporation s common stock with that of the cumulative total return on the NASDAQ Bank Index and the NASDAQ Composite Index for the five-year period ended December 31, 2014. The following information is based on an investment of $100, on December 31, 2009 in the Corporation s common stock, the NASDAQ Bank Index, and the NASDAQ Composite Index, with dividends reinvested.

This graph and other information contained in this section shall not be deemed to be soliciting material or to be filed with the Securities and Exchange Commission or subject to Regulation 14A or 14C, or to the liabilities of Section 18 of the Securities Exchange Act of 1934, as amended.

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Item 6. Selected Financial Data

SELECTED FINANCIAL DATA

(Unaudited)

(Dollars in Thousands, Except Per Share Data)

	Years Ended December 31				
	2014	**2013**	**2012**	**2011**	**2010**
SELECTED FINANCIAL CONDITION DATA:					
Total assets	**$ 743,785**	$ 572,800	$ 545,980	$ 498,311	$ 478,696
Loans	**600,935**	483,832	449,177	401,246	383,086
Securities	**65,832**	44,388	43,799	38,727	33,860
Deposits	**606,973**	466,299	434,557	404,789	386,779
Borrowings	**49,846**	37,852	35,925	35,997	36,069
Common shareholders equity	**73,996**	65,249	61,448	44,342	43,176
Total shareholders equity	**73,996**	65,249	72,448	55,263	53,882
SELECTED OPERATIONS DATA:					
Interest income	**$ 27,669**	$ 25,523	$ 24,427	$ 23,072	$ 22,840
Interest expense	**4,142**	4,124	4,603	5,143	6,455
Net interest income	**23,527**	21,399	19,824	17,929	16,385
Provision for loan losses	**1,200**	1,675	945	2,300	6,500
Net security gains (losses)	**54**	73		(1)	215
Other income	**3,058**	3,865	4,043	3,657	2,580
Other expenses	**(22,610)**	(18,128)	(16,757)	(15,969)	(16,598)
Income (loss) before income taxes	**2,829**	5,534	6,165	3,316	(3,918)
Provision (credit) for income taxes	**1,129**	(403)	(922)	1,098	(3,500)
Net income (loss)	**1,700**	5,937	7,087	2,218	(418)
Preferred dividend and accretion of discount		308	629	766	742
Net income available to common shareholders	**$ 1,700**	$ 5,629	$ 6,458	$ 1,452	$ (1,160)
PER SHARE DATA:					
Earnings (loss) - Basic	**$ .30**	$ 1.01	$ 1.51	$ .42	$ (.34)
Earnings (loss) - Diluted	**.30**	1.00	1.46	.41	(.34)
Cash dividends declared	**.225**	0.170	0.040		
Book value	**11.81**	11.77	11.05	12.97	12.63
Market value - closing price at year end	**11.85**	9.90	7.09	5.42	4.58
FINANCIAL RATIOS:					
Return on average common equity	**2.57%**	9.07%	12.43%	3.30%	(2.64)%
Return on average total equity	**2.57**	8.26	10.26	2.66	(2.06)
Return on average assets	**.28**	1.01	1.23	.30	(.23)
Dividend payout ratio	**75.00**	16.83	2.65	N/A	N/A
Average equity to average assets	**10.94**	12.28	11.95	11.15	11.17
Efficiency ratio	**74.43**	67.46	67.95	68.43	72.57
Net interest margin	**4.19**	4.17	4.17	4.06	3.66

ASSET QUALITY RATIOS:					
Nonperforming loans to total loans	**.66%**	.42%	1.04%	1.99%	2.76%
Nonperforming assets to total assets	**.93**	.58	1.45	2.24	3.37
Allowance for loan losses to total loans	**.86**	.96	1.16	1.18	1.73
Allowance for loan losses to nonperforming loans	**130.49**	230.29	111.33	65.69	62.61
Net charge-offs to average loans	**.14**	.48	.23	.94	1.33
Texas ratio	**9.37**	5.59	10.25	18.56	26.66

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements

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

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.*

- *We have limited experience in integrating acquisitions and may not realize the expected benefits of our recent acquisition of The Peninsula Bank.*

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

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

In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that some allowance requires management to evaluate all available evidence, both negative and positive. Positive evidence necessary to overcome the negative evidence includes whether future taxable income in sufficient amounts and character within the carry back and carry forward periods is available under the tax law, including the use of tax planning strategies. When negative evidence (e.g. cumulative losses in recent years, history of operating loss or tax credit carry forwards expiring unused) exists, more positive evidence than negative evidence will be necessary. At December 31, 2014, net deferred tax assets are approximately $11.498 million. If

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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.*

Among the many requirements if the Dodd-Frank Act for new banking regulations is a requirement for new capital regulations to be adopted within 18 months. These regulations must be at least as stringent as, and may call for higher levels of capital than, current regulations.

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.

Overview

The following discussion and analysis presents the more significant factors affecting the Corporation s financial condition as of December 31, 2014 and 2013 and the results of operations for 2012 through 2014. This discussion also covers asset quality, liquidity, interest rate sensitivity, and capital resources for the years 2013 and 2014. 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. Throughout this discussion, the term Bank refers to mBank, the principal banking subsidiary of the Corporation.

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Taxable equivalent adjustments are the result of increasing income from tax-free loans and investments by an amount equal to the taxes that would be paid if the income were fully taxable based on a 34% federal tax rate, thus making tax-exempt yields comparable to taxable asset yields.

Dollar amounts in tables are stated in thousands, except for per share data.

Executive Summary

The purpose of this section is to provide a brief summary of the 2014 results of operations and financial condition. A more detailed analysis of the results of operations and financial condition follows this summary.

The Corporation reported net income of $1.700 million or $.30 per share, for the year ended December 31, 2014, compared to net income of $5.629 million, or $1.01 per share, for 2013 and $6.458 million, or $1.51 per share, in 2012. The 2014 results include nonrecurring transaction related expenses of $2.475 million. The 2013 and 2012 consolidated and bank results include a deferred tax valuation adjustment of $2.250 million, or $.40 per share and $3.000 million, $.70 per share, respectively.

Total assets of the Corporation at December 31, 2014, were $743.785 million, an increase of $170.985 million, or 29.85% from total assets of $572.800 million reported at December 31, 2013.

At December 31, 2014, the Corporation s loans stood at $600.935 million, an increase of $117.103 million, or 24.20%, from 2013 year-end balances of $483.832 million. Acquired loans, net of purchase accounting adjustments had a balance of $64.123 million at December 31, 2014. Total loan production in 2014 amounted to $183.403 million, which included $29.871 million of secondary market mortgage loans sold. The Corporation also sold $7.075 million of SBA/USDA guaranteed loans. Loan balances were also impacted by normal amortization and paydowns, some of which related to payoffs on participation loans.

Nonperforming loans totaled $3.939 million, or .66% of total loans at December 31, 2014. Nonperforming assets at December 31, 2014, were $6.949 million, .93% of total assets, compared to $3.908 million or .68% of total assets at December 31, 2013.

Total deposits increased from $466.299 million at December 31, 2013, to $606.973 million at December 31, 2014, an increase of 30.17%. The increase in deposits in 2014 was comprised of an increase in wholesale deposits of $45.238 million and an increase in core deposits of $95.436 million, largely a result of the Peninsula transaction. In 2014, the Corporation utilized wholesale deposits in order to better manage interest rate risk in funding fixed rate loans.

Shareholders equity totaled $73.996 million at December 31, 2014, compared to $65.249 million at the end of 2013, an increase of $8.747 million. This change reflects the net income available to common shareholders of $1.700 million, other comprehensive income of $.297 million, an increase related to stock compensation expense of $.429 million, the impact acquisition of Peninsula of $7.804 million, a decrease related to the exercise of stock options of $.032 million, the repurchase of common stock of $.143 million and dividends declared on common stock of $1.308 million. The book value per common share at December 31, 2014, amounted to $11.81 compared to $11.87 at the end of 2013.

On December 5, 2014, the Corporation completed its acquisition of Peninsula Financial Corporation (PFC) and its wholly owned subsidiary, The Peninsula Bank. PFC had six branch offices and $126 million in assets as of the acquisition date. The results of operations due to the merger have been included in the Corporation s results since the acquisition date. The merger was effected by a combination of cash and the issuance of shares of the Corporation s common stock to PFC shareholders. Each share of PFC s 288,000 shares of common stock was converted into the right to receive 3.64 shares of the Corporation s common stock, with cash paid in lieu of fractional shares. PFC shareholders also had the option to receive cash at $46.13 per share of common stock. The conversion of PFC s shares resulted in the issuance of 695,361 shares of the Corporation s common stock and payment of $4.484 million in cash to the former PFC shareholders.

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RESULTS OF OPERATIONS

(dollars in thousands, except per share data)	2014	2013	2012
Taxable-equivalent net interest income	**$ 23,575**	$ 21,471	$ 19,898
Taxable-equivalent adjustment	**(48)**	(72)	(74)
Net interest income, per income statement	**23,527**	21,399	19,824
Provision for loan losses	**1,200**	1,675	945
Other income	**3,112**	3,938	4,043
Other expense	**22,610**	18,128	16,757
Income before provision for income taxes	**2,829**	5,534	6,165
Provision for (benefit of) income taxes	**1,129**	(403)	(922)
Net income	**$ 1,700**	$ 5,937	$ 7,087
Preferred dividend expense		308	629
Net income available to common shareholders	**$ 1,700**	$ 5,629	$ 6,458
Earnings per common share			
Basic	**$ .30**	$ 1.01	$ 1.51
Diluted	**$ .30**	$ 1.00	$ 1.51
Return on average assets	**.28%**	1.01%	1.23%
Return on average common equity	**2.57**	9.07	12.43
Return on average equity	**2.57**	8.26	10.26

Summary

The Corporation reported net income available to common shareholders of $1.700 million in 2014, compared to $5.629 million in 2013 and $6.458 million in 2012. The 2014 results include a provision for loan loss of $1.200 million and nonrecurring transaction related expense of $2.475 million. The 2013 results include a deferred tax valuation adjustment of $2.250 million, and reduced nonperforming costs. The 2012 results include significantly reduced credit related expenses and a decreased loan loss provision.

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 funding sources. Net interest revenue is the Corporation s principal source of revenue, representing 88% of total revenue in 2014. The net interest income is impacted by economic and competitive factors that influence rates, loan demand, and the availability of funding.

Net interest income on a taxable equivalent basis increased $2.104 million from $21.471 million in 2013 to $23.575 million in 2014. In 2014, interest rates were stable with the prime rate at 3.25% for the entire year. The Corporation experienced a decrease, five basis points, in the overall rates on earnings assets from 4.99% in 2013 to 4.94% in 2014. Interest bearing funding sources declined by nine basis points, from .99% in 2013 to .90% in 2014. The combination of these effective rate changes resulted in a slight increase in net interest margin from 4.19% in 2013 to 4.20% in 2014.

In 2013, the Corporation benefited from higher levels of low interest transactional deposit instruments and repricing of term deposits. In addition to the benefits derived from repriced deposit liabilities and a higher level of transactional deposits, the corporation experienced solid loan growth.

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The following table details sources of net interest income for the three years ended December 31 (dollars in thousands):

	2014	Mix	2013	Mix	2012	Mix
Interest Income						
Loans	**$ 26,491**	**95.74%**	$ 24,400	95.60%	$ 23,313	95.44%
Funds sold					18	0.07
Taxable securities	**962**	**3.48**	961	3.77	948	3.88
Nontaxable securities	**64**	**.23**	34	.13	27	0.11
Other interest-earning assets	**152**	**.55**	128	.50	121	.50
Total earning assets	**27,669**	**100.00%**	25,523	100.00%	24,427	100.00%
Interest Expense						
NOW, money markets, checking	**404**	**9.75%**	388	9.41%	548	11.91%
Savings	**15**	**.35**	13	.32	16	0.35
CDs <$100,000	**1,680**	**40.56**	2,033	49.29	2,429	52.77
CDs >$100,000	**304**	**7.34**	380	9.21	433	9.41
Brokered deposits	**815**	**19.68**	654	15.86	520	11.30
Borrowings	**924**	**22.31**	656	15.91	657	14.27
Total interest-bearing funds	**4,142**	**100.00%**	4,124	100.00%	4,603	100.00%
Net interest income	**$ 23,527**		$ 21,399		$ 19,824	
Average Rates						
Earning assets	**4.93%**		4.98%		5.14%	
Interest-bearing funds	**.90**		.99		1.15	
Interest rate spread	**4.03**		3.99		3.99	

As shown in the table above, income on loans provides more than 95% of the Corporation s interest revenue. The Corporation s loan portfolio has approximately $333.009 million of variable rate loans that predominantly reprice with changes in the prime rate and $267.926 million of fixed rate loans. A large portion of the variable rate loans, 44%, or $148.120 million, have interest rate floors. These loans will not reprice until the prime rate increases to the extent necessary to surpass the interest rate floor. A prime rate increase of 100 basis points or more will reprice $104.337 million of these loans with floors, while the majority of the remainder will reprice with an additional 100 basis point increase in the prime rate.

The majority of interest bearing liabilities do not reprice automatically with changes in interest rates, which provides flexibility to manage interest income. Management monitors the interest rate sensitivity of earning assets and interest bearing liabilities to minimize the risk of movements in interest rates.

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The following table presents the amount of taxable equivalent 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.

	Years ended December 31,								
	2014			2013			2012		
(dollars in thousands)	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS:									
Loans (1,2,3)	**$ 509,749**	**$ 26,506**	**5.20%**	$ 462,500	$ 24,454	5.29%	$ 422,440	$ 23,373	5.53%
Taxable securities	**45,172**	**962**	**2.13**	46,294	961	2.08	38,094	948	2.49
Nontaxable securities (2)	**2,062**	**97**	**4.70**	1,002	51	5.09	850	41	4.82
Federal Funds sold	**78**			3			11,127	18	.16
Other interest-earning assets	**3,810**	**152**	**3.99**	3,070	128	4.17	3,070	121	3.94
Total earning assets	**560,871**	**27,717**	**4.94**	512,869	25,594	4.99	475,581	24,501	5.15
Reserve for loan losses	**(5,187)**			(5,045)			(5,232)		
Cash and due from banks	**23,124**			20,535			28,561		
Fixed assets	**10,174**			10,632			10,254		
Other real estate owned	**2,088**			2,800			3,392		
Other assets	**14,542**			13,361			14,184		
	44,741			42,283			51,159		
TOTAL ASSETS	**$ 605,612**			$ 555,152			$ 526,740		
LIABILITIES AND SHAREHOLDERS EQUITY:									
NOW and Money Markets	**$ 114,313**	**$ 309**	**.27%**	$ 120,401	$ 289	.24%	$ 119,053	$ 406	.34%
Interest checking	**45,158**	**95**	**.21**	35,242	99	.28	31,837	142	.45
Savings deposits	**15,717**	**15**	**.10**	13,052	13	.10	13,682	16	.12
CDs <$100,000	**144,061**	**1,680**	**1.17**	133,082	2,032	1.53	138,767	2,429	1.75
CDs >$100,000	**24,288**	**304**	**1.25**	24,243	380	1.57	25,128	433	1.72
Brokered deposits	**69,833**	**815**	**1.17**	53,435	654	1.22	36,569	520	1.42
Borrowings	**45,451**	**924**	**2.03**	37,838	656	1.73	35,973	657	1.83
Total interest-bearing liabilities	**458,821**	**4,142**	**.90%**	417,293	4,123	.99	401,009	4,603	1.15
Demand deposits	**76,880**			67,596			59,730		
Other liabilities	**3,662**			2,091			3,062		
Shareholders equity	**66,249**			68,172			62,939		
	146,791			137,859			125,731		
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$ 605,612**			$ 555,152			$ 526,740		
Rate spread			**4.04**			4.00%			4.00%
Net interest margin/revenue, tax equivalent basis		**$ 23,575**	**4.20%**		$ 21,471	4.19%		$ 19,898	4.18%

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

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

(3) Interest income on loans includes loan fees.

The following table presents the dollar amount, in thousands, of changes in taxable equivalent interest income and interest expense for major components of interest-earning assets and interest-bearing obligations. It distinguishes between changes related to higher or lower outstanding balances and changes due to the levels and fluctuations in interest rates. For each category of interest-earning assets and interest-bearing obligations, information is provided for changes attributable to (i) changes in volume (i.e. changes in volume multiplied by prior period rate) and (ii) changes in rate (i.e. changes in rate multiplied by prior period volume). For purposes of this table, changes attributable to both rate and volume are shown as a separate variance.

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	Years ended December 31,							
	2014 vs. 2013				2013 vs. 2012			
	Increase (Decrease) Due to				Increase (Decrease) Due to			
	Volume	Rate	Volume and Rate	Total Increase (Decrease)	Volume	Rate	Volume and Rate	Total Increase (Decrease)
Interest earning assets:								
Loans	**$ 2,498**	**$ (405)**	**$ (41)**	**$ 2,052**	$ 2,216	$ (1,037)	$ (98)	$ 1,081
Taxable securities	**(23)**	**25**	**(1)**	**1**	204	(157)	(34)	13
Nontaxable securities	**54**	**(4)**	**(4)**	**46**	7	2	1	10
Federal funds sold					(18)	(18)	18	(18)
Other interest earning assets	**31**	**(6)**	**(1)**	**24**		7		7
Total interest earning assets	**$ 2,560**	**$ (390)**	**$ (47)**	**$ 2,123**	$ 2,409	$ (1,203)	$ (113)	$ 1,093
Interest bearing obligations:								
NOW and money market deposits	**$ (15)**	**$ 37**	**$ (2)**	**$ 20**	$ 5	$ (120)	$ (2)	$ (117)
Interest checking	**28**	**(25)**	**(7)**	**(4)**	15	(53)	(5)	(43)
Savings deposits	**3**	**(1)**		**2**	(1)	(2)		(3)
CDs <$100,000	**168**	**(480)**	**(40)**	**(352)**	(100)	(310)	13	(397)
CDs >$100,000	**1**	**(77)**		**(76)**	(15)	(39)	1	(53)
Brokered deposits	**200**	**(30)**	**(9)**	**161**	240	(72)	(34)	134
Borrowings	**132**	**113**	**23**	**268**	34	(33)	(2)	(1)
Total interest bearing obligations	**$ 517**	**$ (463)**	**$ (35)**	**$ 19**	$ 178	$ (629)	$ (29)	$ (480)
Net interest income, tax equivalent basis				**$ 2,104**				$ 1,573

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 2014, the Corporation recorded a provision for loan loss of $1.200 million, compared to a provision of $1.675 million in 2013 and $.945 million in 2012.

Noninterest Income

Noninterest income was $3.112 million, $3.938 million, and $4.043 million in 2014, 2013, and 2012, respectively. The principal recurring sources of noninterest income are the gains on the sale of SBA/USDA guaranteed loans and secondary market loans. In 2014, revenues from these two business lines totaled $1.394 million compared to $1.979 million in 2013 and $2.566 million in 2012. The Corporation, in recent years, expanded its efforts to generate increased income from secondary market loans by adding additional staff and centralizing processing activities. The Corporation also retains the servicing for the majority of mortgage loans sold to the secondary market. In 2014, income from servicing mortgages amounted to $.675 million, compared to $.790 million in 2013 and $.417 million in 2012.

Deposit related income totaled $.701 million in 2014 compared to $.667 million in 2013 and $.699 million in 2012. The Corporation has experienced continued decline in deposit related income as a result of changes in the assessments mandated by new consumer regulations. The current regulatory environment may limit the Corporation s ability to grow these revenue sources.

The following table details noninterest income for the three years ended December 31 (dollars in thousands):

				% Increase (Decrease)	
	2014	**2013**	**2012**	**2014-2013**	**2013-2012**
Deposit service charges	**$ 150**	$ 109	$ 110	**37.61%**	**(.91)%**
NSF Fees	**551**	558	589	**(1.25)**	**(5.26)**
Gain on sale of secondary market loans	**493**	794	1,077	**(37.91)**	**(26.28)**
Secondary market fees generated	**144**	234	313	**(38.46)**	**(25.24)**
SBA Fees	**757**	951	1,176	**(20.40)**	**(19.13)**
Mortgage servicing rights	**675**	790	417	**(14.56)**	**89.45**
Other	**288**	429	361	**(32.87)**	**18.84**
Subtotal	**3,058**	3,865	4,043	**(20.88)**	**(4.40)**
Net security gains	**54**	73		**(26.03)**	**100.00**
Total noninterest income	**$ 3,112**	$ 3,938	$ 4,043	**(20.98)%**	**(2.60)%**

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Noninterest Expense

Noninterest expense was $22.610 million in 2014, compared to $18.128 million and $16.757 million in 2013 and 2012, respectively. In 2014, the increase in noninterest expense totaled $4.481 million, or 24.72%. This increase was higher than normal due in large part to nonrecurring transaction related expenses of $2.475 million, along with other costs related to strategic initiatives. Salaries and benefits, at $10.303 million, increased by $.952 million, 10.18%, from the 2013 expenses of $9.351 million and compared to $8.288 million in 2012. Expense increases on salaries and benefits in 2013 were largely due to increased staffing (due to the additions at our asset based lending subsidiary), combined with increased employee benefits costs relative to health insurance premium increases and stock compensation expenses related to the issuance of restricted stock.

Management will continue to review all areas of noninterest expense in order to evaluate where opportunities may exist which could reduce expenses without compromising service to customers.

The following table details noninterest expense for the three years ended December 31 (dollars in thousands):

	2014	2013	2012	% Increase (Decrease) 2014 - 2013	2013 - 2012
Salaries and benefits	**$ 10,303**	$ 9,351	$ 8,288	**10.18%**	**12.83%**
Occupancy	**2,129**	1,481	1,372	**43.75**	**7.94**
Furniture and equipment	**1,268**	1,102	885	**15.06**	**24.52**
Data processing	**1,150**	1,071	991	**7.38**	**8.07**
Professional service fees:					
Accounting	**375**	362	368	**3.59**	**(1.63)**
Legal	**205**	264	396	**(22.35)**	**(33.33)**
Consulting and other	**583**	443	432	**31.60**	**2.55**
Total professional service fees	**1,163**	1,069	1,196	**8.79**	**(10.62)**
Loan and deposit	**699**	617	877	**13.29**	**(29.65)**
Writedowns and losses on OREO held for sale	**280**	265	489	**5.66**	**(45.81)**
FDIC insurance assessment	**362**	385	459	**(5.97)**	**(16.12)**
Telephone	**327**	303	233	**7.92**	**30.04**
Advertising	**449**	436	376	**2.98**	**15.96**
Nonrecurring transaction related expenses	**2,475**			**100.00**	
Other operating expenses	**2,005**	2,048	1,591	**(2.10)**	**28.72**
Total noninterest expense	**$ 22,610**	$ 18,128	$ 16,757	**24.72%**	**8.18%**

Federal Income Taxes

A deferred tax asset is recognized for temporary differences that will result in deductible amounts in future years and contain tax carryforwards including past net operating losses and tax credits. For example, a temporary difference is created between the reported amount and the tax basis of a liability for estimated expenses if, for tax purposes, those estimated expenses are not deductible until a future year. Settlement of that liability will result in tax deductions in future years, and a deferred tax asset is recognized based on the weight of available evidence. All available evidence, both positive and negative, is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed for some portion or all of a deferred tax asset. Judgment must be used in considering the relative impact of negative and positive evidence. The weight given to the potential effect of negative and positive evidence should be commensurate with the extent to which it can be objectively verified. The more negative evidence that exists, (a) the more positive evidence is necessary and (b) the more difficult it is to support a conclusion that a valuation allowance is not needed.

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 December 31, 2014 had a net operating loss and tax credit carryforwards for tax purposes of approximately $16.2 million, and $2.353 million, respectively. The Corporation will evaluate the future benefits from these carryforwards and at such time as it becomes more likely than not that they would be utilized prior to expiration and recognizes the additional benefits as an adjustment to the valuation allowance. The net operating loss carryforwards expire twenty years from the date they originated. These carryforwards, if not utilized, will begin to expire in the year 2023. A portion of the NOL, approximately $10.5 million, and the majority 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 $1.404 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.

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Current Federal Tax Provision

The Corporation recognized a deferred tax expense of approximately $1.129 million for the year ended December 31, 2014 and a federal income tax benefit of $.403 million for the year ended December 31, 2013. The valuation allowance at December 31, 2014 was approximately $.760 million. The Corporation has reduced the valuation allowance as it was determined that it was more likely than not that these benefits would be realized. In December 2013, the Corporation reduced the valuation by $2.250 million and in June 2012 a reduction of $3.0 million was recorded. The Corporation made these determinations after a thorough review of projected earnings and the composition and sustainability of those earnings over the projected tax carryover period. This analysis substantiated the ability to utilize these deferred tax assets. 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.

In connection with the Peninsula acquisition in December 2014, the Corporation acquired $.933 million of NOL carryforward and approximately $.217 million of various tax credits, which it expects to utilize prior to expiration.

The table below details the Corporation s deferred tax assets and liabilities (dollars in thousands):

		2014		2013
Deferred tax assets:				
NOL carryforward	**$**	**5,500**	$	6,737
Allowance for loan losses		**2,194**		1,585
Alternative Minimum Tax Credit		**1,586**		1,463
OREO Tax basis > book basis		**474**		138
Tax credit carryovers		**767**		672
Deferred compensation		**576**		152
Pension liability		**475**		
Stock compensation		**247**		267
Depreciation		**(88)**		157
Purchase accounting adjustments		**2,095**		
Other		**33**		188
Total deferred tax assets		**13,859**		11,359
Valuation allowance	**$**	**(760)**	$	(760)
Deferred tax liabilities:				
Core deposit premium		**(407)**		
FHLB stock dividend		**(103)**		(103)
Unrealized gain on securities		**(363)**		(111)
Mortgage servicing rights		**(658)**		(452)
Other		**(70)**		
Total deferred tax liabilities		**(1,601)**		(666)
Net deferred tax asset	**$**	**11,498**	$	9,933

As shown in the table above, the NOL and tax credit carryforwards comprise the majority of the deferred tax asset, which is reduced by the $.760 million valuation adjustment as of December 31, 2014. 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 those credits that may expire 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.

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FINANCIAL POSITION

The table below illustrates the relative composition of various liability funding sources and asset make-up.

	December 31,					
	2014		2013		2012	
(dollars in thousands)	Balance	Mix	Balance	Mix	Balance	Mix
Sources of funds:						
Deposits:						
Non-interest bearing transactional deposits	**$ 95,498**	**12.84%**	$ 72,936	12.73%	$ 67,652	12.39%
Interest-bearing transactional deposits	**240,580**	**32.35**	162,162	28.31	169,294	31.01
CD s <$100,000	**134,951**	**18.14**	140,495	24.53	135,550	24.83
Total core deposit funding	**471,029**	**63.33**	375,593	65.57	372,496	68.23
CD s >$100,000	**30,316**	**4.08**	23,159	4.04	24,355	4.46
Brokered deposits	**105,628**	**14.20**	67,547	11.79	37,706	6.91
Total noncore deposit funding	**135,944**	**18.28**	90,706	15.84	62,061	11.37
FHLB and other borrowings	**49,846**	**6.70**	37,852	6.61	35,925	6.58
Other liabilities	**12,970**	**1.74**	3,400	.59	3,050	.56
Shareholders equity	**73,996**	**9.95**	65,249	11.39	72,448	13.27
Total	**$ 743,785**	**100.00%**	$ 572,800	100.00%	$ 545,980	100.00%
Uses of Funds:						
Net Loans	**$ 595,795**	**80.11%**	$ 479,171	83.66%	$ 443,959	81.32%
Securities available for sale	**65,832**	**8.85**	44,388	7.75	43,799	8.02
Federal funds sold			3	.00	3	.00
Federal Home Loan Bank Stock	**2,973**	**.40**	3,060	.53	3,060	.56
Interest-bearing deposits	**5,797**	**.78**	10	.00	10	.00
Cash and due from banks	**21,947**	**2.95**	18,216	3.18	26,958	4.94
Other assets	**51,441**	**6.92**	27,952	4.88	28,191	5.16
Total	**$ 743,785**	**100.00%**	$ 572,800	100.00%	$ 545,980	100.00%

Securities

The securities portfolio is an important component of the Corporation s asset composition to provide diversity in its asset base and provide liquidity. Securities increased $21.444 million in 2014, from $44.388 million at December 31, 2013 to $65.832 million at December 31, 2014. Acquired securities, net of purchase accounting adjustments, totaled $22.144 million at year-end.

The carrying value of the Corporation s securities is as follows at December 31 (dollars in thousands):

	2014	2013
US Agencies	**$ 22,717**	**$ 14,855**

US Agencies - MBS	**13,688**	**7,359**
Corporate	**12,674**	**16,079**
Obligations of states and political subdivisions	**11,473**	**6,095**
US Treasury	**5,280**	
Total securities	**$ 65,832**	**$ 44,388**

The Corporation s policy is to purchase securities of high credit quality, consistent with its asset/liability management strategies. The Corporation classifies all securities as available for sale, in order to maintain adequate liquidity and to maximize its ability to react to changing market conditions. At December 31, 2014, investment securities with an estimated fair market value of $4.181 million were pledged.

Loans

The Bank is a full service lender and offers a variety of loan products in all of its markets. The majority of its loans are commercial, which represents approximately 72% of total loans outstanding at December 31, 2014.

The Corporation continued to experience strong loan demand in 2014 with approximately $183.403 million of new loan production, including $29.871 million of mortgage loans sold in the secondary market. At 2014 year-end, the Corporation s loans stood at $600.935 million, an increase from the 2013 year-end balances of $483.832 million. In 2014, the secondary mortgage loans that were produced and sold totaled $29.871 million while the SBA/USDA loan sales

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amounted to $7.075 million. The production of loans was distributed among the regions, with the Upper Peninsula at $104.601 million, $40.133 million in the Northern Lower Peninsula and $38.669 million in Southeast Michigan.

The December 2014 acquisition of loans added $72.289 million to our consolidated loan portfolio. These acquired loans consisted of approximately $30 million commercial loans and $34 million consumer loans, net of purchase accounting adjustments. These acquired loans did not result in any concentration risk.

Management believes a properly positioned loan portfolio provides the most attractive earning asset yield available to the Corporation and, with changes to the 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. The Corporation is highly competitive in structuring loans to meet borrowing needs and satisfy strong underwriting requirements.

The following table details the loan activity for 2013 and 2014 (dollars in thousands):

Loan balances as of December 31, 2012	$	449,177
Total production		190,918
Secondary market sales		(54,736)
SBA loan sales		(8,393)
Loans transferred to OREO		(932)
Loans charged off, net of recoveries		(2,232)
Normal amortization/paydowns and payoffs		(89,970)
Loan balances as of December 31, 2013	$	483,832
Total production		**183,403**
Total loans acquired		**72,289**
Secondary market sales		**(29,871)**
SBA loan sales		**(7,075)**
Loans transferred to OREO		**(588)**
Loans charged off, net of recoveries		**(721)**
Normal amortization/paydowns and payoffs		**(100,334)**
Loan balances as of December 31, 2014	**$**	**600,935**

Following is a table that illustrates the balance changes in the loan portfolio from 2012 through 2014 year end (dollars in thousands):

							Percent Change	
		2014		**2013**		**2012**	**2014-2013**	**2013-2012**
Commercial real estate	**$**	**315,387**	$	268,809	$	244,966	**17.33%**	9.73%
		101,895		79,655		80,646	**27.92**	(1.23)

Commercial, financial, and agricultural								
One-to-four family residential real estate		**139,553**		103,768		87,948	**34.49**	17.99
Construction:								
Consumer		**9,431**		6,895		7,465	**36.78**	(7.64)
Commercial		**16,284**		10,904		17,229	**49.34**	(36.71)
Consumer		**18,385**		13,801		10,923	**33.21**	26.35
Total	**$**	**600,935**	$	483,832	$	449,177	**24.20**%	7.72%

Our commercial real estate loan portfolio predominantly relates to owner occupied real estate, and our loans are generally secured by a first mortgage lien. Commercial real estate market conditions improved in 2014, and we expect this trend to continue. We make commercial loans for many purposes, including: working capital lines, which are generally renewable annually and supported by business assets, personal guarantees and additional collateral. Commercial business lending is generally considered to involve a higher degree of risk than traditional consumer bank lending.

Following is a table showing the composition of loans by significant industry types in the commercial loan portfolio as of December 31 (dollars in thousands):

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	2014			2013		
	Balance	% of Loans	% of Capital	Balance	% of Loans	% of Capital
Real estate - operators of nonres bldgs	**$ 106,644**	**24.60%**	**144.12%**	$ 100,333	23.14%	153.77
Hospitality and tourism	**46,211**	**10.66**	**62.45**	45,360	10.46	69.52
Lessors of residential buildings	**19,776**	**4.56**	**26.73**	14,191	3.27	21.75
Commercial construction	**16,284**	**3.76**	**22.01**	10,904	2.51	16.71
Gasoline stations and convenience stores	**13,841**	**3.19**	**18.71**	11,534	2.66	17.68
Real estate agents and managers	**9,454**	**2.18**	**12.78**	10,922	2.52	16.74
Other	**221,356**	**51.05**	**299.15**	166,124	38.32	254.60
Total commercial loans	**$ 433,566**	**100.00%**		$ 359,368	82.89%	

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 2014 year-end. The current concentration of real estate related loans represents a broad customer base composed of a high percentage of owner-occupied developments.

Our residential real estate portfolio predominantly includes one-to-four family adjustable rate mortgages that have repricing terms generally from one to three years, construction loans to individuals and bridge financing loans for qualifying customers. As of December 31, 2014, our residential loan portfolio totaled $148.984 million, or 25% of our total outstanding loans.

The Corporation has also extended credit to governmental units, including Native American organizations. Tax-exempt loans and leases decreased from $1.526 million at the end of 2013 to $.858 million at 2014 year-end. The Corporation has elected to refrain from making tax-exempt loans, since they provide no current tax benefit, due to tax net operating loss carryforwards.

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

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.

The Corporation, at December 31, 2014, had performing loans of $3.105 million and no nonperforming loans for which repayment terms were modified to the extent that they were deemed to be restructured loans. The total restructured loans of $3.105 million is comprised of six performing loans, the largest of which had a December 31, 2014 balance of $1.186 million.

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Credit Quality

The table below shows balances of nonperforming assets for the three years ended December 31 (dollars in thousands):

	December 31, 2014 (Unaudited)	December 31, 2013 (Unaudited)	December 31, 2012 (Unaudited)
Nonperforming Assets :			
Nonaccrual loans	**$ 3,939**	$ 1,410	$ 4,687
Loans past due 90 days or more			
Restructured loans		614	
Total nonperforming loans	**3,939**	2,024	4,687
Other real estate owned	**3,010**	1,884	3,212
Total nonperforming assets	**$ 6,949**	$ 3,908	$ 7,899
Nonperforming loans as a % of loans	**.28%**	.42%	1.04
Nonperforming assets as a % of assets	**.63%**	.68%	1.45
Reserve for Loan Losses:			
At period end	**$ 5,140**	$ 4,661	$ 5,218
As a % of average loans	**1.01%**	.96%	1.24
As a % of nonperforming loans	**130.49%**	230.29%	111.33
As a % of nonaccrual loans	**130.49%**	330.57%	111.33
Texas Ratio	**9.37%**	5.59%	10.17
Charge-off Information (year to date):			
Average loans	**$ 509,749**	$ 462,500	$ 442,440
Net charge-offs	**$ 721**	$ 2,232	$ 978
Charge-offs as a % of average loans, annualized	**.14%**	.48%	.23

Management continues to address market issues impacting its loan customer base. In conjunction with the Corporation s senior lending staff and the bank regulatory examinations, management reviews the Corporation s loans, related collateral evaluations, and the overall lending process. The Corporation also utilizes a loan review consultant to perform a review of the loan portfolio. The opinion of this consultant upon completion of the 2014 independent review provided findings similar to management on the overall adequacy of the reserve. The Corporation will again utilize a consultant for loan review in 2015.

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The following table details the impact of nonperforming loans on interest income for the three years ended December 31 (dollars in thousands):

	2014	2013	2012
Interest income that would have been recorded at original rate	**$ 130**	$ 228	$ 313
Interest income that was actually recorded			54
Net interest lost	**$ 130**	$ 228	$ 259

Allowance for Loan Losses

Management analyzes the allowance for loan losses on a quarterly basis to determine whether the losses inherent in the portfolio are properly reserved for. Net charge-offs in 2014 amounted to $.721 million, or .14% of average loans outstanding, compared to $2.232 million, or .48% of loans outstanding in 2012. 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.

A three year history of relevant information on the Corporation s credit quality is displayed in the following table (dollars in thousands):

Allowance for Loan Losses	**2014**	**2013**	**2012**
Balance at beginning of period	**$ 4,661**	$ 5,218	$ 5,251
Loans charged off:			
Commercial	**682**	2,171	775
One-to-four family residential real estate	**290**	141	399
Consumer	**74**	120	82
Total loans charged off	**1,046**	2,432	1,256
Recoveries of loans previously charged off:			
Commercial	**259**	150	253
One-to-four family residential real estate	**22**	26	7
Consumer	**44**	24	18
Total recoveries of loans previously charged off	**325**	200	278
Net loans charged off	**721**	2,232	978
Provision for loan losses	**1,200**	1,675	945
Balance at end of period	**$ 5,140**	$ 4,661	$ 5,218
Total loans, period end	**$ 600,935**	$ 483,832	$ 449,177
Average loans for the year	**509,749**	462,500	422,440
Allowance to total loans at end of year	**.86%**	.96%	1.16%
Net charge-offs to average loans	**.14**	.48	.23
Net charge-offs to beginning allowance balance	**15.47**	42.78	18.63

The computation of the required allowance for loan losses as of any point in time is one of the critical accounting estimates made by management in the financial statements. As such, factors used to establish the allowance could change significantly from the assumptions made and impact future earnings positively or negatively. The future of the national and local economies and the resulting impact on borrowers ability to repay their loans and the value of collateral are examples of areas where assumptions must be made for individual loans, as well as the overall portfolio.

The allowance for loan losses consists of specific and general components. Our internal risk system is used to identify loans that meet the criteria for being impaired as defined in the accounting guidance. The specific component relates to loans that are individually classified as impaired and where expected cash flows are less than carrying value. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. These qualitative factors include: 1) changes in the nature, volume and terms of loans, 2) changes in lending personnel, 3) changes in the quality of the loan review function, 4) changes in nature and volume of past-due, nonaccrual and/or classified loans, 5) changes in concentration of credit risk, 6) changes in economic and industry conditions, 7) changes in legal and regulatory requirements, 8) unemployment and inflation statistics, and 9) underlying collateral values.

At the end of 2014, the allowance for loan losses represented .86% of total loans. The allowance for loan losses at the end of 2014 as a percentage of nonperforming assets was 73.97% compared to 119.27% at 2013 year end. 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. This position is further illustrated with the ratio of the allowance as a percent of nonperforming loans, which stood at 130.49% at December 31, 2014, compared to 230.29% at 2013 year end.

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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 $10.321 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. For the period of December 5, 2014 to December 31, 2014, recorded interest compared to accretable interest on acquired impaired loans was immaterial and no significant payments of principal were recorded.

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

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

Balance at December 31, 2012		3,212
Other real estate transferred from loans due to foreclosure		932
Other real estate sold		(1,996)
Writedowns on other real estate held for sales		(231)
Loss on other real estate held for sale		(33)
Balance at December 31, 2013	$	1,884
Other real estate transferred from loans due to foreclosure		**588**
Other real estate acquired, net of purchase accounting		**1,193**
Other real estate sold		**(375)**
Writedowns on other real estate held for sales		**(228)**
Loss on other real estate held for sale		**(52)**
Balance at December 31, 2014	**$**	**3,010**

During 2014, the Corporation received real estate in lieu of loan payments of $.588 million. In determining the carrying value of other real estate held for sale, the Corporation generally starts with a third party appraisal of the underlying collateral and then deducts estimated selling costs to arrive at a net asset value. After the initial receipt, management periodically re-evaluates the recorded balance and records any additional reductions in the fair value as a write-down of other real estate held for sale.

Deposits

Total deposits at December 31, 2014 were $606.973 million, an increase of $140.674 million, or 30.17% from December 31, 2013 deposits of $466.299 million. Deposits acquired totaled $102.482 million at 2014 year end. The table below shows the deposit mix for the periods indicated (dollars in thousands):

	2014	Mix	2013	Mix	2012	Mix

CORE:								
Non-interest-bearing	**$**	**95,498**	**15.73%**	$	72,936	15.64%	$	67,652	15.57%
NOW, money market, checking		**212,565**	**35.02**		149,123	31.98		155,465	35.78
Savings		**28,015**	**4.62**		13,039	2.80		13,829	3.18
Certificates of Deposit <$100,000		**134,951**	**22.23**		140,495	30.13		135,550	31.19
Total core deposits		**471,029**	**77.60**		375,593	80.55		372,496	85.72
NONCORE:									
Certificates of Deposit >$100,000		**30,316**	**4.99**		23,159	4.97		24,355	5.60
Brokered CDs		**105,628**	**17.40**		67,547	14.48		37,706	8.68
Total non-core deposits		**135,944**	**22.40**		90,706	19.45		62,061	14.28
Total deposits	**$**	**606,973**	**100.00%**	$	466,299	100.00%	$	434,557	100.00%

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. When loans are made with longer-term fixed rates, the Corporation attempts to match these balances with sources of funding with similar maturities in order to mitigate interest rate risk. In addition, the Corporation prices loans so it has an opportunity to reprice the loan within 12 to 36 months.

At December 31, 2014 the Bank had $65.832 million of securities, with a weighted average maturity of 73.9 months. The investment portfolio is intended to provide a source of liquidity to the Corporation with limited interest rate risk. The Corporation may also elect to sell monies as investments in federal funds sold to correspondent banks, and has other interest bearing deposits with correspondent banks. These funds are generally repriced on a daily basis.

The Corporation offers deposit products with 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 speed of change 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 (ALCO) meetings, whose membership includes senior management, board representation and third party investment consultants. During these monthly meetings, we review the current ALCO position and strategize about future opportunities on risks relative to pricing and positioning of assets and liabilities.

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

The following are the Corporation s repricing opportunities at December 31, 2014 (dollars in thousands):

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	1-90 Days	91-365 Days	>1-5 Years	Over 5 Years	Total
Interest-earning assets:					
Loans	$ 209,577	$ 168,091	$ 220,494	$ 2,773	$ 600,935
Securities	5,137	9,430	29,175	22,090	65,832
Other (1)	4,470	908	3,392		8,770
Total interest-earning assets	219,184	178,429	253,061	24,863	675,537
Interest-bearing obligations:					
NOW, money market, savings and interest checking	240,580				240,580
Time deposits	23,720	67,910	73,518	119	165,267
Brokered CDs	20,831	24,404	60,393		105,628
Borrowings	11,767	374	37,305	400	49,846
Total interest-bearing obligations	296,898	92,688	171,216	519	561,321
Gap	$ (77,714)	$ 85,741	$ 81,845	$ 24,344	$ 114,216
Cumulative gap	$ (77,714)	$ 8,027	$ 89,872	$ 114,216	

(1) includes Federal Home Loan Bank stock

The above analysis indicates that at December 31, 2014, the Corporation had a cumulative asset sensitivity gap position of $8.027 million within the one-year timeframe. 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 unexpected 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 $333.009 million of variable rate loans that reprice primarily with the prime rate index. Approximately $148.120 million of these variable rate loans have interest rate floors. This means that the prime rate will have to increase above the floor rate before these loans will reprice. At year end, $104.337 million of these floor-rate loans would reprice with a 100 basis point prime rate increase, with $41.336 million repricing with an additional 100 basis point prime rate increase.

At December 31, 2013, the Corporation had a cumulative asset sensitive gap position of $24.272 million within the one-year time frame.

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.

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.

The table below measures current maturity levels of interest-earning assets and interest-bearing obligations, along with average stated rates and estimated fair values at December 31, 2014 (dollars in thousands). Nonaccrual loans of $3.939 million are included in the table at an average interest rate of 0.00% and a maturity greater than five years.

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Principal/Notional Amount Maturing/Repricing In:

	2015	2016	2017	2018	2019	Thereafter	Total	Fair Value 12/31/2013
Rate Sensitive Assets								
Fixed interest rate securities	$ 8,880	$ 5,055	$ 2,203	$ 11,986	$ 12,541	$ 25,167	$ 65,832	$ 65,832
Average interest rate	1.59	2.27	1.60	1.51	2.12	3.01	2.27%	
Fixed interest rate loans	17,807	27,265	58,265	86,314	55,622	22,653	267,926	268,209
Average interest rate	4.97	5.60	5.13	4.71	4.79	4.92	4.94	
Variable interest rate loans	333,009						333,009	333,360
Average interest rate	4.67						4.67	
Other assets	5,372	924	1,729	498	247		8,770	8,770
Average interest rate	2.38	.86	1.78	1.33	2.04		2.11	
Total rate sensitive assets	$ 365,068	$ 33,244	$ 62,197	$ 98,798	$ 68,410	$ 47,820	$ 675,537	$ 676,171
Average interest rate	4.58%	4.96%	4.91%	4.30%	4.30%	3.53%	4.23%	
Rate Sensitive Liabilities								
Interest-bearing savings, NOW, MMAs, checking	$ 240,580	$	$	$	$	$	240,580	$ 240,580
Average interest rate	.16			0		%	.16%	
Time deposits	136,660	94,797	29,794	8,875	650	119	270,895	270,456
Average interest rate	1.10	1.41	1.49	1.70	2.28	2.29	1.28	
Variable interest rate borrowings	14,067						14,067	14,067
Average interest rate	3.82						3.82	
Fixed interest rate borrowings		15,000		10,000	10,000	779	35,779	36,213
Average interest rate		2.03		1.11	1.72	1.00	1.66	
Total rate sensitive liabilities	$ 377,240	$ 109,797	$ 29,794	$ 18,875	$ 10,650	$ 898	$ 547,254	$ 547,249
Average interest rate	.62%	1.49%	1.49%	1.39%	1.75%	1.17%	.88%	

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 office in Sault Ste. Marie. 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. As of December 31, 2014, the Corporation had excess Canadian assets of $.091 million, which equated to approximately the same valuation in U.S. dollars. Management believes the exposure to short-term foreign exchange risk is minimal and at an acceptable level for the Corporation. Management intends to limit the Corporation s foreign exchange risk by acquiring deposit liabilities approximately equal to its Canadian assets.

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 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. See Note 19 to the consolidated financial statements for additional information.

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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.

During 2014, the Corporation increased cash and cash equivalents by $3.728 million. As shown on the Corporation s consolidated statement of cash flows, liquidity was primarily impacted by cash used in investing activities and cash provided by financing activities. The net change in investing activities included a net increase in loans of $50.969 million and a net increase in securities available for sale of $1.132 million. The net increases in assets were offset by a similar increase in deposit liabilities of $39.724 million. This increase in deposits was composed of an increase in non-core deposits of $45.238 million combined with an increase in core deposits of $95.436 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 Bank s investment portfolio provides added liquidity during periods of market turmoil and overall liquidity concerns in the financial markets. As of December 31, 2014, $61.651 million of the Bank s investment portfolio was unpledged, which makes them readily available for sale to address any short term liquidity needs.

It is anticipated that during 2015, the Corporation will fund anticipated loan production with a combination of core-deposit growth and noncore funding, primarily brokered CDs.

The Corporation s primary source of liquidity on a stand-alone basis is dividends from the Bank. In December 2013, the Bank paid a $3.0 million dividend. Bank capital, after payment of this dividend, was strong and above the well capitalized regulatory level. The Corporation has a $12.0 million line of credit with a correspondent bank, which also serves as a source of liquidity. As of December 31, 2014, $4.0 million was available under this line. The Corporation will continue to explore alternative opportunities for longer term sources of liquidity and permanent equity to support projected asset growth.

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 non-core funding dependency ratio, which explains the degree of reliance on non-core 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. Non-core funding consists of certificates of deposit greater than $100,000, brokered deposits, and FHLB and other borrowings.

At December 31, 2014, the Bank s core deposits in relation to total funding were 71.71% compared to 74.50% in 2013. These ratios indicated at December 31, 2013, that the Bank has increased its reliance on non-core 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 December 31, 2014, the Bank had $28.375 million of unsecured lines available and additional amounts available if secured. Management 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 liquidity plan for 2014 includes strategies to increase core deposits in the Corporation s local markets and will continue to augment local deposit growth efforts with wholesale CD funding, to the extent necessary.

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Contractual Obligations and Commitments

As disclosed in the Notes to the Consolidated Financial Statements, the Corporation has certain obligations and commitments to make future payments under contracts. At December 31, 2014, the aggregate contractual obligations and commitments are (dollars in thousands):

	Payments Due by Period				
Contractual Obligations	**Less than 1 Year**	**1 to 3 Years**	**4 to 5 Years**	**After 5 Years**	**Total**
Total deposits	**$ 472,943**	**$ 124,386**	**$ 9,525**	**$ 119**	**$ 606,973**
Federal Home Loan Bank borrowings		**15,000**	**20,000**		**35,000**
Other borrowings	**474**	**13,818**	**154**	**400**	**14,846**
Directors deferred compensation	**287**	**491**	**441**	**1,022**	**2,241**
Annual rental / purchase commitments under noncancelable leases / contracts	**724**	**1,251**	**913**	**4,232**	**7,120**
TOTAL	**$ 474,428**	**$ 154,946**	**$ 31,033**	**$ 5,773**	**$ 666,180**
Other Commitments					
Letters of credit	**$ 6,072**	**$**	**$**	**$**	**$ 6,072**
Commitments to extend credit	**68,325**				**68,325**
Credit card commitments	**3,267**				**3,267**
TOTAL	**$ 77,664**	**$**	**$**	**$**	**$ 77,664**

Capital and Regulatory

As a bank holding company, the Corporation is required to maintain certain levels of capital under government regulation. There are several measurements of regulatory capital, and the Corporation is required to meet minimum requirements under each measurement. The federal banking regulators have also established capital classifications beyond the minimum requirements in order to risk-rate deposit insurance premiums and to provide trigger points for prompt corrective action in the event an institution becomes financially troubled. As of December 31, 2014, the Corporation and the Bank were well capitalized.

The Corporation and Bank capital is also impacted by the disallowed portion of the Corporation s deferred tax asset. The portion of the deferred tax asset which is allowed to be included in regulatory capital is only that portion that can be utilized within the next 12-month period.

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The following table details sources of capital for the three years ended December 31 (dollars in thousands):

	2014	2013	2012
Capital Structure			
Common shareholders equity	**$ 73,996**	$ 65,249	$ 61,448
Preferred stock			11,000
Total shareholders equity	**73,996**	65,249	72,448
Total capitalization	**$ 73,996**	$ 65,249	$ 72,448
Tangible capital	**$ 68,800**	$ 65,249	$ 72,448
Intangible Assets			
Subsidiaries:			
Core deposit premium	**$ 1,196**	$	$
Goodwill	**3,805**		
Other identifiable intangibles	**195**	1,129	688
Total intangibles	**$ 5,196**	$ 1,129	$ 688
Risk-Based Capital			
Tier 1 capital:			
Total shareholders equity	**$ 73,996**	$ 65,249	$ 72,448
Accumulated other comprehensive income	**(513)**	(216)	(924)
Less: disallowed deferred tax asset	**(6,000)**	(7,000)	(7,100)
Less: disallowed intangibles	**(5,196)**	(113)	(69)
Total Tier 1 capital	**$ 62,287**	$ 57,920	$ 64,355
Tier 2 Capital:			
Allowable reserve for loan losses	**$ 5,140**	$ 4,661	$ 5,218
Qualifying long-term debt			
Total Tier 2 capital	**5,140**	4,661	5,218
Total risk-based capital	**$ 67,427**	$ 62,581	$ 69,573
Risk-weighted assets	**$ 608,961**	$ 489,407	$ 466,039
Capital Ratios:			
Tier 1 Capital to average assets	**8.57%**	10.31%	11.98%
Tier 1 Capital to risk-weighted assets	**10.23%**	11.83%	13.81%
Total Capital to risk-weighted assets	**11.07%**	12.79%	14.93%

Regulatory capital is not the same as shareholders equity reported in the accompanying condensed consolidated financial statements. Certain assets cannot be considered assets for regulatory purposes. The Corporation s acquisition intangibles and a portion of the deferred tax asset are examples of such assets, which was discussed earlier.

The Corporation s and the Bank s actual capital and ratios compared to generally applicable regulatory requirements as of December 31, 2014 are as follows (dollars in thousands):

	Actual		Adequacy Purposes		Well-Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio

Total capital to risk weighted assets:										
Consolidated	**$**	**67,427**	**11.1%**	**≥**	**$**	**48,717**	**≥ 8.0%**	**≥**	**$**	**60,896**	**10.0%**
mBank	**$**	**70,320**	**11.8%**	**≥**	**$**	**47,611**	**≥ 8.0%**	**≥**	**$**	**59,513**	**10.0%**
Tier 1 capital to risk weighted assets:										
Consolidated	**$**	**62,287**	**10.2%**	**≥**	**$**	**36,538**	**≥ 6.0%**	**≥**	**$**	**36,538**	**6.0%**
mBank	**$**	**65,355**	**11.0%**	**≥**	**$**	**35,708**	**≥ 6.0%**	**≥**	**$**	**35,708**	**6.0%**
Tier 1 capital to average assets:										
Consolidated	**$**	**62,287**	**9.6%**	**≥**	**$**	**29,065**	**≥ 4.0%**	**≥**	**$**	**36,332**	**5.0%**
mBank	**$**	**65,355**	**9.1%**	**≥**	**$**	**28,680**	**≥ 4.0%**	**≥**	**$**	**35,850**	**5.0%**

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The Corporation s and the Bank s actual capital and ratios compared to generally applicable regulatory requirements as of December 31, 2013 are as follows (dollars in thousands):

	Actual			Adequacy Purposes			Action Provisions	
	Amount	Ratio		Amount	Ratio		Amount	Ratio
Total capital to risk weighted assets:								
Consolidated	$ 62,581	12.8%	≥	$ 39,153	≥ 8.0%		N/A	N/A
mBank	$ 60,537	12.4%	≥	$ 38,944	≥ 8.0%	≥	$ 48,680	10.0%
Tier 1 capital to risk weighted assets:								
Consolidated	$ 57,920	11.8%	≥	$ 19,576	≥ 4.0%		N/A	N/A
mBank	$ 55,947	11.5%	≥	$ 19,472	≥ 4.0%	≥	$ 29,208	6.0%
Tier 1 capital to average assets:								
Consolidated	$ 57,920	10.3%	≥	$ 22,469	≥ 4.0%		N/A	N/A
mBank	$ 55,947	10.0%	≥	$ 22,352	≥ 4.0%	≥	$ 27,940	5.0%

Impact of Inflation and Changing Prices

The accompanying 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 prices of goods and services.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Incorporated by reference to the Management s Discussion and Analysis of Financial Condition and Results of Operations set forth under Item 7 above.

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Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders

Mackinac Financial Corp.

We have audited the accompanying consolidated balance sheet of Mackinac Financial Corp. (the Corporation) as of December 31, 2014 and 2013, and the related consolidated statements of operations, comprehensive income, changes in shareholders equity and cash flows for each of the years in the three-year period ended December 31, 2014. These financial statements are the responsibility of the Corporation s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Corporation is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mackinac Financial Corp. as of December 31, 2014 and 2013, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America.

March 30, 2015

Auburn Hills, Michigan

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Consolidated Balance Sheets

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

December 31, 2014 and 2013

(Dollars in Thousands)

	December 31, 2014	December 31, 2013
ASSETS		
Cash and due from banks	**$ 21,947**	$ 18,216
Federal funds sold		3
Cash and cash equivalents	**21,947**	18,219
Interest-bearing deposits in other financial institutions	**5,797**	10
Securities available for sale	**65,832**	44,388
Federal Home Loan Bank stock	**2,973**	3,060
Loans:		
Commercial	**433,566**	359,368
Mortgage	**148,984**	110,663
Consumer	**18,385**	13,801
Total Loans	**600,935**	483,832
Allowance for loan losses	**(5,140)**	(4,661)
Net loans	**595,795**	479,171
Premises and equipment	**12,658**	10,210
Other real estate held for sale	**3,010**	1,884
Deferred Tax Asset	**11,498**	9,933
Deposit based intangible	**1,196**	
Goodwill	**3,805**	
Other assets	**19,274**	5,925
TOTAL ASSETS	**$ 743,785**	$ 572,800
LIABILITIES AND SHAREHOLDERS EQUITY		
LIABILITIES:		
Deposits:		
Noninterest bearing deposits	**$ 95,498**	$ 72,936
NOW, money market, interest checking	**212,565**	149,123
Savings	**28,015**	13,039
CDs<$100,000	**134,951**	140,495
CDs>$100,000	**30,316**	23,159
Brokered	**105,628**	67,547
Total deposits	**606,973**	466,299
Borrowings	**49,846**	37,852

Other liabilities		**12,970**		3,400
Total liabilities		**669,789**		507,551
SHAREHOLDERS EQUITY:				
Preferred stock - No par value:				
Authorized 500,000 shares, Issued and outstanding - none and 11,000 shares				
Common stock and additional paid in capital - No par value				
Authorized - 18,000,000 shares				
Issued and outstanding - **6,266,756** and 5,541,390, shares respectively		**61,679**		53,621
Retained earnings		**11,804**		11,412
Accumulated other comprehensive income		**513**		216
Total shareholders equity		**73,996**		65,249
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$**	**743,785**	$	572,800

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Operations

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

Years Ended December 31, 2014, 2013, and 2012

(Dollars in Thousands, Except Per Share Data)

	For the Years Ended December 31, 2014	2013	2012
INTEREST INCOME:			
Interest and fees on loans:			
Taxable	**$ 26,461**	$ 24,295	$ 23,197
Tax-exempt	**30**	105	116
Interest on securities:			
Taxable	**962**	961	948
Tax-exempt	**64**	34	27
Other interest income	**152**	128	139
Total interest income	**27,669**	25,523	24,427
INTEREST EXPENSE:			
Deposits	**3,218**	3,468	3,946
Borrowings	**924**	656	657
Total interest expense	**4,142**	4,124	4,603
Net interest income	**23,527**	21,399	19,824
Provision for loan losses	**1,200**	1,675	945
Net interest income after provision for loan losses	**22,327**	19,724	18,879
OTHER INCOME:			
Deposit service fees	**701**	667	699
Income from loans sold on the secondary market	**637**	1,028	1,390
SBA/USDA loan sale gains	**757**	951	1,176
Mortgage servicing income	**675**	790	417
Net security gains	**54**	73	
Other	**288**	429	361
Total other income	**3,112**	3,938	4,043
OTHER EXPENSE:			
Salaries and employee benefits	**10,303**	9,351	8,288
Occupancy	**2,129**	1,481	1,372
Furniture and equipment	**1,268**	1,102	885
Data processing	**1,150**	1,071	991
Advertising	**449**	436	376
Professional service fees	**1,163**	1,069	1,196
Loan and deposit	**699**	617	877
Writedowns and losses on other real estate held for sale	**280**	265	489
FDIC insurance assessment	**362**	385	459
Telephone	**327**	303	233
Nonrecurring transaction related expenses	**2,475**		

Other		**2,005**		2,048		1,591
Total other expenses		**22,610**		18,128		16,757
Income before income taxes		**2,829**		5,534		6,165
Provision (benefit of) for income taxes		**1,129**		(403)		(922)
NET INCOME		**1,700**		5,937		7,087
Preferred dividend and accretion of discount				308		629
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	**$**	**1,700**	$	5,629	$	6,458
INCOME PER COMMON SHARE:						
Basic	**$**	**.30**	$	1.01	$	1.51
Diluted	**$**	**.30**	$	1.00	$	1.51
Cash dividends per share	**$**	**.225**	$	.170	$	.120

See accompanying notes to consolidated financial statements.

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Consolidated Statement of Comprehensive Income

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

Years Ended December 31, 2014, 2013, and 2012

(Dollars in Thousands)

	For the year ended December 31, 2014	2013	2012
Net income	**$ 1,700**	$ 5,937	$ 7,087
Other comprehensive income			
Change in securities available for sale:			
Unrealized gains (losses) arising during the period	**578**	(999)	907
Reclassification adjustment for securities gains included in net income	**(54)**	(73)	
Tax effect	**(178)**	364	(308)
Unrealized gains (losses) on available for sale securities	**346**	(708)	599
Defined benefit pension plans:			
Net unrealized actuarial loss on defined benefit pension obligation	**(74)**		
Amortization of net loss and settlement cost recognized in income			
Tax effect	**25**		
Changes from defined benefit pension plans	**(49)**		
Other comprehensive income (loss), net of tax	**297**	(708)	599
Total comprehensive income	**$ 1,997**	$ 5,229	$ 7,686

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Changes in Shareholders Equity

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

Years Ended December 31, 2014, 2013, and 2012

(Dollars in Thousands)

	Shares of Common Stock	Preferred Stock Series A	Common Stock and Additional Paid in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income	Total
Balance, January 1, 2012	**3,419,736**	**$ 10,921**	**$ 43,525**	**$ 492**	**$ 325**	**$ 55,263**
Net income				7,087		7,087
Other comprehensive income:						
Net unrealized income on securities available for sale					599	599
Total comprehensive income						7,686
Stock compensation			66			66
Issuance of common stock	2,140,123		11,506			11,506
Divided on common stock				(223)		(223)
Purchase of common stock warrants			(1,300)			(1,300)
Dividend on preferred stock				(550)		(550)
Accretion of preferred stock discount		79		(79)		
Balance, December 31, 2012	5,559,859	11,000	53,797	6,727	924	72,448
Net income				5,937		5,937
Other comprehensive income (loss):						
Net unrealized gain on securities available for sale					(708)	(708)
Total comprehensive income						5,229
Stock compensation			333			333
Issuance of common stock	37,125					
Repurchase of common stock	(55,594)		(509)			(509)
Dividend on common stock				(944)		(944)
Dividend on preferred stock				(308)		(308)
Redemption of Preferred Series A		(11,000)				(11,000)
Balance, December 31, 2013	5,541,390	$	$ 53,621	$ 11,412	$ 216	$ 65,249
Net income				**1,700**		**1,700**

Other comprehensive income (loss):						
Net unrealized gain on securities available for sale					**346**	**346**
Actuarial loss on defined benefit pension obligation					**(49)**	**(49)**
Total comprehensive income					**297**	**1,997**
Stock compensation			**429**			**429**
Issuance of common stock:						
Acquisition - Peninsula Financial Corp	**695,361**		**7,804**			**7,804**
Stock option exercise	**6,580**		**(32)**			**(32)**
Restricted stock award vesting	**37,125**					
Total issuance of common stock	**739,066**		**7,772**			**7,772**
Repurchase of common stock	**(13,700)**		**(143)**			**(143)**
Dividend on common stock				**(1,308)**		**(1,308)**
Balance, December 31, 2014	**6,266,756**	**$**	**$ 61,679**	**$ 11,804**	**$ 513**	**$ 73,996**

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

Years Ended December 31, 2014, 2013, and 2012

(Dollars in Thousands)

	For the year ended December 31, 2014	2013	2012
Cash Flows from Operating Activities:			
Net income	**$ 1,700**	$ 5,937	$ 7,087
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**1,503**	1,657	1,547
Provision for loan losses	**1,200**	1,675	945
Deferred income taxes, net	**1,129**	(403)	(922)
(Gain) loss on sales/calls of securities	**(54)**	(73)	
(Gain) on sale of loans sold in the secondary market	**(493)**	(794)	(1,077)
Origination of loans held for sale in secondary market	**(29,871)**	(55,973)	(74,142)
Proceeds from sale of loans in the secondary market	**30,364**	56,767	75,219
Loss on sale of premises, equipment, and other real estate held for sale	**81**	304	31
Writedown of other real estate held for sale	**228**	231	496
Stock compensation	**429**	333	66
Change in other assets	**(4,112)**	(710)	(61)
Change in other liabilities	**6,337**	350	788
Net cash provided by operating activities	**8,441**	9,301	9,977
Cash Flows from Investing Activities:			
Net increase in loans	**(50,969)**	(37,853)	(50,351)
Net decrease in interest-bearing deposits in other financial institutions	**(225)**		
Purchase of securities available for sale	**(8,317)**	(15,709)	(15,209)
Proceeds from maturities, sales, calls or paydowns of securities available for sale	**9,449**	13,698	10,668
Capital expenditures	**(1,433)**	(1,497)	(2,098)
Net cash used in Peninsula acquisition	**(4,484)**		
Proceeds from sale of premises, equipment, and other real estate	**912**	2,410	775
Redemption of FHLB stock	**87**		
Net cash (used in) investing activities	**(54,980)**	(38,951)	(56,215)
Cash Flows from Financing Activities:			
Net increase in deposits	**39,724**	31,742	29,768
Net activity on line of credit	**9,367**	2,000	
Net proceeds from stock issuance			11,506
Repurchase of common stock	**(143)**	(509)	
Dividend on common stock	**(1,308)**	(944)	(223)
Redemption of Series A Preferred Stock		(11,000)	
Repurchase of common stock warrants			(1,300)
Dividend on preferred stock		(308)	(550)

Proceeds from term borrowing		**3,000**				
Principal payments on borrowings		**(373)**		(73)		(72)
Net cash provided by financing activities		**50,267**		20,908		39,129
Net (decrease) in cash and cash equivalents		**3,728**		(8,742)		(7,109)
Cash and cash equivalents at beginning of period		**18,219**		26,961		34,070
Cash and cash equivalents at end of period	**$**	**21,947**	$	18,219	$	26,961
Supplemental Cash Flow Information:						
Cash paid during the year for:						
Interest	**$**	**4,119**	$	4,157	$	4,172
Income taxes		**100**		149		125
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)		**588**		932		1,352

See accompanying notes to consolidated financial statements.

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Notes to the Consolidated Financial Statements

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of Mackinac Financial Corporation (the Corporation) and Subsidiaries conform to accounting principles generally accepted in the United States and prevailing practices within the banking industry. Significant accounting policies are summarized below.

Principles of Consolidation

The consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries, mBank (the Bank), Mackinac Commercial Credit, LLC (MCC , formed in late 2013) and other minor subsidiaries, after elimination of intercompany transactions and accounts.

Nature of Operations

The Corporation s and the Bank s revenues and assets are derived primarily from banking activities. The Bank s primary market area is the Upper Peninsula, the northern portion of the Lower Peninsula of Michigan, and Oakland County in Lower Michigan. The Bank provides to its customers commercial, real estate, agricultural, and consumer loans, as well as a variety of traditional deposit products. A portion, less than 1.0% of the Bank s commercial loan portfolio consists of leases to commercial and governmental entities, which are secured by various types of equipment. These leases are dispersed geographically throughout the country. Less than 1.0% of the Corporation s business activity is with Canadian customers and denominated in Canadian dollars.

While the Corporation s chief decision makers monitor the revenue streams of the various Corporation products and services, operations are managed and financial performance is evaluated on a Corporation-wide basis. Accordingly, all of the Corporation s banking operations are considered by management to be aggregated in one reportable operating segment.

Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

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.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, noninterest-bearing deposits in correspondent banks, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

Securities

The Corporation s securities are classified and accounted for as securities available for sale. These securities are stated at fair value. Premiums and discounts are recognized in interest income using the interest method over the period to maturity. Unrealized holding gains and losses on securities available for sale are reported as accumulated other comprehensive income within shareholders equity until realized. When it is determined that securities or other investments are impaired and the impairment is other than temporary, an impairment loss is recognized in earnings and a new basis in the affected security is established. Gains and losses on the sale of securities are recorded on the trade date and determined using the specific-identification method.

Notes to the Consolidated Financial Statements

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Federal Home Loan Bank Stock

As a member of the Federal Home Loan Bank (FHLB) system, the Bank is required to hold stock in the FHLB based on the anticipated level of borrowings to be advanced. This stock is recorded at cost, which approximates fair value. Transfer of the stock is substantially restricted.

Interest Income and Fees on Loans

Interest income on loans is reported on the level-yield method and includes amortization of deferred loan fees and costs over the loan term. Net loan commitment fees or costs for commitment periods greater than one year are deferred and amortized into fee income or other expense on a straight-line basis over the commitment period. The accrual of interest on loans is discontinued when, in the opinion of management, it is probable that the borrower may be unable to meet payments as they become due as well as when required by regulatory provisions. 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. Interest income on impaired and nonaccrual loans is recorded on a cash basis.

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, we continue 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. We evaluate 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.

Servicing Rights

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Capitalized servicing rights are reported in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based on the fair value of the rights compared to amortized cost. Impairment is determined by using prices for similar assets with similar characteristics, such as interest rates and terms. Fair value is determined by using prices for similar assets with similar characteristics, when available, or based on discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum.

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Notes to the Consolidated Financial Statements

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses

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

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

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

Troubled Debt Restructuring

Troubled debt restructuring of loans is undertaken to improve the likelihood that the loan will be repaid in full under the modified terms in accordance with a reasonable repayment schedule. All modified loans are evaluated to determine whether the loans should be reported as a Troubled Debt Restructure (TDR). A loan is a TDR when the Corporation, for economic or legal reasons related to the borrower s financial difficulties, grants a concession to the borrower by modifying or renewing a loan that the Corporation would not otherwise consider. To make this determination, the Corporation must determine whether (a) the borrower is experiencing financial difficulties and (b) the Corporation granted the borrower a concession. This determination requires consideration of all of the facts and circumstances surrounding the modification. An overall general decline in the economy or some deterioration in a borrower s financial condition does not automatically mean the borrower is experiencing financial difficulties.

Other Real Estate Held for Sale

Other real estate held for sale consists of assets acquired through, or in lieu of, foreclosure and other long-lived assets to be disposed of by sale, whether previously held and used or newly acquired. Other real estate held for sale is initially recorded at the lower of cost or fair value, less costs to sell, establishing a new cost basis. Valuations are periodically performed by management, and the assets carrying values are adjusted to the lower of cost basis or fair value less costs to sell. Impairment losses are recognized for any initial or subsequent write-downs. Net revenue and expenses from operations of other real estate held for sale are included in other expense.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Maintenance and repair costs are charged to expense as incurred. Gains or losses on disposition of premises and equipment are reflected in income. Depreciation is computed on the straight-line method over the estimated useful lives of the assets.

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Notes to the Consolidated Financial Statements

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Goodwill and Other Intangible Assets

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. The Corporation s core deposit intangible is currently being amortized over its estimated useful life, ten years.

Stock Compensation Plans

On May 22, 2012, the Corporation 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 Corporation s common stock issuable under the plan was set at 575,000. Awards are made at the discretion of the Board of Directors. Compensation cost equal to the fair value of the award is recognized over the vesting period.

Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) is composed of unrealized gains and losses on securities available for sale, and unrecognized actuarial gains and losses in the defined benefit pension plan, arising during the period. These gains and losses for the period are shown as a component of other comprehensive income. The accumulated gains and losses are reported as a component of equity, net of any tax effect. At December 31, 2014, the balance in accumulated other comprehensive income consisted of an unrealized gain on available for sales securities of $.562 million and actuarial losses on the defined benefit pension obligation of $.049 million.

Earnings per Common Share

Diluted earnings per share, which reflects the potential dilution that could occur if outstanding stock options and warrants 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 year ended December 31, 2014, 2013 and 2012 (dollars in thousands, except per share data):

	Year Ended December 31,		
	2014	**2013**	**2012**
Net income	**$ 1,700**	$ 5,937	$ 7,087
Preferred stock dividends and accretion of discount		308	629
Net income available to common shareholders	**$ 1,700**	$ 5,629	$ 6,458
Weighted average shares outstanding	**5,592,738**	5,558,313	4,285,043
Effect of dilutive stock options, vesting of restricted stock units, and common stock warrants outstanding	**61,073**	91,745	
Diluted weighted average shares outstanding	**5,653,811**	5,650,058	4,285,043
Income per common share:			
Basic	**$ .30**	$ 1.01	$ 1.51
Diluted	**$ .30**	$ 1.00	$ 1.51

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Notes to the Consolidated Financial Statements

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Taxes

Deferred income taxes have been provided under the liability method. Deferred tax assets and liabilities are determined based upon the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates which will be in effect when these differences are expected to reverse. Deferred tax expense (benefit) is the result of changes in the deferred tax asset and liability. A valuation allowance is provided against deferred tax assets when it is more likely than not that some or all of the deferred asset will not be realized.

Off-Balance-Sheet Financial Instruments

In the ordinary course of business, the Corporation has entered into off-balance-sheet financial instruments consisting of commitments to extend credit, commitments under credit card arrangements, commercial letters of credit, and standby letters of credit. For letters of credit, the Corporation recognizes a liability for the fair market value of the obligations it assumes under that guarantee.

Recent Developments

In May 2014, the Financial Accounting Standards Board (FASB) issued guidance on the recognition of revenue from contracts with customers. Revenue recognition will depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also requires disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The guidance permits two methods of adoption: retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application. The guidance is effective January 1, 2017 and early adoption is not permitted. The company is currently evaluating the impact of the new guidance and the method of adoption in the consolidated financial results.

Reclassifications

Certain amounts in the 2013 and 2012 consolidated financial statements have been reclassified to conform to the 2014 presentation.

NOTE 2 RESTRICTIONS ON CASH AND CASH EQUIVALENTS

Cash and cash equivalents in the amount of $9.519 million were restricted on December 31, 2014 to meet the reserve requirements of the Federal Reserve System.

In the normal course of business, the Corporation maintains cash and due from bank balances with correspondent banks. Balances in these accounts may exceed the Federal Deposit Insurance Corporation s insured limit of $250,000.

Management believes that these financial institutions have strong credit ratings and the credit risk related to these deposits is minimal.

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 3 SECURITIES AVAILABLE FOR SALE

The carrying value and estimated fair value of securities available for sale are as follows (dollars in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
December 31, 2014				
US Treasury	**$ 5,287**	**$ 3**	**$ (10)**	**$ 5,280**
Corporate	**12,558**	**116**		**12,674**
US Agencies	**22,667**	**144**	**(94)**	**22,717**
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**
December 31, 2013				
Corporate	$ 15,862	$ 218	$ (1)	$ 16,079
US Agencies	15,227		(372)	14,855
US Agencies - MBS	7,078	281		7,359
Obligations of states and political subdivisions	5,893	202		6,095
Total securities available for sale	$ 44,060	$ 701	$ (373)	$ 44,388

At December 31, 2014 and 2013, the mortgage backed securities portfolio was $13.688 million (20.79%) and $7.359 million (16.58%), respectively, of the securities portfolio. At December 31, 2014, the entire mortgage backed securities portfolio consisted of securities issued and guaranteed by either the Federal National Mortgage Association (FNMA) or the Federal Home Loan Mortgage Corporation (FHLMC), United States government-sponsored agencies.

Following is information pertaining to securities with gross unrealized losses at December 31, 2014 and 2013 aggregated by investment category and length of time these individual securities have been in a loss position (dollars in thousands):

	Less Than Twelve Months	Over Twelve Months

	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
December 31, 2014				
US Treasury	**$ (10)**	**$ 3,958**	**$**	**$**
Corporate				
US Agencies	**(9)**	**1,494**	**(85)**	**7,411**
US Agencies - MBS	**(35)**	**4,511**		
Obligations of states and political subdivisions	**(142)**	**386**		
Total securities available for sale	**$ (196)**	**$ 10,349**	**$ (85)**	**$ 7,411**
December 31, 2013				
Corporate	$ (1)	$ 1,390	$	$
US Agencies	(372)	14,855		
US Agencies - MBS				
Obligations of states and political subdivisions				
Total securities available for sale	$ (373)	$ 16,245	$	$

There were 17 securities in an unrealized loss position in 2014 and six in 2013. The gross unrealized losses in the current portfolio are considered temporary in nature and related to interest rate fluctuations. The Corporation has both the ability and intent to hold the investment securities until their respective maturities and therefore does not anticipate the realization of the temporary losses.

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 3 SECURITIES AVAILABLE FOR SALE (CONTINUED)

Following is a summary of the proceeds from sales and calls of securities available for sale, as well as gross gains and losses for the years ended December 31 (dollars in thousands):

	2014	2013	2012
Proceeds from sales and calls	**$ 5,200**	$ 10,156	$ 2,601
Gross gains on sales	**54**	73	
Gross (losses) on sales and calls			

The carrying value and estimated fair value of securities available for sale at December 31, 2014, by contractual maturity, are shown below (dollars in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	**$ 8,986**	**$ 8,824**
Due after one year through five years	**28,744**	**29,081**
Due after five years through ten years	**10,129**	**10,460**
Due after ten years	**3,583**	**3,779**
Subtotal	**51,442**	**52,144**
US Agencies - MBS	**13,461**	**13,688**
Total	**$ 64,903**	**$ 65,832**

Contractual maturities may differ from expected maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. See Note 10 for information on securities pledged to secure borrowings from the Federal Home Loan Bank.

NOTE 4 - LOANS

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

	2014	2013
Commercial real estate	**$ 315,387**	$ 268,809
Commercial, financial, and agricultural	**101,895**	79,655
One to four family residential real estate	**139,553**	103,768
Commercial construction	**16,284**	10,904
Consumer	**18,385**	13,801
Consumer construction	**9,431**	6,895
Total loans	**$ 600,935**	$ 483,832

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. For the period of December 5, 2014 to December 31, 2014, recorded interest compared to accretable interest on acquired impaired loans was immaterial and no significant payments of principal were recorded.

The table below details the acquired portfolio at acquisition date:

	Acquired Impaired	Acquired Non-impaired	Acquired Total
Loans acquired - contractual payments	$ 13,290	$ 53,849	$ 67,139
Nonaccretable difference	(2,234)		(2,234)
Expected cash flows	11,056	53,849	64,905
Accretable yield	(744)	(2,100)	(2,844)
Carrying balance at acquisition date	$ 10,312	$ 51,749	$ 62,061

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 4 LOANS (CONTINUED)

An analysis of the allowance for loan losses for the years ended December 31 is as follows (dollars in thousands):

	2014	2013	2012
Balance, January 1	**$ 4,661**	$ 5,218	$ 5,251
Recoveries on loans previously charged off	**325**	200	278
Loans charged off	**(1,046)**	(2,432)	(1,256)
Provision	**1,200**	1,675	945
Balance, December 31	**$ 5,140**	$ 4,661	$ 5,218

In 2014, net charge off activity was $.721 million, or .14% of average loans outstanding compared to net charge-offs of $2.232 million, or .48% of average loans, in the same period in 2013 and $.978 million, or .23% of average loans, in 2012. During 2014, a provision of $1.200 million was made to increase the allowance. This provision was made in accordance with the Corporation s allowance for loan loss reserve policy, which 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 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.

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Notes to the Consolidated Financial Statements

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 4 LOANS (CONTINUED)

A breakdown of the allowance for loan losses and recorded balances in loans at December 31, 2013 is as follows (dollars in thousands):

[redacted]								
Allowance for loan loss reserve:								
[redacted]								
Charge-offs	(1,539)	(632)		(141)		(120)		(2,432)
[redacted]								
Provision	29	1,262	(47)	(349)	23	246	511	1,675
[redacted]								
[redacted]								
Ending balance	$ 268,809	$ 79,655	$ 10,904	$ 103,768	$ 6,895	$ 13,801	$	$ 483,832
[redacted]								
Net loans	$ 266,960	$ 78,277	$ 10,824	$ 103,252	$ 6,870	$ 13,653	$ (665)	$ 479,171
[redacted]								
Ending balance ALLR:								
[redacted]								
Collectively evaluated	1,750	487	80	413	25	130	665	3,550
[redacted]								
[redacted]								
Individually evaluated	$ 649	$ 1,830	$	$ 385	$	$ 42	$	$ 2,906
[redacted]								
Total	$ 268,809	$ 79,655	$ 10,904	$ 103,768	$ 6,895	$ 13,801	$	$ 483,832

Impaired loans, by definition, are individually evaluated.

A breakdown of the allowance for loan losses, the activity for the period, and recorded balances in loans for the year ended December 31, 2012 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	$ 2,823	$ 1,079	$ 207	$ 1,114	$	$	$ 28	$ 5,251
Charge-offs	(729)	(40)	(6)	(399)		(82)		(1,256)
Recoveries	52	201		7		18		278
Provision	1,121	(548)	(76)	258		64	126	945
Ending balance ALLR	$ 3,267	$ 692	$ 125	$ 980	$	$	$ 154	$ 5,218
Loans:								
Ending balance	$ 244,966	$ 80,646	$ 17,229	$ 87,948	$ 7,465	$ 10,923	$	$ 449,177
Ending balance ALLR	(3,267)	(692)	(125)	(980)			(154)	(5,218)
Net loans	$ 241,699	$ 79,954	$ 17,104	$ 86,968	$ 7,465	$ 10,923	$ (154)	$ 443,959
Ending balance ALLR:								
Individually evaluated	$ 1,662	$ 155	$ 10	$ 112	$	$	$	$ 1,939
Collectively evaluated	1,605	537	115	868			154	3,279
Total	$ 3,267	$ 692	$ 125	$ 980	$	$	$ 154	$ 5,218
Ending balance Loans:								
Individually evaluated	$ 22,910	$ 6,070	$ 858	$ 796	$	$	$	$ 30,634
Collectively evaluated	222,056	74,576	16,371	87,152	7,465	10,923		418,543
Total	$ 244,966	$ 80,646	$ 17,229	$ 87,948	$ 7,465	$ 10,923	$	$ 449,177

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.

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.

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 4 LOANS (CONTINUED)

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 (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.

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

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 4 LOANS (CONTINUED)

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. In 2014 and 2013, commercial construction loans of $3.251 million and $2.951 million, 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 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

Below is a breakdown of loans by risk category as of December 31, 2013 (dollars in thousands):

(4)

	(1) Strong	(2) Good	(3) Average	Acceptable/ Acceptable Watch	(5) Sp. Mention	(6) Substandard	(7) Doubtful	Rating Unassigned	Total
Commercial real estate	$ 1,502	$ 23,310	$ 116,702	$ 125,010	$	$ 2,285	$	$	$ 268,809
Commercial, financial and agricultural	3,741	4,348	27,455	39,070		5,041			79,655
Commercial construction	30	479	2,702	4,340		402		2,951	10,904
One-to-four family residential real estate	251	3,074	1,275	4,482		710		93,976	103,768
Consumer construction								6,895	6,895
Consumer	10		37	43		30		13,681	13,801
Total loans	$ 5,534	$ 31,211	$ 148,171	$ 172,945	$	$ 8,468	$	$ 117,503	$ 483,832

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, and that which would have been recognized was $.130 million for the year ended December 31, 2014. For the year ended December 31, 2013, there was no interest recorded during impairment and that which would have been recognized was $.228 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.

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 4 LOANS (CONTINUED)

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 general result in a provision for loan losses. Subsequent increase in expected cash flows will results 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 $.744 million. The Corporation recorded no accretable yield of the loan mark in 2014.

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 acquisition date:

Contractually required payments including interest	$	13,290
Less: nonaccretable difference		(2,234)
Cash flows expected to be collected		11,056
Less: accretable yield		(744)
Fair value of credit impaired loans acquired	$	10,312

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 4 LOANS (CONTINUED)

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
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**
December 31, 2013						
With no valuation reserve:						
Commercial real estate	$ 513	$	$ 3,045	$	$	$ 153
Commercial, financial and agricultural	59		505			13
Commercial construction			626			3
	361		625			16

One to four family residential real estate						
Consumer construction						
Consumer			2			
With a valuation reserve:						
Commercial real estate	$ 59	$	$ 71	$ 14	$	$ 5
Commercial, financial and agricultural	752		834	265		18
Commercial construction						
One to four family residential real estate	250		261	78		20
Consumer construction						
Consumer	30		30	13		
Total:						
Commercial real estate	$ 572	$	$ 3,116	$ 14	$	$ 158
Commercial, financial and agricultural	811		1,339	265		31
Commercial construction			626			3
One to four family residential real estate	611		886	78		36
Consumer construction						
Consumer	30		32	13		
Total	$ 2,024	$	$ 5,999	$ 370	$	$ 228

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 4 LOANS (CONTINUED)

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

	2014			2013		
	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	**$ 1,857**	**$ 859**	**$ 2,716**	$	$ 572	$ 572
Commercial, financial and agricultural	**104**	**848**	**952**	4	811	815
Commercial construction				20		20
One to four family residential real estate	**1,412**	**1,958**	**3,370**	201	611	812
Consumer construction	**38**	**274**	**312**			
Consumer	**88**		**88**	14	30	44
Total past due loans	**$ 3,499**	**$ 3,939**	**$ 7,438**	$ 239	$ 2,024	$ 2,263

The Corporation acquired loans 30-89 days past due and nonaccrual loans with December 31, 2014 balance of $2.908 million and $2.281 million, respectively.

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**

A roll-forward of nonaccrual activity during the year ended December 31, 2013 (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	$ 3,071	$ 436	$ 675	$ 505	$	$	$ 4,687
Principal payments	(1,478)	(319)	(100)	(88)		(2)	(1,987)
Charge-offs	(1,304)	(616)		(141)		(4)	(2,065)
Advances							
Transfers to OREO	(208)	(37)	(580)	(107)			(932)
Transfers to accruing							
Transfers from accruing	443	1,346		434		36	2,259
Other	48	1	5	8			62
Ending balance	$ 572	$ 811	$	$ 611	$	$ 30	$ 2,024

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 4 LOANS (CONTINUED)

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 that occurred during the years ended December 31 is as follows (dollars in thousands):

	2014		2013	
	Number of Modifications	**Recorded Investment**	**Number of Modifications**	**Recorded Investment**
Commercial real estate		$		$
Commercial, financial and agricultural			1	528
Commercial construction				
One to four family residential real estate				
Consumer construction				
Consumer				
Total troubled debt restructurings		$	1	$ 528

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 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**

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 4 LOANS (CONTINUED)

A roll-forward of troubled debt restructuring during the year ended December 31, 2013 (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	$ 3,611	$ 1,221	$ 858	$ 102	$	$ 5,792
Principal payments	(91)	(460)		(3)		(554)
Charge-offs						
Advances						
New restructured		953				953
Transferred out of TDR						
Transfers to nonaccrual		(528)				(528)
Ending Balance	$ 3,520	$ 1,186	$ 858	$ 99	$	$ 5,663
NONACCRUAL						
Beginning balance	$ 2,162	$	$	$ 102	$	$ 2,264
Principal payments	(1,376)	(5)		(15)		(1,396)
Charge-offs	(793)					(793)
Advances						
New restructured	7	528		4		539
Transfers to foreclosed properties						
Transfers from accruing						
Ending Balance	$	$ 523	$	$ 91	$	$ 614
TOTALS						
Beginning balance	$ 5,773	$ 1,221	$ 858	$ 204	$	$ 8,056
Principal payments	(1,467)	(465)		(18)		(1,950)
Charge-offs	(793)					(793)
Advances						
New restructured	7	1,481		4		1,492

Transfers out of TDRs						
Tansfers to nonaccrual		(528)				(528)
Transfers to foreclosed properties						
Transfers from accruing						
Ending Balance	$ 3,520	$ 1,709	$ 858	$ 190	$	$ 6,277

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.

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 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):

	2014	2013
Loans outstanding, January 1	**$ 9,043**	$ 11,297
New loans	**33**	496
Net activity on revolving lines of credit	**1,390**	(266)
Repayment	**(1,677)**	(2,484)
Loans outstanding, December 31	**$ 8,789**	$ 9,043

There were no loans to related-parties classified substandard as of December 31, 2014 and 2013. In addition to the outstanding balances above, there were unfunded commitments of $.372 million to related parties at December 31, 2014.

NOTE 5 PREMISES AND EQUIPMENT

Details of premises and equipment at December 31 are as follows (dollars in thousands):

	2014	2013
Land	**$ 1,812**	$ 1,781
Buildings and improvements	**15,069**	12,911
Furniture, fixtures, and equipment	**7,892**	6,833
Construction in progress	**87**	145
Total cost basis	**24,860**	21,670
Less - accumulated depreciation	**12,202**	11,460

Net book value	**$**	**12,658**	$	10,210

Depreciation of premises and equipment charged to operating expenses amounted to $1.337 million in 2014, $1.231 million in 2013, and $1.092 million in 2012.

NOTE 6 OTHER REAL ESTATE HELD FOR SALE

An analysis of other real estate held for sale for the years ended December 31 is as follows (dollars in thousands):

		2014		2013
Balance, January 1	**$**	**1,884**	$	3,212
Other real estate transferred from loans due to foreclosure		**588**		932
Other real estate acquired, net of purchase accounting		**1,193**		
Other real estate sold		**(375)**		(1,996)
Writedowns of other real estate held for sale		**(228)**		(231)
Loss on sale of other real estate held for sale		**(52)**		(33)
Balance, December 31	**$**	**3,010**	$	1,884

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 7 DEPOSITS

The distribution of deposits at December 31 is as follows (dollars in thousands):

	2014	2013
Noninterest bearing	**$ 95,498**	$ 72,936
NOW, money market, checking	**212,565**	149,123
Savings	**28,015**	13,039
CDs <$100,000	**134,951**	140,495
CDs >$100,000	**30,316**	23,159
Brokered	**105,628**	67,547
Total deposits	**$ 606,973**	$ 466,299

The aggregate amount of deposits that meet or exceed the $250,000 FDIC insurance limit was $6.610 million and $5.056 million at December 31, 2014 and 2013, respectively.

Maturities of non-brokered time deposits outstanding at December 31, 2014 are as follows (dollars in thousands):

2015	**$ 91,426**
2016	**58,464**
2017	**10,733**
2018	**3,875**
2019	**650**
Thereafter	**119**
Total	**$ 165,267**

NOTE 8 GOODWILL AND OTHER INTANGIBLE ASSETS

During the fourth quarter, 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 an accelerated cash flow 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 $1.196 million at December 31, 2014. Amortization expense in 2014 is $.010 million. Amortization expense for the next five years is expected to be at $.121 million per year.

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 9 SERVICING RIGHTS

Mortgage Loans

Mortgage servicing rights (MSRs) are recorded when loans are sold in the secondary market with servicing retained. As of December 31, 2014, the Corporation had obligations to service $224 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 December 31, 2014.

The following summarizes the fair value of the mortgage servicing rights capitalized and amortized. There was no valuation allowance required (dollars in thousands):

		December 31, 2014		December 31, 2013
Balance at beginning of period	**$**	**1,129**	$	638
Additions from loans sold with servicing retained		**636**		675
MSRs acquired in Peninsula transaction		**539**		
Amortization		**(310)**		(184)
Book value of MSRs at end of period	**$**	**1,994**	$	1,129

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 December 31, 2014 and December 31, 2013 was approximately $46 million and $59 million. The Corporation valued these servicing rights at $.198 million as of December 31, 2014 and $.200 million at December 31, 2013. This valuation was established in consideration of the discounted cash flow of expected servicing income over the life of the loans.

NOTE 10   BORROWINGS

Borrowings consist of the following at December 31 (dollars in thousands):

	2014	2013
Federal Home Loan Bank fixed rate advances at December 31, 2014 with a weighted average rate of 1.68% maturing in 2016, 2018 and 2019	**$ 35,000**	$ 35,000
Correspondent bank line of credit - holding company	**8,000**	2,000
Bank line of credit - wholly owned asset based lending subsidiary	**3,367**	
Correspondent bank term note, current floor rate of 4%, maturing December 28, 2017	**2,700**	
USDA Rural Development, fixed-rate note payable, maturing August 24, 2024 interest payable at 1%	**779**	852
	$ 49,846	$ 37,852

The Federal Home Loan Bank borrowings are collateralized at December 31, 2014 by the following: a collateral agreement on the Corporation s one to four family residential real estate loans with a book value of approximately $40.582 million; mortgage related and municipal securities with an amortized cost and estimated fair value of $3.983 million and $4.181 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 December 31, 2014.

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 10 BORROWINGS (CONTINUED)

The USDA Rural Development borrowing is collateralized by loans totaling $.121 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 $.724 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.

Maturities and principal payments of borrowings outstanding at December 31, 2014 are as follows (dollars in thousands):

2015	$	474
2016		18,842
2017		9,976
2018		10,077
2019		10,077
Thereafter		400
Total	$	49,846

NOTE 11 INCOME TAXES

The components of the federal income tax provision (credit) for the years ended December 31 are as follows (dollars in thousands):

	2014	2013	2012

Current tax expense (benefit)	$	$	$
Change in valuation allowance		(2,250)	(3,000)
Deferred tax expense (benefit)	**1,129**	1,847	2,078
Provision for (benefit of) income taxes	**$ 1,129**	$ (403)	$ (922)

A summary of the source of differences between income taxes at the federal statutory rate and the provision (credit) for income taxes for the years ended December 31 is as follows (dollars in thousands):

	2014	**2013**	**2012**
Tax expense at statutory rate	**$ 962**	$ 1,882	$ 2,096
Increase (decrease) in taxes resulting from:			
Tax-exempt interest	**(25)**	(47)	(49)
Change in valuation allowance		(2,250)	(3,000)
Nondeductible transaction expenses	**176**		
Other	**16**	12	31
Provision for (benefit of) income taxes, as reported	**$ 1,129**	$ (403)	$ (922)

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Notes to the Consolidated Financial Statements

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 11 INCOME TAXES (CONTINUED)

Deferred income taxes are provided for the temporary differences between the financial reporting and tax bases of the Corporation s assets and liabilities. The major components of net deferred tax assets at December 31 are as follows (dollars in thousands):

		2014		2013
Deferred tax assets:				
NOL carryforward	**$**	**5,500**	$	6,737
Allowance for loan losses		**2,194**		1,585
Alternative Minimum Tax Credit		**1,586**		1,463
OREO Tax basis > book basis		**474**		138
Tax credit carryovers		**767**		672
Deferred compensation		**576**		152
Pension liability		**475**		
Stock compensation		**247**		267
Depreciation		**(88)**		157
Purchase accounting adjustments		**2,095**		
Other		**33**		188
Total deferred tax assets		**13,859**		11,359
Valuation allowance	**$**	**(760)**	$	(760)
Deferred tax liabilities:				
Core deposit premium		**(407)**		
FHLB stock dividend		**(103)**		(103)
Unrealized gain on securities		**(363)**		(111)
Mortgage servicing rights		**(658)**		(452)
Other		**(70)**		
Total deferred tax liabilities		**(1,601)**		(666)
Net deferred tax asset	**$**	**11,498**	$	9,933

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 December 31, 2014 had a net operating loss and tax credit carryforwards for tax purposes of approximately $16.2 million, and $2.353 million, respectively. The Corporation will evaluate the future benefits from these carryforwards and at such time as it becomes more likely than not that they would be utilized prior to expiration and recognizes the additional benefits as an adjustment to the valuation allowance. The net operating loss carryforwards expire twenty years from the date they originated. These carryforwards, if not utilized, will begin to expire in the year 2023. A portion of the NOL, approximately $10.5 million, and the majority 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 $1.404 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 recognized a deferred tax expense of approximately $1.129 million for the year ended December 31, 2014 and a deferred tax benefit of $.403 million for the year ended December 31, 2013. The valuation allowance at December 31, 2014 was approximately $.760 million. The Corporation has reduced the valuation allowance as it was determined that it was more likely than not that these benefits would be realized. In December 2013, the Corporation reduced the valuation by $2.250 million and in June 2012 a reduction of $3.0 million was recorded. The Corporation made these determinations after a thorough review of projected earnings and the composition and sustainability of those earnings over the projected tax carryover period. This analysis substantiated the ability to utilize these deferred tax assets. 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.

In connection with the Peninsula acquisition in December 2014, the Corporation acquired $.933 million of NOL carryforward and approximately $.217 million of various tax credits, which it expects to utilize prior to expiration.

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 12 OPERATING LEASES

The Corporation currently maintains seven operating leases for office locations. The first operating lease, for our location in Birmingham, was originated in September 2005 and had an original term of 66 months with an option to renew for an additional five year period. The original term of this was extended during 2011 for an additional three year term and again in 2014 for an additional three year term.

The second operating lease, for a second location in Manistique, was executed in April 2010, the terms of which began at that time. The original term of this lease is three years and will automatically renew and extend for four additional consecutive terms of two years each.

The third operating lease, for a loan production office in Traverse City, was executed in May 2012, the terms of which began in August 2012. The original term of this lease is three years with options for two consecutive renewal terms of three years each.

The fourth operating lease was initiated in December 2013 as the Corporation consolidated its banking offices in Marquette. The original term of this lease is 15 years with options for two consecutive renewal terms of four years each.

With the acquisition, the Corporation acquired three additional operating leases for office locations. The first, for an additional location in Marquette, was executed in February 2011 with a term of five years. The second, for the location in Negaunee was executed in September 2012 with an initial term of five years, with option to renew for one additional term of five years. The final, for a location in Ishpeming was executed in April 2008 for an initial term of five years. This lease was renewed in May 2013 for an additional five years.

Future minimum payments for base rent, by year and in the aggregate, under the initial terms of the operating lease agreements, consist of the following (dollars in thousands):

2015	$	724
2016		680
2017		571
2018		455
2019		458
Thereafter		4,232

Total	$	7,120

Rent expense for all operating leases amounted to $.885 million in 2014, $.280 million in 2013, and $.269 million in 2012.

NOTE 13 RETIREMENT PLAN

The Corporation has established a 401(k) profit sharing plan. Employees who have completed three months of service and attained the age of 18 are eligible to participate in the plan. Eligible employees can elect to have a portion, not to exceed 80%, of their annual compensation paid into the plan. In addition, the Corporation may make discretionary contributions into the plan. Retirement plan contributions charged to operations totaled $214,000, $198,000, and $161,000 in 2014, 2013, and 2012, respectively.

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 14 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 (dollars in thousands):

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

The following table sets forth the plan s funded status and amounts recognized in the Corporation s balance sheets and the activity from date of acquisition (dollars in thousands):

		2014
Change in benefit obligation:		
Benefit obligation when acquired	$	3,229
Service cost		
Interest cost		9
Actuarial gain (loss)		52
Benefits paid		
Benefit (asset) obligation at end of year		3,290
Change in plan assets:		
Fair value of plan assets when acquired		2,118
Actual return on plan assets		(11)
Employer contributions		
Benefits paid		
Fair value of plan assets at end of year		2,107
Funded status		(1,183)
Unrecognized net actuarial loss		
Prepaid (accrued) pension expense, included with other assets or liabilities	$	(1,183)

The accumulated benefit obligation at December 31, 2014 was $3.290 million.

Net pension costs included in the Corporation s results of operations was immaterial.

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 14 DEFINED BENEFIT PENSION PLAN (CONTINUED)

Assumptions in the actuarial valuation are:

	2014
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%

NOTE 15 DEFERRED COMPENSATION PLAN

Prior to the recapitalization in 2004, as an incentive to retain key members of management and directors, the Corporation established a deferred compensation plan, with benefits based on the number of years the individuals have served the Corporation. This plan was discontinued and no longer applies to current officers and directors. A liability was recorded on a present value basis and discounted using the rates in effect at the time the deferred compensation agreement was entered into. The liability may change depending upon changes in long-term interest rates. The liability at December 31, 2014 and 2013, for vested benefits under this plan, was $.362 million and $.447 million, respectively. These benefits were originally contracted to be paid over a ten to fifteen-year period. The final payment is scheduled to occur in 2023. The deferred compensation plan is unfunded; however, the Bank maintains life insurance policies on the majority of the plan participants. The cash surrender value of the policies was $1.572 million and $1.506 million at December 31, 2014 and 2013, respectively. Deferred compensation expense for the plan was $16,000, $25,000, and $30,000 for 2014, 2013, and 2012, respectively.

The Peninsula Financial Corporation, acquired by the Corporation in December 2014, also had a deferred compensation plan, which was similar in nature to the Corporation s discontinued plan. The liability for this plan as of 2014 year end was $1.340 million and the bank owned life insurance policy as a cash surrender value of $1.666 million. This Plan was also discontinued by the Corporation and will not apply to future employees or directors of the Corporation.

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 16 REGULATORY MATTERS

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 December 31, 2014, the Corporation is well capitalized.

Regulatory guidelines require bank holding companies to maintain a minimum ratio of qualifying total capital to risk-weighted assets of 8.0%, of which at least 4.0% must be in the form of Tier 1 Capital. Guidelines also mandate a minimum tangible Tier 1 leverage ratio of 3.0% for strong bank holding companies. For all other bank holding companies, the minimum tangible Tier 1 leverage ratio is 4.0%. In addition, regulatory guidelines continue to consider the tangible Tier 1 leverage ratio in evaluating proposals for expansion or new activities.

Effective January 1, 2015, the Corporation will be 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 December 31, 2014 are as follows (dollars in thousands):

	Actual		Adequacy Purposes		Well-Capitalized	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total capital to risk weighted assets:						
Consolidated	**$ 67,427**	**11.1%**	**≥ $ 48,717**	**≥ 8.0%**	**≥ $ 60,896**	**10.0%**
mBank	**$ 70,320**	**11.8%**	**≥ $ 47,611**	**≥ 8.0%**	**≥ $ 59,513**	**10.0%**
Tier 1 capital to risk weighted assets:						
Consolidated	**$ 62,287**	**10.2%**	**≥ $ 36,538**	**≥ 6.0%**	**≥ $ 36,538**	**6.0%**
mBank	**$ 65,345**	**11.0%**	**≥ $ 35,708**	**≥ 6.0%**	**≥ $ 35,708**	**6.0%**
Tier 1 capital to average assets:						
Consolidated	**$ 62,287**	**8.6%**	**≥ $ 29,065**	**≥ 4.0%**	**≥ $ 36,332**	**5.0%**
mBank	**$ 65,355**	**9.1%**	**≥ $ 28,680**	**≥ 4.0%**	**≥ $ 35,850**	**5.0%**

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 16 REGULATORY MATTERS (CONTINUED)

The Corporation s and the Bank s actual capital and ratios compared to generally applicable regulatory requirements as of

December 31, 2013 are as follows (dollars in thousands):

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital to risk weighted assets:						
Consolidated	$ 62,581	12.8%	≥ $ 39,153	≥ 8.0%	N/A	N/A
mBank	$ 60,537	12.4%	≥ $ 38,944	≥ 8.0%	≥ $ 48,680	10.0%
Tier 1 capital to risk weighted assets:						
Consolidated	$ 57,920	11.8%	≥ $ 19,576	≥ 4.0%	N/A	N/A
mBank	$ 55,947	11.5%	≥ $ 19,472	≥ 4.0%	≥ $ 29,208	6.0%
Tier 1 capital to average assets:						
Consolidated	$ 57,920	10.3%	≥ $ 22,469	≥ 4.0%	N/A	N/A
mBank	$ 55,947	10.0%	≥ $ 22,352	≥ 4.0%	≥ $ 27,940	5.0%

NOTE 17 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. 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 and $.683 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.

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, 2014	111,375	$	7.91
Granted during the year	52,774		12.95
Vested during the year	(37,125)		7.91
Nonvested balance at December 31, 2014	127,024	$	10.07

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 17 STOCK COMPENSATION PLANS (CONTINUED)

As of December 31, 2014, unrecognized compensation expense allotted to the Bank was $1.038 million.

The Corporation also has outstanding stock options. A summary of stock option transactions for the years ended December 31 is as follows:

	2014	2013
Outstanding shares at beginning of year	**237,152**	242,152
Granted during the year		
Exercised during the year	**(70,502)**	
Expired during the year	**(146,650)**	(5,000)
Outstanding shares at end of year	**20,000**	237,152
Exercisable shares at end of year	**4,000**	124,861
Weighted average exercise price per share at end of year	**$ 11.33**	$ 9.88
Shares available for grant at end of year		

Following is a summary of the options outstanding and exercisable at December 31, 2014:

Exercise Price	Outstanding	Number Exercisable	Unvested Options	Weighted Average Remaining Contractual Life-Years
$ 10.65	10,000	2,000	8,000	.54
$ 12.00	10,000	2,000	8,000	.96
	20,000	4,000	16,000	.75

NOTE 18 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 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 and an additional $600,000 on December 17, 2013. Neither of these authorizations has an expiration date. In 2014, MFNC paid cash dividends of $.225 per share which decreased equity by $1.308 million.

In August 2012 the Corporation consummated the previously announced $7.000 million rights offering and the investment by Steinhardt Capital Investors, LLLP (SCI) by issuing 2,140,123 shares of common stock for net proceeds of $11.506 million. Also, in August 2012, the Corporation exited the TARP Capital Purchase Program (CPP) when the Corporations 11,000 Series A Preferred Shares, issued in April, 2009 to the U.S. Treasury, were publically offered and sold. The Corporation repurchased the 379,310 of Common Stock Warrants issued to the U.S. Treasury under the CPP in December, 2012 for $1.3 million. During 2013, the Corporation redeemed all of the outstanding Series A Preferred Shares.

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 19 - COMMITMENTS, CONTINGENCIES, AND CREDIT RISK

Financial Instruments with Off-Balance-Sheet Risk

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

The Corporation s exposure to credit loss, in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit, is represented by the contractual amount of those instruments.

The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. These commitments at December 31 are as follows (dollars in thousands):

		2014		2013
Commitments to extend credit:				
Variable rate	**$**	**44,134**	$	36,039
Fixed rate		**24,191**		15,070
Standby letters of credit - Variable rate		**6,072**		5,077
Credit card commitments - Fixed rate		**3,267**		3,152
	$	**77,664**	$	59,338

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

At December 31, 2014, there were no pending material legal proceedings to which the Corporation is a party or to which any of its property was subject, except for proceedings which arise in the ordinary course of business. In the opinion of management, pending legal proceedings will not have a material effect on the consolidated financial position or results of operations of the Corporation.

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 December 31, 2014 represents $107.835 million, or 26.47%, compared to $100.333 million, or 27.92%, of the commercial loan portfolio on December 31, 2013. The remainder of the commercial loan portfolio is diversified in such categories as hospitality and tourism, real estate agents and managers, new car dealers, gaming, petroleum, forestry, agriculture, and construction. Due to the diversity of the Bank s locations, the ability of debtors of residential and consumer loans to honor their obligations is not tied to any particular economic sector.

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 20 - FAIR VALUE

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.

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.

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Notes to the Consolidated Financial Statements

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 20 - FAIR VALUE (CONTINUED)

The following table presents information for financial instruments at December 31 (dollars in thousands):

		December 31, 2014		**December 31, 2013**	
	Level in Fair Value Hierarchy	**Carrying Amount**	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**
Financial assets:					
Cash and cash equivalents	Level 1	$ **21,947**	$ **21,947**	$ 18,219	$ 18,219
Interest-bearing deposits	Level 2	**5,797**	**5,797**	10	10
Securities available for sale	Level 2	**65,832**	**65,832**	44,388	44,388
Federal Home Loan Bank stock	Level 2	**2,973**	**2,973**	3,060	3,060
Net loans	Level 3	**595,795**	**596,429**	479,171	479,538
Accrued interest receivable	Level 3	**1,680**	**1,680**	1,351	1,351
Total financial assets		$ **694,024**	$ **694,658**	$ 546,199	$ 546,566
Financial liabilities:					
Deposits	Level 2	$ **606,973**	$ **606,534**	$ 466,299	$ 465,431
Borrowings	Level 2	**49,846**	**50,280**	37,852	37,487
Accrued interest payable	Level 3	**205**	**205**	182	182
Total financial liabilties		$ **657,024**	$ **657,019**	$ 504,333	$ 503,100

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.

The following is information about the Corporation s assets and liabilities measured at fair value on a recurring basis at December 31, 2014 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 December 31, 2014 and December 31, 2013 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 December 31, 2014 or December 31, 2013.

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 20 - FAIR VALUE (CONTINUED)

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 held for sale. 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 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

Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2013

(dollars in thousands)	Balance at December 31, 2013	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, 2013
Assets					
Impaired loans	$ 2,024	$	$	$ 2,024	$ 2,075
	1,884			1,884	265

Other real estate held for sale	$	2,340

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).

NOTE 21   BUSINESS COMBINATIONS

The Corporation completed its acquisition of Peninsula Financial Corporation (PFC) and its wholly owned subsidiary, The Peninsula Bank. PFC had six branch offices and $126 million in assets of December 5, 2014. The results of operations due to the merger have been included in the Corporation s results since the acquisition date. The merger was effected by a combination of cash and the issuance of shares of the Corporation s common stock to PFC shareholders. Each share of PFC s 288,000 shares of common stock was converted into the right to receive 3.64 shares of the Corporation s common stock, with cash paid in lieu of fractional shares. PFC shareholders also had the option to receive cash at $46.13 per share of common stock. The conversion of PFC s shares resulted in the issuance of 695,361 shares of the Corporation s common stock and $4.484 million in total for all shares exchanged for cash.

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MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 21 BUSINESS COMBINATIONS (CONTINUED)

The table below highlights the allocation of the purchase price:

PRO FORMA GOODWILL CALCULATION

AS OF DECEMBER 5, 2014

Purchase Price:				
Peninsula shares outstanding at December 5, 2014		288,000		
Price per share /Cash Price	$	46.13		
Aggregate value of Mackinac stock issued, 695,361 shares, at a market value of $11.41 in exch for 190,800 shares	$	7,934		
Cash consideration $46.13 for 97,200 shares		4,484		
Cash for partial shares		2		
Total purchase price			$	12,420
Net assets acquired:				
Cash and cash equivalents	$	6,295		
Securities available for sale		27,768		
Federal Home Loan Bank stock		394		
Loans		67,139		
Premises and equipment		2,918		
Other real estate owned		1,011		
Deposit based intangible		1,206		
Other assets		6,035		
Total assets		112,766		
Non-interest bearing deposits		10,250		
Interest bearing deposits		90,700		
Total deposits		100,950		
Other liabilities		3,201		
Total liabilities		104,151		
Net assets acquired				8,615
Goodwill			$	3,805

The results of operations for the twelve months ended December 31, 2014, include the operating results of the acquired assets and assumed liabilities for the 26 days subsequent to the acquisition date. PFC s results of operations prior to the acquisition date are not included in the Corporation s consolidated statement of comprehensive income.

The Corporation recorded merger related expenses of $1.622 million after tax during the twelve months ended December 31, 2014. These expenses were for professional services such as legal, accounting and contractual arrangements for consulting services and data processing termination fees.

The following table provides the unaudited pro forma information for the results of operations for the twelve months ended December 31, 2014, as if the acquisition had occurred on January 1. These adjustments reflect the impact of certain purchase accounting fair value measurements, primarily on the loan and deposit portfolios of PFC. In addition, the merger-related costs noted above are excluded from the 2014 results of operations, for comparative purposes. Further operating cost savings are expected along with additional business synergies as a result of the merger which are not presented in the pro forma amounts. These unaudited pro forma results are presented for illustrative purposes only and are not intended to represent or be indicative of the actual results of operations of the combined banking organization that would have been achieved had the merger occurred at the beginning of the period presented, nor are they intended to represent or be indicative of future results of the Corporation.

	2014	2013
Net interest income	$ 27,952	$ 26,387
Noninterest income	4,647	4,733
Net income	7,740	6,706
Net income per diluted share	$ 1.22	$ 1.06

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Notes to the Consolidated Financial Statements

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 21 BUSINESS COMBINATIONS (CONTINUED)

In most instances, determining the fair value of the acquired assets and assumed liabilities required the Corporation to estimate the cash flows expected to result from those assets and liabilities and to discount those cash flows at appropriate rates of interest. The most significant of those determinations is related to the valuation of acquired loans. For such loans, the excess cash flows expected at merger over the estimated fair value is recognized as interest income over the remaining lives of the loans. The difference between contractually required payments at merger and the cash flows expected to be collected at merger reflects the impact of estimated credit losses and other factors, such as prepayments. In accordance with the applicable accounting guidance for business combinations, there was no carry-over of PFC s previously established allowance for loan losses.

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 the criteria, which are accounted for under ASC 310-20 (acquired non-impaired). In addition, the loans are further categorized into different pools based primarily on the type and purpose of the loan.

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Notes to the Consolidated Financial Statements

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 22 - PARENT COMPANY ONLY FINANCIAL STATEMENTS

BALANCE SHEETS

December 31, 2014 and 2013

(Dollars in Thousands)

		2014		2013
ASSETS				
Cash and cash equivalents	**$**	**1,693**	$	1,301
Investment in subsidiaries		**83,226**		65,881
Other assets		**5,884**		567
TOTAL ASSETS	**$**	**90,803**	$	67,749
LIABILITIES AND SHAREHOLDERS EQUITY				
Line of Credit	**$**	**8,000**	$	2,000
Other borrowing		**2,700**		
Other liabilities		**6,107**		500
Total liabilities		**16,807**		2,500
Shareholders equity:				
Preferred stock - no par value:				
Authorized 500,000 shares, 11,000 shares issued and outstanding				
Common stock and additional paid in capital - no par value				
Authorized 18,000,000 shares				
Issued and outstanding - **6,266,756** and 5,541,390 shares respectively		**61,679**		53,621
Retained earnings		**11,804**		11,412
Accumulated other comprehensive income		**513**		216
Total shareholders equity		**73,996**		65,249
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**$**	**90,803**	$	67,749

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Notes to the Consolidated Financial Statements

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 22 - PARENT COMPANY ONLY FINANCIAL STATEMENTS (CONTINUED)

STATEMENTS OF OPERATIONS

Years Ended December 31, 2014, 2013, and 2012

(Dollars in Thousands)

	2014	2013	2012
INCOME:			
Interest income	$	$ 1	$ 3
Total income	$	$ 1	$ 3
EXPENSES:			
Interest expense on borrowings	**210**		
Salaries and benefits	**609**	482	280
Professional service fees	**247**	208	562
Nonrecurring transaction related expenses	**1,284**		
Other	**304**	520	340
Total expenses	**2,654**	1,210	1,182
Loss before income taxes and equity in undistributed net income of subsidiaries	**(2,654)**	(1,209)	(1,179)
(Benefit of) income taxes	**(726)**	(411)	(393)
Loss before equity in undistributed net income of subsidiaries	**(1,928)**	(798)	(786)
Equity in undistributed net income of subsidiaries	**3,628**	6,735	7,873
Net income	**1,700**	5,937	7,087
Preferred dividend and accretion of discount		308	629
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	**$ 1,700**	$ 5,629	$ 6,458

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Notes to the Consolidated Financial Statements

MACKINAC FINANCIAL CORPORATION AND SUBSIDIARIES

NOTE 22 - PARENT COMPANY ONLY FINANCIAL STATEMENTS (CONTINUED)

STATEMENTS OF CASH FLOWS

Years Ended December 31, 2014, 2013, and 2012

(Dollars in Thousands)

	2014	2013	2012
Cash Flows from Operating Activities:			
Net income	**$ 1,700**	$ 5,937	$ 7,087
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed net (income) of subsidiaries	**(3,628)**	(6,735)	(7,873)
Increase in capital from stock compensation	**429**	333	66
Change in other assets	**(5,664)**	2,587	92
Change in other liabilities	**8,603**	(3)	(163)
Net cash provided by (used in) operating activities	**1,440**	2,119	(791)
Cash Flows from Investing Activities:			
Investments in subsidiaries	**(4,000)**	(3,000)	
Net cash paid for acquisition of Peninsula	**(4,484)**		
Net cash (used in) investing activities	**(8,484)**	(3,000)	
Cash Flows from Financing Activities:			
Increase on term borrowing	**3,000**		
Principal payments on borrowings	**(300)**		
Net activity on line of credit	**6,000**	2,000	
Proceeds from issuance of common stock			11,506
Repurchase of common stock	**(143)**	(509)	
Purchase of common stock warrants			(1,300)
Dividend on common stock	**(1,121)**	(944)	(223)
Dividend on preferred stock		(308)	(550)
Redemption of Series A Preferred Stock		(11,000)	
Net cash provided by (used in) financing activities	**7,436**	(10,761)	9,433
Net increase (decrease) in cash and cash equivalents	**392**	(11,642)	8,642
Cash and cash equivalents at beginning of period	**1,301**	12,943	4,301
Cash and cash equivalents at end of period	**$ 1,693**	$ 1,301	$ 12,943

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Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

As of the end of the period covered by this report, management of the company, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the effectiveness of the design and operation of the Corporation s disclosure controls and procedures as defined under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the Exchange Act). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Corporation s disclosure controls and procedures were effective, in ensuring the information relating to the Corporation (and its consolidated subsidiaries) required to be disclosed by the Corporation in the reports it files or submits under the Exchange Act was recorded, processed, summarized and reported to the Corporation s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

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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 December 31, 2014 that have materially affected, or are reasonably likely to materially affect, the Corporation s internal control over financial reporting.

Report on Management s Assessment of Internal Control over Financial Reporting

Mackinac Financial Corporation is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements included in this Form 10-K. The consolidated financial statements and notes included in this Form 10-K have been prepared in conformity with generally accepted accounting principles in the United States and necessarily include some amounts that are based on management s best estimates and judgments.

We, as management of Mackinac Financial Corporation, are responsible for establishing and maintaining effective internal control over financial reporting that is designed to produce reliable financial statements in conformity with generally accepted accounting principles in the United States. The system of internal control over financial reporting as it relates to the financial statements is evaluated for effectiveness by management and tested for reliability through a program of internal audits. Actions are taken to correct potential deficiencies as they are identified. Any system of internal control, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden and misstatements due to error or fraud may occur and not

be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement preparation.

Management assessed the Corporation s system of internal control over financial reporting as of December 31, 2014, in relation to criteria for the effective internal control over financial reporting as described in Internal Control Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concludes that, as of December 31, 2014, its system of internal control over financial reporting is effective and meets the criteria of the Internal Control Integrated Framework.

Item 9B. Other Information

None.

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PART III

Item 10. Directors, Executive Officers, and Corporate Governance

Executive Officers of the Registrant

The executive officers of the Corporation are listed below. The executive officers serve at the pleasure of the Board of Directors and are appointed by the Board annually. There are no arrangements or understandings between any officer and any other person pursuant to which the officer was selected.

Name	Age	Position
Paul D. Tobias	64	Chairman and Chief Executive Officer
Kelly W. George	47	President
Ernie R. Krueger	65	Executive Vice President/Chief Financial Officer

Additional information for the executive officers of the registrant is included in the Corporation s Proxy Statement for its 2015 Annual Meeting of Shareholders under the caption Directors and Officers.

The information set forth under the captions Information About Directors and Nominees and Section 16(a) Beneficial Ownership Reporting Compliance in the Corporation s definitive Proxy Statement for its May 27, 2015, Annual Meeting of Shareholders (the Proxy Statement), a copy of which will be filed with the SEC prior to the meeting date, is incorporated herein by reference.

Item 11. Executive Compensation

Information relating to compensation of the Corporation s executive officers and directors is contained under the captions Remuneration of Directors and Executive Compensation, in the Corporation s Proxy Statement and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information relating to security ownership of certain beneficial owners and management is contained under the caption Beneficial Ownership of Common Stock in the Corporation s Proxy Statement is incorporated herein by reference.

The following table provides information as of December 31, 2014 with respect to compensation plans (including individual compensation arrangements) under which equity securities of the Corporation are authorized for issuance. All such compensation plans were previously approved by security holders.

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Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise issue price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity stock option compensation plans approved by security holders:			
Issued and outstanding:			
Stock options	20,000	$ 11.30	
Restricted stock awards - August 2012	74,250	7.91	
Restricted stock awards - March 2014	52,774	12.95	
Shares available for future issuance			283,224
Total	147,024	$ 10.18	283,224

Item 13. Certain Relationships, Related Transactions and Director Independence

Information relating to certain relationships and related transactions is contained under the caption Indebtedness of and Transactions with Management in the Corporation s Proxy Statement and is incorporated herein by reference.

Additional information is contained under the caption Information about Directors and Executive Officers within the Corporation s Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

Information relating to principal accountant fees and services is contained under the caption Principal Accountant Fees and Services in the Corporation s Proxy Statement and is incorporated herein by reference.

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PART IV

Item 15. Exhibits and Financial Statement Schedules

(commission file number for all incorporated documents: 0-20167)

(a) The following documents are filed as a part of this report.

1. Consolidated Financial Statements

(i) The financial statements of the Corporation included in this Form 10-K are listed in Part II, Item 8.

2. All of the schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are either not required under the related instruction, the required information is contained elsewhere in the Form 10-K, or the schedules are inapplicable, and therefore have been omitted.

3. Exhibits

The exhibits required to be filed as part of this Form 10-K are listed in the attached Exhibit Index.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Corporation has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, dated March 31, 2015.

MACKINAC FINANCIAL CORPORATION

/s/ Paul D. Tobias
Paul D. Tobias
Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on March 29, 2013, by the following persons on behalf of the Corporation and in the capacities indicated. Each director of the Corporation, whose signature appears below, hereby appoints Paul D. Tobias and Ernie R. Krueger, and each of them severally, as his attorney-in-fact, to sign in his name and on his behalf, as a director of the Corporation, and to file with the Commission any and all Amendments to this Report on Form 10-K.

Signature	
/s/ Paul D. Tobias Paul D. Tobias Chairman, Chief Executive Officer & Director (principal executive officer)	/s/ Ernie R. Krueger Executive Vice President/Chief Financial Officer (principal financial and accounting officer)
/s/ Walter J. Aspatore Walter J. Aspatore - Director	/s/ Joseph D. Garea Joseph D. Garea Director
/s/ Robert E. Mahaney Robert E. Mahaney Director	/s/ Robert H. Orley Robert H. Orley - Director
/s/ Dennis B. Bittner Dennis B. Bittner Director	/s/ L. Brooks Patterson L. Brooks Patterson Director
/s/ Kelly W. George Kelly W. George President & Director	/s/ Randolph C. Paschke Randolph C. Paschke Director
/s/ David R. Steinhardt David R. Steinhardt Director	

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INDEX TO EXHIBITS

Exhibit Number	Exhibit Description	Form	File No.	Incorporated by Reference Exhibit	Filing Date	Filed Herewith
2.1	Agreement and Plan of Merger by and among Mackinac Financial Corporation, PFC Acquisition, LLC and Peninsula Financial Corporation	8-K	000-20167	2.1	7/23/2014	
2.2	First Amendment to the Agreement and Plan of Merger, dated as of October 17, 2014, by and among Mackinac Financial Corporation, PFC Acquisition, LLC and Peninsula Financial Corporation	8-K	000-20167	2.1	10/20/2014	
3.1	Articles of Incorporation and all amendments (most recent amendment filed December 14, 2004)	10-K	000-20167	3.1	3/31/2009	
3.2	Certificate of Designations of Fixed Rate Cumulative Perpetual Preferred Stock, Series A of Mackinac Financial Corporation dated April 21, 2009	8-K	000-20167	3.1	4/24/2009	
3.3	Third Amended and Restated Bylaws adopted March 18, 2014	8-K	000-20167	3.1	3/24/2014	
10.1	Deferred Compensation, Deferred Stock, and Current Stock Purchase Plan for the Corporation s Nonemployee directors**	10-K	000-20167	10.2	3/28/2000	
10.2	North Country Financial Corporation Stock Compensation Plan**	10-K	000-20167	10.3	3/28/2000	
10.3	North Country Financial Corporation 1997 Directors Stock Option Plan**	10-K	000-20167	10.4	3/28/2000	
10.4	North Country Financial Corporation 2000 Stock Incentive Plan**	10-Q	000-20167	10.1	5/12/2000	
10.5	North Country Financial Corporation Supplemental Executive Retirement Plan**	10-Q	000-20167	10.6	11/5/1999	
10.6	Form of Director and Officer Indemnification Agreement**	8-K	000-20167	10.1	3/24/2014	
10.7	Mackinac Financial Corporation 2012 Incentive Compensation Plan**	DEF14A	000-20167	Annex I	4/25/2012	
10.8	First Amended and Restated Securities Purchase Agreement dated May 23, 2012 between the Corporation and Steinhardt Capital Investors, LLLP	8-K	000-20167	10.1	5/23/2012	
10.9	First Amendment to the First Amended and Restated Securities Purchase Agreement dated May 30, 2012, between the Corporation and Steinhardt Capital Investors, LLLP	8-K	000-20167	10.1	5/31/2012	
10.10	Employment Agreement, dated as of August 10, 2012, by and between Mackinac Financial Corporation and Paul D. Tobias**	8-K	000-20167	10.1	8/15/2012	
10.11	Employment Agreement, dated as of August 10, 2012, by and between Mackinac Financial Corporation and Kelly W. George**	8-K	000-20167	10.2	8/15/2012	
10.12	Employment Agreement, dated as of August 10, 2012, by and between Mackinac Financial Corporation and Ernie R. Krueger**	8-K	000-20167	10.3	8/15/2012	

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Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Filed Herewith
10.13	First Amendment to Employment Agreement, dated as of March 24, 2015, by and between Mackinac Financial Corporation and Paul D. Tobias **	8-K	000-20167	10.1	3/27/2015	
10.14	First Amendment to Employment Agreement, dated as of March 24, 2015, by and between Mackinac Financial Corporation and Kelly W. George **	8-K	000-20167	10.1	3/27/2015	
10.15	First Amendment to Employment Agreement, dated as of March 24, 2015, by and between Mackinac Financial Corporation and Ernie R. Krueger **	8-K	000-20167	10.1	3/27/2015	
10.16	Form of Restricted Stock Unit Award Agreement under the Mackinac Financial Corporation 2012 Incentive Compensation Plan**	8-K	000-20167	10.3	8/13/2012	
10.17	Warrant Repurchase Letter Agreement dated December 19, 2012	8-K	000-20167	10.1	12/20/2012	
21	Subsidiaries of the Corporation					*
23.1	Consent of Plante Moran, PLLC					*
31	Rule 13(a) 14(a) Certifications					*
32.1	Section 1350 Chief Executive Officer Certification					*
32.2	Section 1350 Chief Financial Officer Certification					*
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***					*

* Filed herewith.

** Management compensatory plan, contract, or arrangement.

*** As provided in Rule 406T of Regulation S-T, this information shall not be deemed filed for the purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934 or otherwise subject to liability under those Sections.